THE WASHINGTON STATE DEPARTMENT OF ECOLOGY REISSUES CLEAN AIR RULE

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Energy Alert

On June 1 the Washington State Department of Ecology ("Ecology") reissued a draft Clean Air Rule ("CAR"). A prior iteration of the rule was filed on January 6, 2016, but was withdrawn by Ecology to address and incorporate feedback from stakeholders and covered parties[1]. Ecology anticipates that the revised CAR will be finalized sometime in September 2016; comments on the proposed rule are due by July 22, 2016.

Like the withdrawn rule, the intent of the reissued CAR is to establish emission standards to cap and reduce greenhouse gas ("GHG") emissions from in-state stationary sources, petroleum product producers and importers, and natural gas distributors[2]. The CAR would cover two-thirds of all in-state GHG emissions[3], including both public and private sector parties.

According to Ecology, some of the changes in the reissued rule include "incorporating mechanisms to ensure emissions are reduced while supporting business growth; recognizing early actions already taken to reduce emissions; and an effective pathway for power plants."[4]

Reactions to the reissued CAR have been mixed. Some stakeholders have raised concerns about the costs of implementing the program and the potential costs to energy customers. Others have asserted that the proposal would not sufficiently reduce emissions to protect the environment. [5]

Below, we address what parties could be affected by the reissued rule, how the rule would operate, and the different options for compliance[6]. We also outline the significant changes and significant omissions in the reissued CAR as well as the key dates for stakeholder input and covered party compliance.

AFFECTED ENTITIES

Like the withdrawn draft CAR, the reissued draft CAR applies to particular emitters including (1) owners or operators of a stationary source located in Washington, (2) petroleum product producers in Washington or importers to Washington; or (3) natural gas distributors in Washington[7]. The rule targets emitters from particular source categories[8] that include stationary fuel combustion, petroleum and natural gas systems, pulp and paper manufacturing, electrical transmission and distribution equipment use, and underground coal mines.

Within the above source categories, the reissued CAR would apply to covered parties[9] that emit more than the compliance threshold of 100,000 metric tons of CO2e[10]. Beginning in 2017, every three years the compliance threshold would be reduced and more organizations would be brought into the program[11]. And, just like in the withdrawn CAR, energy-intensive, trade-exposed ("EITE") parties would have delayed entry into the program, and would not be required to begin compliance until 2020[12].

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NEWLY PROPOSED STRUCTURE

The structure of the reissued CAR is similar to the withdrawn rule. Under the reissued rule, Ecology must assign a baseline GHG emissions value for each non-EITE-covered[13] party[14]. After Ecology determines each covered party's baseline, it would assign each covered party with a GHG reduction pathway or the covered party's annual reduction requirement[15]. Every three years covered parties would be required to demonstrate that each year they have made reductions in emissions at a rate equal to 1.7% of their established baseline. This would result in an approximate 5% reduction in emissions over the entire three-year compliance period.

Covered parties can reduce their emissions and comply with the rule in the following ways:

1. Direct reduction of emissions. If a covered party reduces its emissions below that required by the rule, it would generate emission reduction units ("ERU") that can be traded or sold to other covered parties or banked for up to ten years to meet future reduction obligations;[16]
2. Purchase ERUs from other covered parties that have reduced their emissions below the rule's requirements;
3. Obtain ERUs from projects within Washington[17]; and
4. Purchase allowances from programs outside Washington.

At the end of each three-year compliance period, covered parties must submit a compliance report to Ecology[18]. The compliance report must contain: (1) a record of ERUs generated; (2) a record of ERUs banked; (3) a record of ERU transactions; and (4) documentation that a third-party verified the compliance report[19]. Third-party verifiers must submit a complete verification report to Ecology by the compliance report deadline[20]. The verification report includes a review of the covered party's accounting of emissions, emissions reductions, ERUs, and all information relevant to demonstrating compliance with the applicable emission standards. To create the report, the verifier will review the covered party's compliance report, conduct an on-site visit, interview key personnel, and review data to ensure complete and accurate reporting[21]. Third-party verifiers must be approved by Ecology[22].

