WASHINGTON'S CAP-AND-INVEST AUCTIONS FREQUENTLY ASKED QUESTIONS

February 28, Washington will conduct its first auction of greenhouse gas emissions allowances as part of the state's cap-and-invest program. This is a major milestone in the implementation of the state's Climate Commitment Act (CCA), which places a declining, enforceable limit — or "cap" — on greenhouse gas emissions to ensure that Washington meets or exceeds its climate goals of cutting emissions 45% below 1990 levels by 2030, 70% below 1990 levels by 2040, and 95% below 1990 levels by 2050. Compliance with the program began on January 1, 2023, and this will be the first quarterly auction held by Washington's Department of Ecology (Ecology) where regulated entities have an opportunity to secure allowances, or permits to emit one metric ton of greenhouse gas emissions.

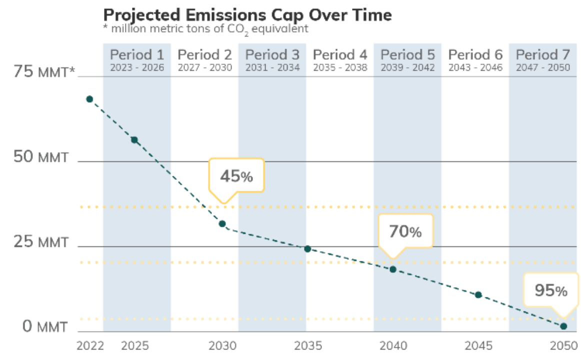
By putting a cap on pollution, the CCA ensures emissions decline over time. In addition to existing policies designed to deploy clean technology, a price is used to help meet the limit, driving down reductions first where they are the lowest cost and enabling higher ambition. The revenue raised from the program will be put back into Washington communities through investments in climate resilience, healthier air quality and clean energy jobs.

For more information, please contact the authors or visit the Washington Department of Ecology website.

Auction Basics

Q. Why is Washington auctioning allowances?

A. Auctioning allowances is a key part of Washington's cap-and-invest program, which is a tool for achieving the state's emission reduction targets. To ensure that emissions are cut in line with Washington's 2030, 2040 and 2050 greenhouse gas reduction goals, the Climate Commitment Act puts an enforceable, declining limit on all major sources of greenhouse gas emissions across the state's economy.



Source: *Washington Department of Ecology*

The cap declines annually and is enforced by requiring every polluting facility covered under the program to hold one allowance, or permit to emit one ton of greenhouse gas emissions, for every ton of climate pollution that it emits. Each year, Washington's Department of Ecology will create only as many allowances as the declining cap allows, reducing the number of emissions that are available year after year to ensure that regulated entities across Washington's economy reduce their emissions in line with the cap.

The quarterly auctions administered by Ecology are opportunities for regulated businesses to purchase allowances to comply with the program. Regulated businesses that do not comply must pay steep fines and submit additional penalty allowances.

Washington's cap-and-invest program operates alongside a suite of policy solutions that advance climate goals along with environmental justice and local air quality goals. The cap acts as a backstop on emissions, putting an enforceable limit on climate pollution to require that economy-wide emissions decline at the pace and scale needed for Washington to achieve its climate commitments. A well-designed, firm and declining limit on emissions from across Washington's economy gives the state the greatest possible certainty of achieving its climate goals and protecting Washington's communities and households from the most dangerous impacts of climate change.

Q. How do regulated facilities get allowances?

A. Utilities and some industries are given allowances directly to benefit ratepayers and to prevent businesses from moving their pollution across state borders (known as leakage) to jurisdictions where they do not face a cap on emissions. Preventing leakage is important for retaining jobs in Washington, and also safeguards against the possibility for climate pollution to simply shift elsewhere and escape regulation.

Importantly, no-cost allowances are also provided directly to electric and natural gas utilities in order to **protect ratepayers against potential price increases** on their utility bills, prioritizing low-income ratepayers.

Apart from these specific cases, most of the allowances are auctioned by the Department of Ecology to regulated businesses that need them for compliance under the cap. This is where the carbon price is determined: the cost of purchasing an allowance at auction is set by the market. This carbon price acts alongside the hard cap on emissions, creating a powerful incentive for regulated businesses to cut greenhouse gas emissions and making the cost of allowances part of their decision-making about when and how to reduce emissions.

Q. How do auctions work?

A. Washington's quarterly auctions, administered by the Department of Ecology, are sealed-bid auctions, in which participating facilities can choose to submit a single bid for all the allowances they want, or can submit a series of bids for groups of allowances at different prices. The bids are then sorted in order of bid price, starting with the highest bid, and allocated to each bidder in that order. After all the allowances have been accounted for, **the lowest bid that successfully won allowances is the price that all bidders will pay**. Any participating facilities who bid below that threshold will have to purchase their allowances at a future auction, or on the secondary market from other businesses and individuals.

Washington will be using the same format and auction platform used by the joint California-Quebec emissions market administered by the Western Climate Initiative, Inc. (WCI).

Q: When will the auctions be held?

A: Each year, Washington's Department of Ecology will hold four allowance auctions. The first of these quarterly cap-and-invest auctions will be held on February 28th, 2023, and a summary of auction results will be released on March 7, 2023. The remaining 2023 allowance auctions are expected to be held on May 31st, August 30th, and December 6th. A list of expected auction dates for 2023 can be found here.

Q. Are there any price stabilization measures in place?

A. There are several key features included in the design of these auctions to ensure stable and predictable prices: the price floor, price ceiling and the Allowance Price Containment Reserve (APCR).

