Updates
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Washington State Implements Major Programs To Reach Climate Goals

Two climate-related regulatory programs affecting business and industry in Washington state took effect on January 1, 2023. First, the Climate Commitment Act introduces an economywide emissions cap-and-invest program. Second, the Clean Fuels Program will regulate transportation emissions. Together, these programs are intended to help the state reach ambitious statutory emissions reductions targets, including a goal of achieving a 95% reduction in greenhouse gas (GHG) emissions below 1990 levels by 2050. This Update discusses how the Washington State Department of Ecology (Ecology) has worked to implement the programs since the Legislature enacted them in 2021 and the implications of these programs on businesses in the state.

Background

In 2020, the Washington State Legislature passed a statute recognizing the state's desire to be a national leader in renewable energy development, energy efficiency, emissions standards, sustainable production, and environmental stewardship. The Legislature also determined that Washington should participate in a market-based system to achieve greenhouse gas emissions reductions and minimize the potential for leakage of emissions and jobs outside of the state.

The same statute updated the state's emissions reductions goals and declared that the state would limit anthropogenic greenhouse gas emissions to achieve mandated targets. It provides that, by 2050, Washington shall reduce greenhouse gas emissions to 95% below 1990 levels. The 2020 legislation was ambitious but did not enact any specific policies to achieve the mandated reductions or advance the state's leadership in the area of climate change.

In 2021, the Legislature enacted two statutes intended to help the state achieve its greenhouse gas emissions targets—the Climate Commitment Act (the Act) and the Clean Fuels Program. The Legislature gave Ecology until January 1, 2023, to develop the rules necessary to implement these two new programs.

The Climate Commitment Act

The Climate Commitment Act establishes a greenhouse gas emissions cap-and-invest program for covered businesses—utilities, industrial facilities, and other operations that emit more than 25,000 annual metric tons of carbon dioxide equivalent (CO_2e). Other entities may opt in to the program or participate in the market for allowances.

The Act establishes an initial limit, or cap, on greenhouse gas emissions. The cap is steadily reduced over time to match emission limits. The cap is set and maintained by Ecology's distribution and auctioning of a controlled number of allowances, each equal to one metric ton of CO_2e. Ecology will provide no-cost allowances to "emissions-intensive, trade-exposed" (EITE) facilities in certain industries to reduce the risk of emissions and jobs leaving the state. Ecology will also provide no-cost allowances to utilities and natural gas suppliers; to protect against consumer price increases, some of these entities' no-cost allowances must be consigned to auctions for the benefit of customers.

Throughout 2022, Ecology promulgated rules to implement the economywide program. First, Ecology updated the rules for reporting greenhouse gas emissions to align monitoring and reporting requirements with the new program. Ecology also issued a rule that allows companies to apply for EITE status if they are not covered by the statutory definition that designates EITEs by industry. Finally, Ecology developed extensive implementation rules for the program, including rules establishing the structure of an allowance auction and trading market, offset project procedures and protocols, and enforcement provisions.

Under the implementation rules, entities that emit more greenhouse gases than are covered by their no-cost allowances must purchase additional allowances at auction or from another entity with excess allowances or purchase offset credits. Ecology will announce floor and ceiling prices for auctioned allowances and establish a reserve. Ecology will use an auction platform provided by the Western Climate Initiative (WCI), a nonprofit that provides auction platforms for cap-and-trade systems in California, Quebec, and Nova Scotia.[1] Before participating in the WCI auction platform or trading allowances, entities must disclose detailed corporate information and designate multiple account representatives.

Even before the Climate Commitment Act went into effect in January 2023, EITEs provided production and fuel consumption data to allow Ecology to determine a carbon-intensity or mass-based baseline for granting allowances. An EITE's distribution of no-cost allowances depends on the entity's performance relative to its baseline over the course of a four-year compliance period.

Ecology will hold the first quarterly allowance auction on February 28, 2023. Pursuant to the new implementation rules, Ecology announced a 2023 auction floor price of $22.20 per allowance. Auction participants may bid on allowances in lots of 1,000 and must submit bid guarantees prior to the auction.

In addition to the statewide emissions cap and allowance market, the Climate Commitment Act adopted several environmental justice policies. Thirty-five percent of the program's proceeds will go toward projects that reduce or mitigate impacts on overburdened communities, and at least 10% of proceeds will go to projects with tribal support, which includes projects formally supported or directly administered by a tribe. The statute defines an overburdened community as a geographic area where people are exposed to environmental pollutants or contaminants through multiple pathways, which may result in significant adverse health outcomes or effects. The statute also establishes a new air monitoring program to assess the impact of emissions on overburdened communities across the state, which may lead to stricter air quality standards or emissions control requirements for sources in those areas.

