DEPARTMENT OF ECOLOGY
State of Washington

CTED | Community, Trade and Economic Development

Responding to the Climate Change Challenge December 2008

Compliance and Flexibility

Proposed Regional Cap-and-Trade Program

A design for a regional market-based climate program that reduces global warming pollution to promote a thriving economy and protect public health

Overview

In the Western Climate Initiative (WCI) cap-and-trade program, a facility or entity that emits 10,000 metric tons of greenhouse gases (GHG) or more each year will be required to report those emissions. This reporting threshold is consistent with Washington State's current reporting law.

If actual total emissions meet or exceed 25,000 metric tons of GHG during any one year of a three-year compliance period[1], the facility or entity will be required to turn in allowances, or tradable emission permits, within six months of that compliance period's end. The allowances must be equal to the emissions produced. A portion of the emissions may also be covered with offset credits. The requirement to submit allowances or offset credits is called a "compliance obligation". Each allowance and offset credit is equal to one metric ton of carbon dioxide equivalent (CO_2e).

Flexibility and cost savings

The WCI jurisdictions have included a number of design features that provide compliance flexibility and help reduce the cost of allowances, including:

- **Offsets.** An offset is a project that reduces GHG emissions (or increases GHG sequestration) in sectors that are outside the cap-and-trade program, or at facilities and entities whose emissions are below the threshold set for the program. If certain criteria are met, the project may receive a credit that can be sold to a covered facility or entity, in any jurisdiction, to meet its compliance obligation. The WCI design identifies forestry, agriculture, and waste management as priorities for offset projects.
- **Three-year compliance periods.** This compliance period gives covered facilities and entities flexibility in operations and GHG reduction planning, as well as in the timing of their purchase of allowances or offset credits.
- **Unlimited banking.** If a facility or entity has more allowances or offset credits than it needs to meet its compliance obligation, they can bank the allowances or offset credits and use them for future compliance periods.
- **Auctioning.** Some percentage of allowances should be auctioned to allow for price discovery. This way, those who buy allowances will have information as to what the allowances are worth in the market. This will also reduce the potential for market manipulation.

- **Allowances and credits from other systems.** If the WCI jurisdictions link to other cap-and-trade programs, such as the Regional Greenhouse Gas Initiative in the Northeast or the Mid-West Accord, facilities and entities may be able to buy allowances and offset credits from those programs to meet a WCI compliance obligation.

Allowance distribution

There are three ways allowances will be distributed to covered facilities and entities:

- At regional auctions held in regular intervals during a compliance period.
- Free distribution by the state.
- Trading between private parties.

Regional auctions during compliance periods

Each jurisdiction can decide how much of their allowances they will auction. The WCI design recommends the following percentages:

- A minimum of 10 percent when the program starts in 2012.
- A minimum of 25 percent by 2020.
- As much as 100 percent after 2020.

Each jurisdiction can also decide when to increase the percentage of allowances they auction and who can buy their allowances at auction.

The WCI jurisdictions have established a new subcommittee on Market Operations and Oversight to design the auction process and limit market manipulation and excessive speculation.

Free distribution by the state

Allowances not auctioned will be distributed free by the state. The state can choose who will get the free allowances and on what basis. For example, the state may provide allowances to:

- Facilities and entities with a compliance obligation.
- Specific facilities or entities, such as rate regulated utilities and pipelines.
- Individual citizens or public interest groups.
- Facilities and entities that manufacture commodities and compete in the international market.
- Specialty or niche manufacturing facilities.

The allowances may be distributed based on:

- Historical or actual emissions.
- Performance benchmarks.
- Megawatt hours of electricity produced.
- Other measures to recognize equity or competitiveness concerns.

The WCI design allows the jurisdictions to standardize the distribution of allowances to some industries that operate in more than one WCI jurisdiction to address competitiveness issues.

Trading between private parties

Holders of allowances may sell them to other private parties. The Market Operation and Oversight Subcommittee will be reviewing the applicable authorities and laws for regulating the market, including requirements for disclosure of sales to ensure transparency and minimize manipulation and excessive speculation.

More information

Washington's Climate Change web site
www.ecy.wa.gov/climatechange/index.htm

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[1] The initial compliance periods are 2012-2014; 2015-2017; 2018-2020.