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FROM: Charles Pace, Ph.D.

RE: Department of Ecology AO #24-02 Chapter 173-441 WAC Reporting of Emissions of Greenhouse Gases and Chapter 173-446-WAC, Climate Commitment At program Rule – Cap and-Invest Program Updates

As requested in your notice dated June 1, 2006, I am submitting these comments re your proposed Cap-and-Invest Program Updates ("C&I"). FYI, I am a (retired) economist and, for the past four decades, have earned my living providing econometric/policy analysis for tribal, federal, state and local governments, as well as supporting tribal governments in complex litigation, intergovernmental negotiations, and legislative/administrative initiatives. My focus has been on energy and natural resource management.

Generally, I support the State of Washington's efforts to shoulder our fair share of the burden of global climate pollution reduction. As the landmark <u>Climate Commitment Act</u> ("CCA"), Chapter 70A.65 RCW, found:

> [C]limate change is one of the greatest challenges facing our state and the world today, an existential crisis with major negative impacts on environmental and human health.

RCW 70A.65.OO5(1). However, I have several concerns with the Department of Ecology's (Ecology) proposal. To facilitate your review, I have organized them under four headings, each addressing specific infirmities. With respect to each of the infirmities, I'll summarize relevant statutes, highlight applicable case law, and describe the problematic aspects of the proposed program update.

Infirmity #1

Enacted in 2021 with auctions beginning in 2023, Washington's climate commitment program is specifically described as a cap-and-invest system, which has been praised, e.g., for its equity-focused approach, which secures funding to provide infrastructure for over-burdened communities, including but not limited to federally recognized Indian tribes. My first concern is that in the proposed program update Ecology is actively moving forward with a sweeping program, expanding its regulatory coverage to bring entirely new sectors into the program for upcoming compliance periods. These are identified by code—specifically the North American Industrial Classification System ("NAICS")--used by agencies in the USA and elsewhere to classify business establishments. At the highest level of aggregation, NAICS has 11 analytical 'supersectors.' At the finest level of detail, it has 1,012 types of enterprises.

The program already covers large emitters, e.g., major industrial plants, fuel suppliers and electric/natural gas utilities. In the original CCA and in amendments thereto, NAICS is used to identify large emitters, like major industrial plants, fuel suppliers and electric/natural gas facilities. See: SB 6058 (2024); HB 1975 (2025); HB 1912 (2025) and HB 1416 (2026). It now appears that Ecology is actively moving forward with sweeping programs updates and linkage rule-making to bring entirely new sectors into the program for upcoming compliance periods. This includes railroads, and waste-to-energy facilities, and imported electricity. My concern is that the sweeping additions to the reach of Ecology's regulations go far beyond the CCA and subsequent legislation.

Moreover, there is virtually no analysis of likely socioeconomic impacts on Washington's citizens, even though Ecology acknowledges in the program update that a cost-benefit analysis is required under RCW 34.05.328. See Notice, p.3. In broad strokes, Ecology's analysis is missing in action, thin enough to fit between wallpaper and a wall. It addresses compliance costs and very little else. See Ecology Publication No. 26-14-045, June 2026.

As set forth in Washington's Administrative Procedure Act (APA), RCW 34.05.570, courts generally defer to an agency's expertise but will not hesitate to invalidate any policy if the underlying statutory text does not explicitly sanction an agency's expansion of its regulatory power. In several high-profile cases, Washington courts have found Ecology exceeded its statutory authority and/or improperly expanded its regulatory scope beyond what the Legislature intended.

For example, in <u>Assoc. of Washington Business v Ecology</u> (2020)--a major climate case--the Washington Supreme Court found that Ecology's regulation of "indirect emitters" had no legislative authorization to expand the reach of it's regulations beyond entities that "directly release" contaminants. Similarly, in <u>Swinomish Indian Tribal Community v Ecology</u> (2013)--a landmark water case—the Supreme Court found Ecology's interpretation of statuary exceptions overly broad.

In this case, the Court ruled Ecology had no authority to override/bypass senior water rights and could not find a safe harbor under the guise of an "overriding public interest." The Supreme Court—reaffirming its 2013 <u>Swinomish</u> decision re exceptions, in <u>Foster v. Ecology</u> (2015) ruled that Ecology cannot impair existing rights by routinely applying a "balancing test" to operate outside the strict/narrow parameters set by the Legislature.

The "bright line" rule here is simple: administrative agencies only possess the powers explicitly granted them by the Legislature. Ecology is no exception, and, to the point, adverse decisions against the agency span air quality and water law. In the present case, the Legislature neither directs nor authorizes Ecology to expand its regulations, notwithstanding the fact that it uses the NAICS to identify sectors. As a corollary, I also think it would be inadvisable for Ecology to proceed with this expansion absent a careful analysis of socioeconomic impacts on these specific industries.