The Clean Fuels Program

Transportation is Washington's greatest single source of greenhouse gas emissions. To reduce transportation emissions, the Washington Legislature passed the Clean Fuels Program in 2021, which directed Ecology to adopt rules establishing a clean fuel standard to limit the aggregate, overall greenhouse gas emissions per unit of transportation fuel energy to 20% below 2017 levels by 2034. With this new program, Washington joins California, Oregon, and British Columbia in establishing clean fuel standards.

Ecology adopted the final Clean Fuel Standard on November 28, 2022, and the standard went into effect on January 1, 2023. Over the next 12 years, the standard will reduce annual transportation emissions statewide by 20%, or by about 4.3 million metric tons of carbon dioxide. This is equivalent to permanently taking more than 900,000 cars off the road.

The standard applies to transportation fuels provided for sale in Washington, including electricity and any liquid or gaseous fuels used to propel motor vehicles or intended for transportation purposes. Regulated entities are typically importers and producers of fuels such as gasoline, diesel, ethanol, and biodiesel. The standard does not apply to fuels used in aircraft, rail locomotives, marine vessels, or military tactical vehicles. The standard uses a market approach to incentivize fuel producers to reduce the "carbon intensity" of their products, or the amount of carbon pollution generated over the product's life cycle relative to the energy delivered.

Providers of fuels with a carbon intensity lower than the established target are eligible to opt in to the program to generate and sell credits to the regulated fuel suppliers that need to purchase credits. Opt-in entities will likely be entities that can claim electricity credits, like electric utilities, transit providers, or businesses that own electric vehicle charging stations, as well as biofuel producers. These clean fuel producers can generate revenue through the sale of clean fuels credits. The program's goal is to spur the production of cleaner blends of traditional fuels, like gas and diesel, and to stimulate investment in alternative fuels and electric vehicles.

Regulated entities that provide higher-carbon fuels, like petroleum refiners and importers, can comply with the standard by improving the efficiency of their extraction, refining, and distribution processes; modifying crude production methods to capture and sequester carbon; blending low-carbon biofuels into the fuel they sell; or buying credits generated by low carbon fuel providers and alternative fuel providers.

Beginning in early January 2023, regulated fuel suppliers must register for the program in the new Washington Fuels Reporting System. This online system allows regulated entities to (1) register for the program, (2) report fuel transactions, (3) calculate the credits and deficits generated by these transactions, and (4) trade credits to achieve compliance. Ecology will assign and track tradable and bankable compliance obligations and credits as entities participate in the market.

Implications for Washington Businesses and Industry

Ecology engaged in significant rulemaking activities in 2022 to get these two major greenhouse gas emissions regulatory programs implemented by January 1, 2023. Entities covered by the programs should carefully assess the regulatory requirements for each new program to ensure that they complete the many administrative details necessary to fully participate and comply in the first quarter of 2023.

Looking forward, Ecology will assess opportunities to link Washington's new programs with similar programs in other states. The Climate Commitment Act was modeled on California's emissions cap-and-trade system (which is already linked to Quebec's similar system), and the statute directs Ecology to seek linkage. This would provide a larger market for emissions allowances and offset credits. Similarly, the Clean Fuels Program legislation directs Ecology to harmonize the standard with similar programs in states with significant amounts of fuel imported or exported from Washington.

These new regulatory programs will impose significant administrative and compliance costs on many Washington businesses. However, because the programs are market-based, businesses that can efficiently achieve emissions reductions or carbon-intensity improvements should be on the lookout for opportunities. For example, a facility covered by the Climate Commitment Act that has excess allowances may trade or sell those allowances to an entity that cannot reduce emissions because of cost or technology constraints, or they can bank those allowances for a future year. Similarly, a business that invests in electric vehicle charging stations may generate credits to sell to producers of high-carbon-intensity fuel.

Washington's new climate-related regulations are intended to take a major step toward achieving the state's emissions reductions targets. Although the state's success at meeting those targets is unclear at this early stage, businesses should carefully plan their long-term compliance strategies.

Endnote

[1] Although the Climate Commitment Act directed Ecology to pursue formal linkage with other jurisdictions' markets, Washington's cap-and-invest program is not yet linked to any other market and entities cannot yet use allowances or other compliance instruments purchased from California or any other state or province.

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