SIGNIFICANT DIFFERENCES IN THE REISSUED CAR

While the basic structure of the reissued CAR is similar to the withdrawn rule, there are significant differences.

Emission Reduction Units

The reissued draft rule contains several changes to the use and tracking of ERUs. These changes include:

> **a. The establishment of an ERU reserve[23].** The reissued draft rule would create a reserve to address comments received from industry and environmental stakeholders about protecting and encouraging business growth while also reducing carbon pollution. The reserve would operate by banking a small percentage of the ERUs generated by covered parties[24]. ERUs from increased efficiency or reduction in an EITE-covered party's production can also be banked in the reserve[25]. When covered entities restart[26] or expand operations in Washington, Ecology would set aside ERUs from the reserve to offset

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> the increase in emissions and would then retire the ERUs from the account so that they cannot be used again. If there are excess ERUs in the reserve after each compliance period, the excess can be used and distributed by the newly established Environmental Justice Advisory Committee[27]. **b. The establishment of an ERU registry.[28]** Ecology would develop an electronic database to track ERUs (a feature that was not included in the withdrawn version of the CAR). The registry would be created to ensure that there is a secure and reliable method to track ERUs. **c. Different approach using allowances to generate ERUs for compliance[29].** Like the withdrawn draft rule, a covered party may use allowances from external programs to generate ERUs. Under the reissued rule, though, after the 2020–2022 compliance period a covered party's use of allowances is limited to 50% of its compliance obligation. This percentage would be decreased each compliance period until it reaches 5% in 2035. However, the reissued rule would not limit the external bodies from which covered parties can obtain allowances to generate ERUs. Under the withdrawn draft CAR, covered parties were limited to obtaining ERUs from the Regional Greenhouse Gas Initiative, California's cap-and-trade program, or Quebec's cap-and-trade program[30]. The reissued rule does not expressly limit the programs from which a covered party may obtain allowances to generate ERUs for compliance[31].

Compliance calculation for EITE-covered parties

EITE-covered parties are the only beneficiaries of revisions that recognize efforts and early actions to reduce greenhouse gases and improve efficiency. The reissued rule changes the way in which Ecology would determine an EITE-covered party's reduction pathway. Under the withdrawn draft rule, Ecology assigned each covered party, EITE and non-EITE alike, a GHG emissions reduction pathway using the same methodology[32]. Under the reissued draft rule, a mass-based GHG emission reduction pathway and emission reduction requirement that is used for other covered parties would not apply to EITE-covered parties[33].

Instead, an EITE-covered party's reduction pathway and emission reduction requirement would be determined by the particular entity's production efficiency as compared to other entities in its same sector[34]. Once an EITE-covered party is compared to its national peers, the entity would be placed in one of three categories: less efficient, average, or more efficient. The more efficient the entity as compared to national peers within the same industry, the less it would be required to reduce emissions[35]. The efficiency reduction rate for each EITE-covered party is calculated once and remains constant for each calendar year[36].

The Clean Power Plan and Other Carbon Emission Reduction Programs

The withdrawn draft rule did not address compliance with the Clean Power Plan ("CPP"). Under the reissued draft rule, if stationary sources are covered by the CPP they will be considered to comply with the reissued CAR at the beginning of the first compliance period of the CPP[37]. The applicability of this section depends on whether the Environmental Protection Agency approves Washington's implementation plan[38] as well as the outcome of the current litigation regarding the CPP[39]. Emission reductions resulting from compliance with the CPP would be used to comply with the provisions of the reissued CAR[40].

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While the reissued CAR addresses compliance with the CPP, it does not address the potential impact of a carbon tax initiative that will be on the ballot this November[41]. Ecology previously noted that it would take the effects of this initiative into consideration if and when it passed.