The **price floor** works as a minimum price for allowances — allowance prices cannot drop below the price floor, which helps ensure that regulated entities are still subject to a minimum price signal to reduce emissions even in a scenario where demand for allowances becomes lower than expected. The price floor also ensures a certain and reliable minimum level of revenue from the auctions, which is invested in projects that will further reduce greenhouse gas emissions and improve air quality.

The **price ceiling** tackles the other side of the equation, ensuring that the cost of allowances does not rise above a maximum price set by Ecology. If the allowance price reaches the price ceiling, additional allowances are made available at the ceiling price. Any revenue from the sale of allowances at the price ceiling will be used to secure additional emissions reductions on a ton-for-ton basis for every allowance that is sold at the price ceiling, keeping Washington on track to achieve its climate goals.

Finally, the **Allowance Price Containment Reserve (APCR)** in Washington operates as a soft price ceiling, providing an additional layer of stability to the market's price signal. A certain amount of allowances — 5% of the annual cap per year — are held in a reserve and are not available at auction unless specific trigger prices are reached. If prices go above a certain level (for 2023, the Tier 1 price in Washington is $46.05 per allowance), then the reserve allowances become available in the market, which helps to contain costs for covered entities. It's important to note that all of the allowances in the APCR come from under the cap, meaning they are part of the program's allowance budget and are not additional to the amount of emissions allowed by the program's declining cap.

For 2023:

- The price floor is set at $22.20.
- The APCR Tier 1 price is $51.90 and the Tier 2 price is $66.68.
- The price ceiling is set at $81.47.

These prices are set at the same level as the floor, APCR, and ceiling prices in California's market, building alignment between the programs. Each year, the floor, ceiling, and APCR trigger prices will be increased by 5% plus the rate of inflation.

Q: How does the cap-and-invest system protect consumers from price impacts?

A: To guard against price impacts, the Department of Ecology gives free emissions allowances directly to electricity and natural gas utilities for the purpose of addressing any cost burden from the cap-and-invest program on customers. All of these directly allocated allowances (including any revenue from auctioning the allowances, if the utilities make them available at auction) must be used for the benefit of ratepayers, prioritizing low-income customers.

Compliance

Q. What do facilities need to do to comply with the program?

A. In order to comply with the program, covered facilities need to obtain enough compliance instruments to cover their greenhouse gas emissions on a ton-for-ton basis. To comply with the program, regulated businesses must reduce their emissions, obtain emissions allowances from Ecology at the quarterly auctions, or obtain offset credits by investing in projects that reduce, remove, or avoid greenhouse gas emissions (such as reforestation, urban tree planting, or atmospheric ozone removal).

The CCA only allows businesses to cover a small amount of their compliance obligation with offsets (with a maximum of 5% to 8% per regulated entity in the first compliance period) to help reduce pollution where onsite reductions are not feasible or too expensive. At least half of the offsets must come from activities that provide direct environmental benefits to Washington. Ecology must reduce the overall emissions cap — and therefore, the number of allowances issued — on a ton-for-ton basis for every offset used.

Q. What happens if facilities don't meet their obligations?

A. If facilities do not submit the required number of allowances, they face strict penalties. If a business fails to turn in sufficient allowances to the Department of Ecology for compliance, they are fined and required to turn in four allowances for each allowance that is missing. This makes their compliance obligation four times what it would otherwise be. Regulated entities that do not comply with the program may also be fined up to $50,000 per violation, per day.

Q. How long are compliance periods?

A. Compliance periods under the program are four years long, with the first compliance period ending December 31, 2026. By the end of each compliance period, regulated emitters have to have submitted compliance instruments, either in the form of emissions allowances or a limited number of offset credits, equal to their covered emissions for the duration of the compliance period. While the majority of those compliance instruments must be submitted by the end of the compliance period, each year emitters face an additional requirement to submit compliance instruments equal to 30% of their emissions for the prior year.

Q. Can facilities save unused allowances for future use?

A. Regulated entities have the ability to "bank" unused allowances for future use, purchasing them at auction and then saving them to cover their compliance obligation in the future. Banking provides flexibility for facilities, which can help reduce the cost of compliance. Allowance banking also gives entities an incentive to reduce emissions early on, as they can save those banked allowances for future use. While the overall emissions budget remains the same, reducing emissions earlier in time can provide important climate benefits, as the impact of long-lived climate pollutants on the atmosphere is cumulative; much of the pollution we are emitting into the atmosphere today will linger and continue to cause warming for decades to come.

After the Auction

Q: What auction results will be made publicly available?

A: After the auction takes place, Ecology will publish information about auction settlement prices and results, as well as auction proceeds and allowances in holding accounts. Results from the first auction are expected to be made available on March 7, 2023 on the Department of Ecology's auctions and trading website. You can sign up for auction updates from the Department of Ecology here. EDF will also be releasing blogs highlighting the results of each auction, which will be available on EDF's Climate 411 blog.

Q. What will happen to the money that is raised through the auction?

A. Revenue from the sale of emissions allowances at auction will be invested into critical climate projects across Washington state that reduce climate and air pollution and build climate resilience. The CCA requires that a minimum 35% — and a goal of 40% — of revenues raised from the program be invested in projects that provide direct and meaningful benefits to communities that are disproportionately overburdened with environmental harms and health impacts. An additional 10% of the investments must be used for projects supported by Tribes. These investments offer a huge opportunity to supercharge Washington's transition to a cleaner, healthier, more equitable economy.

For more information, please contact:
Caroline Jones, U.S. Climate Analyst, cajones@edf.org
Kjellen Belcher, U.S. Climate Manager, kbelcher@edf.org

Environmental Defense Fund
257 Park Avenue South
New York, NY 10010

T 212 505 2100
F 212 505 2375
EDF.org