Updates

The Washington Department of Ecology (Ecology) recently announced rulemaking intended to clarify a key cost containment provision of the Climate Commitment Act (CCA), the state's carbon emissions cap-and-trade program.

The rulemaking targets use of allowances purchased in price containment reserve auctions. Only entities with a compliance obligation—and not general market participants (investors)—may participate in allowance price containment reserve (APCR) auctions. The APCR auctions are designed to ensure that covered entities can obtain enough allowances to meet compliance obligations at a reasonable price—a lofty goal, as the price for allowances in the first three regular auctions has significantly exceeded original estimates. Other measures will likely be necessary to stabilize the allowance market and rein in compliance costs.

Background

The CCA establishes a statewide 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 with fewer emissions may opt in to the program, and the program also allows general market participants to obtain allowances as an investment or to retire them. The CCA establishes an annual cap on greenhouse gas emissions, which is set and maintained by Ecology's distribution and auction of a controlled number of allowances (each of which is equal to one metric ton of CO_2e). Subject to holding limits, allowances may be used for current or future compliance obligations. The program, established in legislation passed in 2021, went into effect January 1, 2023, and Ecology held the first three quarterly allowance auctions in February, May, and August, respectively.

Allowance Proceeds Exceed Expectations

Ecology announced a floor price of $22.20 for the 2023 allowance auctions, but settlement prices have significantly exceeded that price throughout the year. The settlement price for the February 2023 auction was $48.50, and auction proceeds totaled almost $300 million. The settlement price for current-year allowances at the May 2023 auction was $56.01, and the auction of current-year and future-vintage (2026) allowances totaled $557 million. The settlement price for the August 2023 auction of current-year allowances was $63.03. The total proceeds from the August 2023 auction have not yet been announced, but the state will certainly surpass $1 billion in program proceeds after just three regular quarterly auctions.

Washington modeled the CCA on California's emissions cap-and-trade program. In 2020 and early 2021, when the Washington State Legislature was considering the CCA, the settlement price per allowance in California's auctions hovered around $20 per allowance. The California auction settlement price increased in 2021 but has remained around the $30 to $35 range in 2023, significantly lower than Washington's 2023 auction settlement prices.

The settlement prices in the Washington market triggered APCR auctions after the second and third 2023 quarterly auctions. Ecology set the APCR auction trigger price at $51.90 for 2023. The first APCR auction, held in August 2023, netted more than $62 million in proceeds, as Ecology sold available allowances offered at two price points.

The next APCR auction will be held in November 2023. In an attempt to support market stability and control compliance costs, Ecology has announced that it will frontload the supply by offering 5 million allowances in the November APCR auction and will offer these allowances only at the lower price point of $51.90.

Current Rulemaking Offers One Tool To Contain Compliance Costs

In June 2023, Ecology announced that it had adopted an emergency rule to clarify entities' use of allowances obtained at APCR auctions. APCR allowances are not assigned a "vintage" or year, and holding limits that generally apply by vintage year did not apply to these "vintage-less" allowances. Ecology's original rules also did not direct that APCR auctioned allowances be deposited into compliance accounts, despite the legislature's intent that these allowances would be purchased and used only for compliance and not for sale or trade on the secondary market. The June 2023 emergency rule addressed these two issues. Ecology issued another emergency rule in September 2023 to extend the measures while it initiates the normal rulemaking process, and it anticipates one more extension of the emergency rule. The current rulemaking will make the emergency rule permanent.

The current rulemaking regarding APCR-auctioned allowances is one tool meant to rein in the price of compliance with the CCA. The APCR auctions are intended to ensure that entities with a compliance obligation can obtain allowances at a reasonable price and not compete with investors. "Vintage-less" APCR allowances can be used to meet current or future compliance obligations, subject to the holding limits that now apply to restrict how many allowances any one entity may have at a given time. The public comment period on the proposed rules will run through November 1, 2023, and Ecology anticipates the rule will become effective in spring 2024.

Ecology Considering Other Cost Containment Measures

The legislature directed Ecology to pursue linkage of Washington's market and the joint market for allowances in California and Quebec. The California and Quebec joint market is approximately six times the size of Washington's market, so linkage could lower allowance prices. Ecology must first make a formal determination that linkage would benefit the state's environment, economy, and communities. Ecology anticipates that a preliminary determination will come in fall 2023; linkage would not occur until at least 2025.

The CCA also allows entities to use offsets for a small portion of their compliance obligation. Because offset credits typically cost less than allowances, increasing offset credit availability could put downward pressure on allowance prices. However, at this early point in the program, no offset projects have been approved for credit issuance. And, looking forward, Washington's offset program appears to be more restrictive than California's.

Finally, although the CCA includes some directives for the auction's significant proceeds, there may be opportunities for the state to invest in programs or grants to reduce compliance costs, especially for those businesses seeking to reduce emissions by increasing their use of renewable energy.

Takeaways

Although the current rulemaking is intended to clarify one cost containment tool, the cost of compliance with the CCA continues to exceed original estimates. It will take time for the allowance market to stabilize, in part because actions that may contain costs cannot be immediately implemented. Businesses should be on the lookout for opportunities to carefully plan long-term compliance strategies, including capital investments, to reduce emissions to mitigate the impact of further allowance price increases.

Explore more in

Climate Law   Environment, Energy & Resources   Sustainability & Corporate Responsibility   Energy Infrastructure & Clean Technology

Related insights

Update

An Enforcement Blast From the COVID-19 Past: DOJ Aggressively Targeting PPP Loan Recipients

Update

Implications of California Governor Newsom’s Veto of AI Safety Bill SB 1047