INFIRMITY #2

In the State of Washington, administrative and environmental law prohibit an agency from improperly segmenting review of a program with large, controversial impacts into pieces, that is 'piecemealing.' Under the State Environmental Policy Act ("SEPA"), RCW 43.21C, and its implementing regulations, this practice has been the subject of extensive litigation with consistent rulings against attempts to use this maneuver, holding that doing so violates the core SEPA mandate. For more, see WAC 197-11060(3)(b) and 197-11-060(5)(d)(ii).

The case law here is extensive. In Juanita Bay Valley Community Ass'n v. City of Kirkland (1973), the foundational appellate case addressing piecemealing, the Court of Appeals established that an agency cannot break a single macro-proposal into small, seemingly innocuous micro-actions. SEPA, it ruled, mandates a comprehensive, look-ahead analysis before irreversible resource commitments are made. In Weyerhaeuser v. Pierce County (1994), the Supreme Court held that if an agency fails to analyze closely related, foreseeable cumulative impacts, the entire threshold determination of the environmental analysis is void. Likewise, in Indian Trail Property Owner's Ass'n v. City of Spokane (1994), the Court of Appeals re-affirmed that phased review cannot be used as a loophole to avoid assessing the total, ultimate environmental footprint of a proposal. If the subsequent controversial outcomes are clearly foreseeable consequence of the initial phase, they must be evaluated together.

Ecology's proposed update fails in every respect to satisfy this requirement. It expressly acknowledges in its limited environmental documentation that it is setting the stage for a subset of controversial—possibly objectionable—outcomes but then fails to assess them. Consequently, any challenger with standing can successfully sue; Ecology's action will like be interpreted as prejudgment or, possibly, a deliberate evasion of SEPA's requirements.

Remedies include: (1) invalidating the agency's threshold determination or environmental analysis; (2) voiding any policy or permit enacted under such faulty documentation; and (3) remanding the issue back to Ecology with instructions to compile a single comprehensive environmental analysis that openly addresses controversial outcomes.

INFIRMITY #3

As indicated above, the Devil here is by no means confined to Ecology's violations at the departmental level. There are formidable conflicts with Constitutional provisions re commerce among states and with international governments. Among the violations of federal law, one of lines of effort will focus on violations of federal antitrust law. This requires a (brief) glance at the so-called State Action Immunity Doctrine. To maintain antitrust immunity, Ecology's program must satisfy the strict two-pronged "Mid-Cal Test." The first prong being "clear articulation." This requires that Washington State must have a clearly articulated and affirmatively expressed policy to displace free market competition. This prong, in my opinion, is satisfied, by the CCA as amended, which explicitly directs Ecology to establish a cap-and-invest program and seek linkage with other jurisdictions to control emissions.

The second prong of the Mid-Cal Test requires that the State actively supervise any anti-competitive structure it might create, ensuring that actors aren't operating a self-serving cartel under the guise of state regulation. Here, I believe the joint auction mechanics quickly becomes legally perilous. Because Washington is joining a multi-jurisdictional market, no single state has sovereign control over the auction administration or price-discovery mechanism. In a stand-alone Washington market, Ecology completely controls auction rules, monitors compliance and prevents manipulation. However, if Washington links to the CA-Quebec market, the auction platform will be administered by a third-party (presumably non-profit) entity. In addition, market dynamics and enforcement decisions happening simultaneously in CA and Quebec will exert influence on, inter alia, allowance holding limits and bidding behavior in Washington.

In effect, Washington will have unlawfully delegated its regulatory sovereignty to a multi-state consortium. It follows that Washington will likely fail the supervision prong of Mid-Cal, arguably participating in, say, multi-state price-fixing, allowance-pooling schemes administered by an unaccountable regional block, etc.

In my opinion, however, the biggest vulnerability to anti-trust jurisprudence occurs where antitrust law collides with the Ecology's intent to provide preferential treatment to Washington-based corporations. Targeted, free allocations to Washington-based corporations are especially problematical. If Ecology hands out substantial amounts of free allowances to in-state corporation, say, to protect them from "carbon leakage," local corporations become powerful market participants in all linked, multi-state seconding trading markets.

If Washington corporations hoard these free allowances, or in any way artificially control the price of compliance instruments on such secondary markets, they—the in-state corporations—lose immunity and can be sued directly, under the Sherman Antitrust Act , the Clayton Antitrust Act, and Section 5 of the Federal Trade Commission Act. Unless Washington explicitly mandates that they use their free allowance to effectively "squeeze" the market, these private corporations have no immunity cover.

If out-of-state plaintiffs prove that Ecology turned a blind eye to local corporations exploiting their free-allowance windfalls to dominate the multi-state market, federal courts would likely rule that the State had failed to meet the active supervision requirement. Once Washington's immunity is broken, the entire joint auction mechanism can be treated as an illegal interstate agreement to restrain trade, thereby threatening to dismantle the linkage agreement(s) altogether.

