WASHINGTON STATE DEPARTMENT OF ECOLOGY PROPOSES GHG LIMITS IN "CLEAN AIR RULE"

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Energy and Environmental, Land and Natural Resources Alert

The Washington Department of Ecology ("Ecology") kicked off what promises to be a busy year in state-level greenhouse gas ("GHG") regulation by releasing a first draft of the Washington Clean Air Rule (the "Rule" or the "Draft Rule") on January 6, 2016.[1] The Draft Rule[2] takes a unique approach to limiting GHG emissions from certain non-mobile emissions sources and aims to achieve substantial emissions reductions in Washington State that are greater than those required by the EPA's Clean Power Plan.[3]

Ecology's intent is to limit carbon pollution from certain non-mobile emissions sources in Washington and help slow climate change. But given the structure of the Rule, it is unclear whether those goals will be met. Part of the challenge is that, to a large extent, "carbon pollution" is a global concern related to the global concentration of GHG in the atmosphere—not a localized phenomenon with effects that are realized only on a local scale. Ecology has already concluded that 45% of GHG emissions in Washington State come from mobile sources such as cars, buses, planes and trucks. Another 25% comes from heating buildings. The Rule applies to a limited set of non-mobile sources with large emissions—those in specified source categories with emissions over 100,000 metric tons of CO2-equivalent ("CO2e") of GHGs per year—and Ecology has not yet explained whether and to what extent emissions reductions from this limited set of regulated parties will slow climate change. Additionally, stakeholders are raising concerns about the cost of implementing the program, potential costs to consumers and potential unintended adverse environmental impacts as the covered sectors transition between fuels.[4]

It remains to be seen whether the Rule can survive political and potential legal challenges. Nonetheless, the Rule represents a significant stride by the State of Washington to address GHG emissions and, if adopted, would develop a framework to commoditize, and therefore, incentivize changes in how some industries manage their GHG emissions.

HOW THE RULE WORKS

Ecology calls the Draft Rule a "cap and reduce" program.[5] It does not have a traditional cap-and-trade structure like that associated with California's GHG emissions program. Nor does the Rule apply to every GHG emitter in the state. The Rule instead targets the state's biggest non-mobile GHG emitters and requires them to reduce their GHG emissions by a specified percentage every three years.

The rule targets only emitters from specified source categories. The specified source categories are listed in the Draft Rule at Proposed WAC 173-441-120 and mirror (with some exceptions) those found in the federal Mandatory Greenhouse Gas Reporting rules (40 C.F.R. Part 98).

They include:

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- Stationary fuel combustion;
- Electricity generation;
- Chemical manufacturing processes;
- Materials manufacturing processes;
- Petroleum and natural gas systems;
- Landfills and wastewater treatment; and
- Petroleum product producers and importers
- Natural gas distributors

Proposed WAC 173-441-120.[6]

Notably, the Draft Rule excludes petroleum fuels made for aviation or maritime use or exported outside of Washington, as well as the TransAlta power plant, agricultural practices, emissions associated with imported electricity or the industrial combustion of woody biomass.[7]

Even within these source categories, the rule applies only to sources that generate GHG emissions above an established compliance threshold. In total, Ecology predicts that the Rule would reduce GHG emissions at an annualized rate of between 4.5 and 6.2 million metric tons per year by 2025, and between 5.5 and 7.7 million metric tons per year by 2035.[8] By comparison, the current total GHG emissions of Washington State is approximately 91.7 million metric tons per year of GHG.[9]

The Rule establishes an initial threshold—set in terms of metric tons of CO_2e[10] emitted per year—at 100,000 metric tons per year, but that threshold is reduced by 5,000 tons every three years until it reaches a lower regulatory threshold of 70,000 tons.[11] Any facility within one of the defined source categories that emits at or above the then-current threshold is subject to the rule, and any facility below is not.[12]

Emitters subject to the rule must achieve GHG emissions reductions of 5% from a 2012-2016 baseline every three years beginning in 2017 or the first year that an emitter is subject to the rule.[13] There are several ways to reduce emissions:[14]

1. An emitter can directly reduce the amount of GHGs it emits.
2. An emitter can obtain emissions reduction credits from another regulated emitter in Washington (i.e., from a regulated emitter or an emitter that has voluntarily opted to become a regulated party, either of which has reduced emissions more than required and has generated credits for sale[15]).
3. An emitter can obtain carbon credits from an established carbon market in North America, including the market established for California's cap-and-trade program, the Regional Greenhouse Gas Initiative (RGGI), and Quebec's cap-and-trade program.[16]
4. An emitter may obtain credits from a third-party that has developed emissions reduction project(s) in Washington with verifiable credits that are acceptable by Ecology. This does not include carbon sequestration projects.

