Report to Legislature on EITE Allowance Allocation 2035-2050

Document 4: Potential methods for allocating allowances to EITEs

The Washington Department of Ecology (Ecology) is preparing a report about no-cost allocation to emissions-intensive, trade-exposed Industries (EITEs) under the Cap-and-Invest Program.

EITEs are important local industries and manufacturing facilities that produce a variety of products including paper, food, building materials, glass, and airplanes. In establishing the Climate Commitment Act (CCA), the Legislature recognized that EITEs faced unique challenges in reducing their greenhouse gas emissions in the early years of the Cap-and-Invest Program.

The Legislature decided to issue allowances at no cost to these industries through to 2034 and didn't specify the approach to providing no-cost allowances to EITEs for 2035-2050. Ecology is required to prepare a report to the Legislature that offers information and recommendations on how best to proceed. This report will include consideration of:

- Best practices for avoiding leakage (when EITEs relocate or limit their operations)
- Different approaches for measuring the emissions generated by EITEs per unit of production
- Opportunities and barriers for decarbonizing EITEs in Washington
- How to allocate no-cost allowance to EITEs from 2035-2050
- Implications for environmental justice outcomes, local air quality, statewide emissions limits, and revenues generated by Cap-and-Invest auction

Further information on EITEs can be found at Ecology's website: Emissions-intensive, trade-exposed industries.

Opportunities to provide report input

Ecology is providing multiple engagement opportunities to make sure EITEs, Tribes, covered entities, community organizations, and other interested parties can provide input into the development of Ecology's report to the Legislature. This includes establishing two advisory groups – EITE Industries Advisory Group and EITE Policy Advisory Group – as well as hosting forums for Tribes, the public, and community organizations.

Ecology is specifically seeking feedback on the approach for allocating no-cost allowances from 2035-2050 as well as understanding the potential impacts on individuals and communities where EITE facilities are located. Comments may be submitted through the electronic platform until Sept. 3, 2025 at 11:59 p.m.

To stay updated on the progress of the report, the advisory groups, and public meetings, sign up for the EITE Industries email list.

Document 4: Potential methods for allocating allowances to EITEs for 2035-2050

Disclaimer

This document sets out the draft findings from staff screening of potential methods for allocating allowances to emissions-intensive, trade exposed industries (EITEs) from 2035-2050 to avoid leakage and maintain the competitiveness of EITEs within the Cap-and-Invest Program. The purpose of the document is to support discussions with advisory groups and enable interested parties and the public to provide feedback on the draft findings and information.

The draft findings and information in this document do not represent the official position of Ecology or the Legislature on any policy or issue mentioned in this document. The final report will incorporate feedback received from advisory group members and other interested parties.

This is the fourth document with draft materials that Ecology has released to date as follows:

- Document 1: Best practice policies for avoiding leakage (May 1, 2025)
- Document 2: Methods for developing greenhouse gas benchmarks (May 1, 2025)
- Document 3: Framework for assessing potential methods for EITE allowance allocation (May 29, 2025)
- Document 4: Potential methods for allocating allowances to EITEs from 2035-2050 (May 29, 2025)

Section 1: Context and Background

1. RCW 70A.65.110(4)(a) requires Ecology to describe alternative methods for determining the amount and schedule of allowances to be provided to EITEs from 2035-2050 in its report to the Legislature.
2. Document 1 and 2 set out the draft findings and supporting information from Ecology's review of best practice policies for addressing leakage and benchmarking EITEs. This document builds off the draft findings and information in these two documents to identify and describe potential methods for allocating allowance to EITEs from 2035-2050.
3. This document is structured as follows:
    a) Section 1: Context and Background
    b) Section 2: Description of potential methods for allocating allowances to EITEs from 2035-2050.
    c) Section 3: Illustrative examples of possible combination of options (scenarios).
4. As identified in Document 1, best practices policies for avoiding leakage and maintaining competitiveness of EITEs under carbon pricing programs are considered to be those policies that achieve the following four objectives:
    a) Establish a level playing field for EITEs producing within the jurisdiction vis-à-vis competitors in jurisdictions without comparable carbon pricing policies.
    b) Identify and target assistance to industrial sectors that are most at risk of leakage.

c) Maintain incentives for EITEs to decarbonize their operations and reward efficient production within the jurisdiction.

d) Align with the overarching goal of carbon pricing programs – to reduce emissions in line with jurisdictional (and global) emission reductions targets.