INFIRMITY #4

In addition to antitrust violations, the integration of Washington C&I market with CA-Quebec's joint carbon market, raises extraordinary questions under constituional law. My concerns go to both the Interstate and International Commerce Clauses. As both the Legislature and Ecology must know, the US Constitution grants Congress the power to regulate commerce with foreign nations and among the states. Under the Dormant Commerce Clause and the Foreign Commerce Clause, states are prohibited from passing legislation that discriminates against or unduly burdens interstate and/or international commerce.

It appears that Washington's C&I program will impose compliance obligations on entities based on the life-cycle emissions of products, like electricity or transportation fuels, consumed in Washington, even if those products are generated out of state. Washington cannot lawfully dictate how out-or-state producers, for example, coal and natural gas plants in MT or WY, must operate. Similarly, it cannot penalize out-of-state entities asymmetrically compared to in-state providers of so-called 'clean' energy. That would be an unconstitutional extra-territorial regulation because its practical effect would be to control conduct occurring completely outside Washington's borders.

In addition, because the carbon market includes Quebec, a Canadian province, Washington is entering a regulatory structure that spans international borders. The Foreign Commerce Clause and Foreign Affairs Power give to the federal government exclusive dominion over international relations. As an aside, I note in passing that, in 2019, under the Trump Administration, the US Department of Justice sue California, arguing that its linkage agreement with Quebec violated the Treaty and Compact Clauses. Under the Biden Administration, the Department of Justice "settled" with California on an "amicable" basis and the District Court ruled that California's non-binding linkage did not constitute a formal sovereign "treaty" or "compact" requiring Congressional approval.

I don't believe for one second that the District Court's ruling would or could have prevailed upon appeal. Thus it might prove "unavailing" in the federal court for the Western District of Washington, or that matter any trial or appellate court of competent jurisdiction. But this is not the real danger. In my opinion, if Washington goes forward,a federal court, either at the district or appellate level, will rule that sub-national carbon markets interfere on their face with unified federal policy and thus are preempted as a matter of law. Washington joining the Quebec-CA market will reopen all of these structural infirmities. This will inevitably prove to be an irresistible opportunity to a Trump Administration's Department of Justice.

A correlative concern is preferential treatment and severe vulnerabilities of the C&I that under the Dormant Commerce Clause. I think it will go as follows: Ecology provides certain local entities with preferential treatment, such as no-cost allowance allocations for 'EITE' industries, local manufacturing, refining, and electric utilities, arguing it is prevent businesses leaving Washington to avoid compliance costs. I

f Ecology structures free allowances or offset credits in a manner that explicitly favors in-state corporations while denying the same to out-of-state competitors operating in the same market, this will be determined to be a facially discriminatory policy and thus trigger strict scrutiny. Strict scrutiny renders the linkage agreements 'dead on arrival' unless Washington can prove it has a compelling local purpose that cannot be met by any non-discriminatory means.

A state can subsidize local industry from its general fund, but it cannot couple a regulatory burden—in this case the carbon cap—with a targeted exemption or rebate, e.g. free allowances. That would insulate local businesses while leaving out-of-state competitors exposed. On the other hand, if an out-of-state manufacture exporting goods into Washington faces the full financial brunt of the carbon pricing scheme while a local Washington-based competitor receives an offset buffer from Ecology, the C&I program acts as a defacto unconstitutional tariff.

SUMMARY

In summary, I believe that if Ecology moves forward with the program updates as presently designed, it will not survive in state and/or federal tribunals. This will reflect badly on the State's administrative and legislative branches, undermining rather than supporting the laudable purpose expressed in the landmark Climate Commitment Act ("CCA") of shouldering our fair share of the burden of adapting to a complex and changing global climate.

If Ecology's regulations strictly adhered to the power(s) expressly granted by the Legislature, it would be operating safely within the State of Washington's statutory boundaries. But even that is not the case. The Legislature did not authorize Ecology to expand its regulations, linkage agreements and enforcement strategies to the manufacturing super-sector. That is clearly a 'bridge too far.' Moreover, Ecology must provide a detailed analysis of the impacts, which it has not done. Nevertheless, preparations for linkage agreements are like a drumbeat echoing thru the original CCA and the subsequent amendments that have occurred, particularly in the 2024-2026 time frame. Even so, Ecology decision to bifurcate the analysis so that it does not consider the socioeconomic effects of joining the CA-Quebec market is, in my opinion, an obvious violation of Washington law. Ecology is 'whistling past the graveyard.'

And for very good reasons! As I discussed above, there are still very formidable structural conflicts between Washington joining any interstate compact absent congressional action. Likewise, states cannot usurp federal authority and engage in commerce with a foreign government. Constitutional provisions and long-settled federal case law are stacked exceedingly high against any state engaging in interstate compacts absent congressional authorization. In summary, the Devil here is not confined to just the details. Consequently, I believe Ecology would be well advised to proceed with extreme caution!

Thank you for your review and consideration.