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5. An emitter can self-develop or fund a project or program in Washington that permanently reduces carbon emissions in a manner approved by Ecology (see the section below on "ERUs" for examples of projects and programs that would meet this requirement).

The Rule contains both carrots and sticks. Any emitter that reduces more than the amount required by the Rule can either bank emissions for future compliance years or sell reduction credits to others.[17] On the other hand, any emitter failing to comply with the Rule may be subject to penalties of up to $10,000 per violation/per day under Ecology's enforcement auth[18]ority._ftn18

For certain emitters, the Draft Rule would be implemented on a staggered schedule. The initial compliance period begins in 2017, but industries categorized as "Energy Intense and Trade Exposed" ("EITE") industries are given an extra three years to comply.[19] These are industries that create specified products in Washington that are sold globally, such as airliners, steel products and paper.[20] This delay in the compliance period reflects the fact that Ecology added this portion of the rule late in the drafting process in response to public comment and has not yet had an opportunity to examine its effects on industry.[21]

GENERATING AND TRADING CARBON CREDITS

Baseline GHG emissions for emitters will be generated from emissions years 2012-2016._ftn22 From there, Ecology will determine reduction pathways.[23] If the reported emissions levels are lower than a source's GHG emissions reduction pathway level, the source may generate emission reduction units ("ERUs") in amount equal to the difference.[24]

An ERU represents one metric ton of GHGs measured in C02e.[25] As noted above, these units may be composed of any of the GHGs listed in WAC 173-441-040 (Ecology's GHG reporting rule) or chlorofluorocarbons or hydrochlorofluorocarbons that are destroyed.[26] The reductions must occur within Washington unless they are generated under an established carbon market in North America, as mentioned above.[27] Once an ERU is used for a compliance obligation, it must be retired and cannot be sold, traded, reallocated or otherwise transferred._ftn28 The use of an ERU must be recorded in a compliance report that is due 120 days after an emitter's emission reporting deadline.[29]

ERUs must be real, permanent, enforceable and verifiable, and cannot be otherwise required under other legal obligations (with some exceptions).[30] All ERUs are subject to third-party verification, and all compliance reports must be third-party verified.[31]

Examples of acceptable emissions reduction measures that would translate into ERUs include:[32]

- **Energy**
  - Energy efficiency above the cost-effective threshold required by Energy Independence Act
  - Renewable energy not used to meet Energy Independence Act renewable portfolio standard
- **Industrial**
  - Refrigerant, gas management and pneumatic controller protocols from the American Carbon Registry
  - Combined heat and power projects (co-gen), as documented by Ecology

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- **Transportation**
  - Overachievement of workplace commute trip reduction goals
  - Fleet efficiency and truck protocols from American Carbon Registry
- **Methane Management**
  - Livestock, landfill and waste protocols from Climate Action Reserve

ERUs may be traded, sold or otherwise transferred between emitters as long as "sufficient documentation" is provided. This may include contracts, memorandums of understanding or other similar records. [33]

COSTS AND BENEFITS OF COMPLIANCE

Ecology prepared a cost-benefit analysis of the proposed rule, which estimates a range of $5–$65 per metric ton of GHG to reduce emissions, depending on how an emitter meets compliance obligations. For example, onsite emissions reductions, including co-firing woody biomass, efficiencies in industrial motor systems, or use of wind power may cost $30–$65 per metric ton. Emissions reductions projects, such as purchasing carbon offsets or funding carbon reduction projects, may cost $5–$29 per metric ton. Purchasing credits from the approved carbon markets such as RGGI or California's cap-and-trade market could cost $10–$15 per metric ton. By comparison, Carbon Washington, one of the two competing carbon initiatives on the ballot set the costs of compliance at $15–$25 per metric ton.[34]

Ecology's report also summarizes the costs of additional reporting, verification and possible associated criteria and toxic air pollutant emissions.

In evaluating benefits from the proposed rule, Ecology quantified the value of reduced GHG emissions using an estimate of the social cost of carbon from a report generated by a federal interagency working group in 2010. Substantial controversy surrounds the 2010 report and other estimates have been and will be generated.[35]

A CROWDED FIELD

The Draft Rule is one of several new efforts aimed at limiting GHG emissions. Most prominent among these is the EPA's recently promulgated Clean Power Plan.[36] The Clean Power Plan aims to achieve substantial GHG emissions reductions nationwide by requiring states to curb emissions associated with electricity generation. As of now, Washington appears to be on target to meet its state specific GHG reduction goal under the Clean Power Plan without substantially deviating from plans and laws that are already on the books. With that in mind, Ecology is preparing a state implementation plan now.