SIGNIFICANT OMISSIONS FROM THE REISSUED CAR

Significantly, the reissued CAR did not create a more robust, voluntary trading platform for ERUs, despite stakeholders' encouragement to Ecology to consider adding this to the new rule. In public outreach, Ecology said that its authority to issue the CAR is limited by the emissions-driven mandate of the Clean Air Act, and it could not, without legislation providing for a cap-and-trade system, create or allocate tradeable allowances. Additionally, the reissued CAR does not recognize early action for all covered entities; only EITE-covered parties may benefit under the CAR through early actions that increase efficiency.

While the reissued CAR gets one step closer to a more robust trading platform by creating an ERU reserve and registry and not limiting the external bodies from which covered parties can obtain ERUs, it does not facilitate the creation of an initial baseline of streamlined, fungible, tradeable allowances that covered entities could offer on the broader, national carbon-trading platform. Without the initial baseline of allowances, the intended effects of the rule could take more time and more administrative costs to implement. In the meantime, covered entities may be more likely to purchase allowances from markets outside Washington because those transactions are potentially more efficient and less expensive than implementing actual emissions reductions at their facilities.

KEY DATES

- May 31, 2016: Proposed rule re-released.
- July 22, 2016: Comment period concludes.
- September 2016: Anticipated publication of the final rule.
- 2017: Baselines measured using data from 2012–2016.
- 2021: Non-EITE-covered party compliance reports due to Ecology.
- 2024: EITE-covered party compliance reports due to Ecology.

NOTES:

[1[*Chapter 173-442 WAC, Clean Air Rule: Overview of Rulemaking,* http://www.ecy.wa.gov/programs/air/rules/wac173442/1510ov.html (last visited June 6, 2016).

[2] *Chapter 173-442 WAC, Clean Air Rule: Overview of Rulemaking,* http://www.ecy.wa.gov/programs/air/rules/wac173442/1510ov.html (last visited June 6, 2016).

[3] Under the withdrawn and newly proposed draft rule, GHGs include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride. Proposed WAC 173-441-020(g).

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[4] *Ecology releases updated rule to cap carbon pollution: opportunity for public to review and comment* (June 1, 2016) http://www.ecy.wa.gov/news/2016/072.html.

[5] *Wash. State Says Updated Rule To Cap Carbon Pollution Will Be More Effective*, Bellamy Pailthorp, KPLU, (Jun 2, 2016), http://www.kplu.org/post/wash-state-says-updated-rule-cap-carbon-pollution-will-be-more-effective.

[6] For a detailed description of the withdrawn draft CAR see *Washington State Department of Ecology Proposes GHG Limits in "Clean Air Rule,"* Ankur K. Tohan, Alyssa A. Moir, and Daniel Kelly-Stallings (Jan. 20, 2016) http://www.klgates.com/washington-state-department-of-ecology-proposes-ghg-limits-in-clean-air-rule-01-20-2016/.

[7] Proposed WAC 173-442-020(1)(j).

[8] WAC 173-441-020 contains a full list of the covered source categories. Exemptions to the source categories are detailed in proposed WAC 173-442-040(a).

[9] "Covered party" is defined as "the owner or operator of a: (i) Stationary source located in Washington; (ii) Petroleum product producer in Washington or importer to Washington; or (iii) Natural gas distributor in Washington." Proposed WAC 173-442-020(j).

[10] Proposed WAC 173-442-030(3).

[11] *Id.*

[12] Proposed WAC 173-442-030(2).

[13] Ecology's process for establishing an emissions reduction pathway for EITE-covered parties will be discussed further below.

[14] Proposed WAC 173-442-050.

[15] Proposed WAC 173-442-060.

[16] ERUs must originate from GHG emission reductions occurring within Washington. Proposed WAC 173-442-100(2).

