Updated December 2023

Washington State

Years in Operation	The first compliance period began on 1 January 2023. Ecology may suspend the programme in 2055 if it determines by 1 December 2055 that the 2050 emissions limit has been met for two or more consecutive years.
Target(s)	• 45% below 1990 levels by 2023 • 70% below 1990 levels by 2040 • 95% below 1990 levels by 2050 and achieve net zero emissions by 2050 The programme is expected to account for 52.4% of Washington's abatement efforts through 2030 (26.2 $MtC0_2e$ of the required 50 MtC0se emissions reduction).
Overall Cap & Trajectory	Allowance budgets will decline by 7% reduction per year during the first compliance period, as follows: • 63.29 million tCO2e in 2023 • 58.52 million tCO2e in 2024 • 53.76 million tCO2e in 2025 • 48.99 million tCO2e in 2026
Sectors covered	As of 2023: • Gasoline and on-road diesel • Electricity generation (including imports) • Large stationary sources that emit over 25,000 tCO2e annually • Natural gas distributed to homes and commercial businesses As of 2027: • Waste to energy facilities As of 2031: • Railroads Landfills were removed from the programme after the passage of HB 1663, which establishes a landfill-specific methane-reduction programme.

	Fuels used for agricultural operations, aviation fuels, marine fuels combusted outside of Washington, emissions from exported fuels, and entities that emit less than 25,000 tCO2e annually are not covered by the programme.
GHGs covered	• CO2 • CH_4 • N2O • SF_6 • HFCs • PFCs • Any other gas or gases designated by the department by rule.
Number of entities covered	Roughly 100 entities
Allocation method	Allowances are distributed through free allocation, free allocation with consignment, and auction. The programme distributes free ("no-cost") allowances to natural gas utilities, electric utilities, and emissions-intensive trade exposes (EITE) facilities. Allocation is determined on an individual facility basis using a variety of methods. No-cost allowance allocation to facilities designated as EITE based on carbon intensity baseline (or mass-based baseline where carbon intensity cannot be determined). EITEs receive allowances equal to 100% of their emissions based on a carbon intensity benchmark for their emissions for 2015-2019 for the first compliance period (2023-2026). Allocations decrease by 3% of the allocation baseline for each of the second and third compliance period (2027 to 2030 and 2031 to 2034). Electric utilities receive one allowance for each tonne of emissions associated with the cost burden effect for each qualifying electric utility for each emissions year. Allowances must be consigned to auction for the benefit of ratepayers, transferred at no cost to an electric generating facility as described in WAC 173-446-4251, deposited for compliance, or a combination. Natural gas utilities received an initial free allocation equal to 93% of their allocation baseline, which declines in line with the cap decline factor through 2030 and by additional increments based on the 2030 allowance budget through 2049. No cost allowances allocated to natural gas utilities may be consigned to auction for the benefit of ratepayers, deposited for compliance, or a combination of both. The percentage of allowances that must be consigned at auction increases from 65% in 2023 to 100% in 2030.

[1] https://app.leg.wa.gov/WAC/default.aspx?cite=173-446-425

Trading rules	The programme imposes holding and purchase limits that limit the overall quality of allowances that entities can hold or purchase. Third-party financial entities can also participate in trading if they meet certain prerequisites.
Use of offsets and linking	First compliance period: Offset usage is limited to 8% of an entity's compliance obligation, where no more than 5% may come from projects not located on federally recognised tribal land (FRTL), and no more than 3% for projects located on FRTL. Second compliance period: Offset usage is limited to 6% of an entity's compliance obligation, where no more than 4% may come from projects not located on FRTL, and no more than 2% for projects located on FRTL. Third and subsequent compliance periods. Offset usage is limited to 6% of an entity's compliance obligation, where no more than 4% may come from a combination of projects located on and off of FRTL, and the remaining 2% must come from projects located on FRTL. If Washington has linked with another jurisdiction, at least 50% of offsets must be sourced from projects that provide direct environmental benefits (DEBs) to the state during the first compliance period, with that number increasing to 75% during the second and subsequent compliance periods If Washington has not linked, 100% of offsets must provide DEBs to the state. Ecology may modify the offset usage limits "when appropriate" to ensure achievement of the proportionate share of statewide emissions limits or to align with other linked jurisdictions.
Price containment	The programme has a price floor and a price ceiling. The 2023 auction floor price was $22.20 and will increase by 5% annually plus inflation. The 2023 price ceiling trigger was $81.47. Ecology also maintains an allowance price containment reserve (APCR). Ecology will offer sales of allowances from the APCR in the quarter following any quarter in which the auction settlement price was at or above the Tier 1 price ($51.90 in 2023) or when new covered and opt-in entities enter the programme and allowances from the emissions containment reserve are exhausted. Bids at an APCR auction must be at either the Tier 1 price of the Tier 2 price ($66.68 in 2023). Price tier values increase by 5% annually plus inflation. If the APCR runs our of allowances, Ecology will generate new allowances whilst using the corresponding revenues to invest in abatement. Banking is allowed; borrowing is not allowed.
Emissions containment	Ecology will maintain an emissions containment reserve to ensure prices are kept above the floor and will seed the reserve through various mechanisms, including the transfer of 2% of the annual allowance budget for 2023-2026. Ecology will also withdraw allowances from auctions where the emission containment reserve trigger price is met. If it links with another jurisdiction, Ecology will set