In addition, Washington State lawmakers are looking ahead to November elections, when two competing carbon reduction initiatives look to find their way onto the state's initiative ballot.[37] Ecology has indicated that it will analyze the effects of these initiatives on the new Clean Air Rule if and when one of them passes at the ballot box.

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KEY DATES

January 6, 2016: Draft Rule released.
April 8, 2016: Comment period ends.
Summer 2016: Anticipated release of Final Rule.
2017: Baselines measured using data from 2012-2016.
2017: Three-year compliance period begins for non-EITE emissions sources.
2019: End of first compliance period.
2020: Beginning of compliance period for EITE emissions sources.

Notes:

[1] Department of Ecology News Release, January 6, 2016, *available at* http://www.ecy.wa.gov/news/2016/002.html.

[2] For complete text of the draft rule and other rulemaking documents, see http://www.ecy.wa.gov/programs/air/rules/wac173442/1510docs.html.

[3] *See* EPA's Clean Power Plan: Structure, Implications for the Grid, and Next Steps, http://www.klgates.com/epas-clean-power-plan-structure-implications-for-the-grid-and-next-steps-08-13-2014/

[4] Brandon Housekeeper, "Proposed Carbon Cap Raises Concerns," *Olympia Business Watch*, January 7, 2016, *available at* https://www.awb.org/olympia-business-watch-1/?bid=19263

[5] *See, e.g.*, Draft Clean Air Rule media briefing, Jan. 6, 2016, *available at* http://www.ecy.wa.gov/news/2016/002.html.

[6] For a list of companies expected to be impacted by the Rule, *see* http://www.ecy.wa.gov/programs/air/rules/docs/CARcoveredparties.pdf.

[7] Proposed WACs 173-442-030(2), -040(2).

[8] Department of Ecology, *Preliminary Cost-Benefit and Least-Burdensome Alternative Analysis*, at 33, *available at* https://fortress.wa.gov/ecy/publications/documents/1502020.pdf.

[9] *Washington State Greenhouse Gas Emissions Inventory, 2010-2011*, at 4, *available at* https://fortress.wa.gov/ecy/publications/documents/1402024.pdf.

[10] This includes the following GHGs: carbon dioxide, nitrous oxide, methane, hydrofluorocarbon, perfluorinated compounds, sulfur hexafluoride and nitrogen trifluoride. Proposed WAC 173-441-020.

[11] Proposed WAC 173-442-060.

[12] The exception to this is that emitters can voluntarily submit to compliance. *See* Proposed WAC 173-442-060(4).

[13] As noted, some emitters will become subject to the rule only when the emissions threshold drops. For those emitters, the compliance period begins when they exceed the then-applicable threshold.

[14] Proposed WACs 173-442-110, & -120.

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[15] Under the Draft Rule, emitters can voluntarily opt to become a regulated party. *See* Proposed WAC 173-442-060(4).

[16] Proposed WAC 173-442-190.

[17] Proposed WAC 173-442-150(1).

[18] Draft Clean Air Rule media briefing, Jan. 6, 2016, *available at* http://www.ecy.wa.gov/news/2016/002.html.

[19] Proposed WAC 173-442-060(1)(b); *see also* http://www.ecy.wa.gov/programs/air/rules/docs/CARcoveredparties.pdf.

[20] *See* Proposed WAC 173-442-020(1)(e).

[21] Draft Clean Air Rule media briefing, Jan. 6, 2016, *available at* http://www.ecy.wa.gov/news/2016/002.html.

[22] Proposed WAC 173-442-0709(1).

[23] Proposed WAC 173-442-080.

[24] Proposed WAC 173-442-120(1).

[25] Proposed WAC 173-442-110(1).

[26] Proposed WAC 173-442-110(2).

[27] Proposed WAC 173-442-180, -190.

[28] Proposed WAC 173-442-110(4).

[29] Proposed WAC 173-442-110, -120.

[30] Proposed WAC 173-442-160(1).

[31] Proposed WAC 173-442-210.

[32] Proposed WAC 173-442-180.

[33] Proposed WAC 173-442-150(1).

[34] *See* Carbon Washington's proposal at http://carbonwa.org/policy/. The Alliance for Jobs and Clean Energy, the organization proposing a competing carbon tax initiative, has not yet defined a price per metric ton. *See* http://jobscleanenergywa.com/.

[35] *See* EPA, "The Social Cost of Carbon," athttp://www3.epa.gov/climatechange/EPAactivities/economics/scc.html.

[36] *See EPA's Clean Power Plan: A Regional Analysis*, http://www.klgates.com/epas-clean-power-plan-a-regional-analysis-09-11-2015/.

[37] "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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