[17] The projects that may be used to generate ERUs include transportation activities, combined heat and power activities, energy activities, livestock and agricultural activities, industrial sector activities, certain EFSEC-recognized emission reductions, and Ecology-approved emission reductions. WAC 173-442-160(1).

[18] Proposed WAC 173-442-200, -210.

[19] Proposed WAC 173-442-210.

[20] Proposed WAC 173-442-210, -220.

[21] Proposed WAC 173-442-220(3).

[22] A third-party verifier must be approved by [E]cology. Approval requires: (i) demonstrating to [E]cology's satisfaction that the third-party verifier has sufficient knowledge of the relevant methods and protocols in this chapter. . . (ii) registering as a third-party with [E]cology (both individuals and organizations); and (iii) active accreditation or recognition as a third-party verifier under at least one of the following GHG programs: (A) California Air Resources Board's mandatory reporting of GHG emissions program; (B) The Climate Registry; (C)

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Climate Action Reserve; (D) American National Standards Institute (ANSI); or (E) other GHG verification program approved by Ecology.

[23] Proposed WAC 173-442-240.

[24] Proposed WAC 173-442-240(1)(a).

[25] Proposed WAC 173-442-240(1)(a)(i)(B).

[26] Proposed WAC 173-442-240(3)(a).

[27] Proposed WAC 173-442-240(3)(b). The Environmental Justice Advisory Committee would be convened by Ecology and, according to the agency, "will be comprised of persons who are well-informed on the principle of environmental justice and who represent communities of color, low-income communities, and environmental justice interests from geographically diverse areas of the state." Proposed WAC 173-442-240(3)(b).

[28] Proposed WAC 173-442-230.

[29] Proposed WAC 173-442-170.

[30] Withdrawn Proposed WAC 173-442-190.

[31] The allowances must satisfy the requirements of Proposed WAC 173-44-170. Under Proposed WAC 173-442-170, a covered party could use allowances from external GHG emission reduction programs to generate ERUs when Ecology determines:
(a) the allowances are issued by an established multisector GHG emission reduction program;
(b) the covered party is allowed to purchase allowances within that program; and
(c) the allowances are derived from methodologies congruent with chapter 173-441 WAC.

[32] *See* Withdrawn Proposed WAC 173-442-080.

[33] Proposed WAC 173-442-070(1).

[34] Proposed WAC 173-442-070(2).

[35] Proposed WAC 173-442-070(3)(b)(i)-(iii). For example, if the entity is more efficient than most of the other entities in its sector, Ecology must set the entity's emission reduction rate at less than that required to meet the GHG emission reduction pathway if the EITE is a regular covered party.

[36] Proposed WAC 173-442-070(2), (3).

[37] Proposed WAC 173-442-040(4).

[38] In order for a covered party's compliance with the CPP to be sufficient for compliance with the CAR, Washington's implementation plan under the CPP must require a greater GHG emission reduction than what is required under 40 C.F.R. Part 60, subpart UUUU. Proposed WAC 173-442-040(4)(b). In addition, when a unit within a covered party's facility is subject to the CPP, then only the GHG emissions from that unit(s) is covered. Id. at -040(4)(c).

[39] Notably, the implementation of the CPP was stayed by the United States Supreme Court. See High Court Grants Stay of Clean Power Plan, David Raphael, Alyssa A. Moir, Ankur K. Tohan, Alyssa M. Fritz, and Brigid R. Landy, (Feb. 11, 2016), http://www.klgates.com/high-court-grants-stay-of-clean-power-plan-02-11-2016/.

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[40] Proposed WAC 173-442-150(1)(e)(ii)(A); Ecology releases updated rule to cap carbon pollution: Opportunity for public to review and comment, (June 1, 2016), http://www.ecy.wa.gov/news/2016/072.html.

[41] Carbon Washington's Initiative 732 is a go after all, The Seattle Times, December 24, 2015, available at http://www.seattletimes.com/seattle-news/environment/carbon-washingtons-initiative-732-is-a-go-after-all/.

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