	an emission containment reserve trigger price at a level equal to that of the other jurisdiction.
Penalties for non-compliance	A covered entity must annually surrender allowances equivalent to 30% of emissions from the previous year within the current compliance period by 1 November annually. At the end of each four-year compliance period, a covered entity must surrender allowances equivalent to 100% of emissions for the compliance period, less allowances already surrendered. Failure to surrender on time results in an immediate surrender obligation equivalent to four times the missing balance. Ecology must issue an order (involving a plan and schedule for coming into compliance), a penalty of up to $10,000 per day, or both, to entities that fail to meet the surrender obligation. Ecology may issue a penalty of up to $50,000 per day per violation for bidder collusion, providing false or withholding information, or violation of auction or registration requirements. For the first compliance period, as part of a "phased implementation" approach, Ecology may reduce the amount of the penalty by adjusting the monetary amount or the number of penalty allowances not timely provided.
Use of reserves	Revenue from consigning no-cost allowances given to electricity and natural gas utilities will be used for the benefit of ratepayers while all other revenue will further the state's emissions reduction targets, address the impacts of global warming on affected habitats, species, and communities, support industry sectors that sequester emissions, and increase investment in the clean energy economy. These investments will be managed through the following accounts: • Carbon Emissions Reduction Account, capped at $5.2 billion through FY2037 and half of auction proceeds thereafter, for emissions reduction programmes in the transportation sector (eg, transportation alternatives, alternative fuel infrastructure, freight transportation improvements). • Climate Investment Account, to support climate mitigation, adaption and resilience programmes. 75% is initially allocated to the Climate Commitment Account and 25% is initially allocated to the Natural Climate Solutions Account. • Air Quality and Health Disparities Account, intended to direct at least $20 million per biennium for programmes that improve air quality monitoring and outcomes.

Major Developments

Since its launch, Washington's cap-and-invest system has seen auction prices consistently clearing significantly above pre-programme expectations, raising serious compliance cost concerns. As a result of the unexpectedly high allowance prices, the programme has generated, within the first three quarters, revenues nearly doubling the anticipated revenue for the entire year2. The high allowance prices are largely driven by tight market conditions resulting from the programme's stringent early period compliance requirements, combined with limited flexibilities. These concerns have been exasperated by state actions that have raised uncertainties and called into question the efficacy and longevity of the programme.

ECY is positioning linkage with Quebec and California as an important element to reduce the programme's costs. Under the state's own admission, "Washington continuing as a standalone program and rejecting linkage could lead to the program being curtailed or even repealed, … [as the program] may not be large enough, or liquid enough, to avoid allowance prices increasing to a level that could undermine the durability and longevity of the program." In early November, ECY's director confirmed that the state will pursue linkage with California and Quebec. Pending a decision from California and Quebec, the earliest linkage could be pursued would be 2025, though linkage by 2027 may be a more reasonable expectation.

In response to the higher-than-anticipated costs, Democrat Senator Mark Mullet released draft legislation to better align the programme with WCI market. Important proposals include: reduced annual cap reduction factor from 7% to 3.6% over 2023-2030, hiking cap decline rate in later years to maintain same 2050 target, expand APCR supply to align compliance costs with California, and use of programme revenues above ECY initial estimates to provide cost relief for consumers. The bill will be introduced once the legislative session begins in January. Additionally, Washington I-2117, a citizen-initiated ballot measure to repeal the cap-and-invest programme has obtained the minimum required signatures to qualify as an Initiative to the Legislature, and will likely be included on the ballot at the next state general election on 5 November 2024.

Market Commentary

The APCR was first triggered following the programme's second auction in May, which saw 8.585 million current vintage allowances clear at $56.01. ECY's initial APCR allocation methodology communicated in June allocated 1.054 million APCR allowances equally split between both tier prices ($51.90 and $66.68) for auction. The limited number of allowances offered at the tier 1 price saw the auction largely oversubscribed, and caught many market participants off guard, resulting in significant increases within secondary markets.

The next auction in August cleared at $63.03 triggering the APCR for the second time in a row. In response to the August auction results, ECY unexpectedly changed course on the state's APCR allocation methodology, offering 5 million APCR allowances at the tier 1 price for the November APCR auction, a substantial shift from the 1.25 million that would have been allocated under the original APCR methodology. ECY justified this shift to help balance WCA supply and demand while reducing compliance costs. These changes in APCR auction rules without prior notice saw significant market volatility, with secondary market prices falling from $65.75 to $54.55.
In advance of the December auction, ECY released the following APCR schedule to provide clarity to market participants. As part of the communication, ECY announced that up to

[2] https://www.seattletimes.com/seattle-news/environment/was-carbon-pricing-program-nears-1-billion-in-revenue-far-outpacing-early-estimates/

2026, all APCR allowances will be offered at the Tier 1 price.

APCR Annual Schedule			
2023	2024	2025	2026
8 million	7 million	3 million	~700,000

At the time of writing, it is unclear if the change in APCR methodology will result in adequate cost-containment to prevent a third triggering of the APCR at the December auction. If the APCR is triggered, ECY intends to offer a minimum of 1.946 million APCR allowances (the remaining amount in the 2023 APCR pool defined in June).

Useful Links

Cap-and-Invest Overview

August 2023 Auction Public Proceeds Report

Cap-and-Invest Linkage Background

Washington's Linkage Decision

Mark Mullet Draft Legislation

Cap-and-Invest Repeal Ballot

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