5. These four objectives (key design considerations) were used as a framework for identifying potential methods or options for avoiding leakage and maintaining competitiveness of EITEs under the Cap-and-Invest Program from 2035-2050, which are described in this document.
6. The purpose of this document is to enable advisory group members and other interested parties to provide feedback on the potential options, which will then be assessed by Ecology using the proposed assessment framework set out in Document 3. In particular, **Ecology is seeking feedback on whether the proposed policy options cover all the viable approaches for allocating allowance to EITEs within the Cap-and-Invest Program, or if are there other options that should be considered.**

Section 2: Potential methods for EITE allowance allocation for 2035-2050

7. This section describes potential methods for allocating allowance to EITEs from 2035-2050. It is based upon the draft key finding in Document 1 that the allocation of no-cost allowances to EITEs remains a 'best practice' approach for avoiding leakage and maintaining competitiveness of EITEs within sub-national[1] carbon pricing programs like Washington's Cap-and-Invest Program.
8. The potential methods or 'options' are grouped under for key design considerations:
    a) Establish a level playing field for EITEs producing within the jurisdiction
    b) Identify and target industrial sectors most at risk of leakage
    c) Maintain decarbonization incentives for EITEs and rewarding efficient production
    d) Align with program cap and emissions limits.
9. The options listed under each of the four key design considerations are in most cases not mutually exclusive, and different combinations of options could be utilized as part of the design of the EITE allowance allocation approach for 2035-2050. Section 3 provides illustrative examples of how different options could be used in combination.
10. This document does not provide any assessment of the options listed in Section 2, but does indicate where further analysis may be required to clarify details of potential options.

Establish a level playing field for EITEs producing within the jurisdiction

11. Establishing a level playing field for EITEs within Washington vis-à-vis competitors in jurisdictions without carbon pricing policies is a key design consideration for addressing leakage and maintaining competitiveness of EITEs regulated by the Cap-and-Invest Program.
12. Based upon the review of best practice policies (Document 1) staff have identified the following potential options to help achieve this objective:
    a) **Continue providing no-cost allowances to EITEs from 2035 onwards using an output-based allocation method** as the default approach[2] that is designed to align

[1] As discussed in Document 1, the main alternative to no-cost allowance allocation is a 'carbon border adjustment mechanism' which is likely to face legal challenges to implementation in Washington.
[2] With exceptions for facilities that cannot establish a carbon-intensity baseline or equivalent.

with annual program allowance budgets and other applicable policy objectives. Most of the options described below are contingent on this option being implemented.

b) **Periodically monitor developments in carbon pricing policies in key competitor jurisdictions** (i.e. other states and trading partners), **and relevant federal policies** (e.g. trade, climate, and/or energy) in order to identify any major changes in leakage risk that may warrant changes to EITE policies in Washington. This option is compatible with all options identified in this document.

c) **Explore other policies or strategies that could be adopted in Washington to mitigate leakage and maintain competitiveness of EITEs**, for example, incentivizing the procurement of products manufactured consistent with more stringent environmental regulations, such as Buy Clean, Buy Fair, or using auction revenues to help EITEs decarbonize[3] and overcome competitiveness issues as noted in Document 1. This option would require further work to assess which other policies might be suitable and effective for Washington and to consider how they would work in tandem with, or potentially supplant, existing EITE policies in the CCA.

Identify and target industrial sectors most at risk of leakage

13. Identifying and targeting assistance for EITEs in Washington that are most at risk of leakage is a key design consideration for addressing leakage and maintaining competitiveness of EITEs regulated by the Cap-and-Invest Program.

14. Based upon the review of best practice policies (Document 1), there is an opportunity to develop a more targeted approach to assessing leakage risk across EITE sectors in Washington. Staff have identified the following potential methods for helping to achieve this objective:

    a) **Developing an objective approach for assessing leakage risk for EITEs in Washington, including from purchased electricity**, and periodically monitoring and assessing any major changes in leakage risk. This option would require further work to determine suitable quantitative and qualitative criteria and methods for assessing leakage risk for EITEs in Washington.

    b) **Applying an 'assistance factor'[4] that provides differentiated levels of no-cost allowances to industrial sectors** based on an assessment of leakage risk facing each sector.[5] This option would be contingent on further work to develop an objective approach for assessing leakage risk and determining the basis for any differentiation between sectors.

    c) **Provide no-cost allowances or other compensation to EITEs to address any leakage risk associated with purchased electricity**. This option would be contingent on further work to assess leakage risk associated with purchased electricity in Washington and the development of a method for determining the amount of allowances or compensation to be provided to EITEs, and it could be implemented with or without the 'assistance factor' option above.

[3] Some CCA funds have already been allocated to EITEs to support emissions reduction projects.
[4] See Document 1 for discussion on assistance factors and other types of 'discount factors'.
[5] E.g. based upon 6 digit NAICS codes.

Maintain decarbonization incentives for EITEs and reward efficient production

15. Maintaining incentives for EITEs to decarbonize their operations and rewarding investment in efficient production within Washington is a key design consideration for addressing leakage and maintaining competitiveness of EITEs regulated by the Cap-and-Invest Program.
16. Based upon the review of best practice policies (Document 1) and benchmarking methods (Document 2), staff have identified the following potential options to help achieve this objective:
    a) **Continue using the output-based allocation method with facility-specific carbon-intensity baselines** as currently prescribed in the CCA from 2035 onwards. Under this option EITEs would retain their existing carbon-intensity baselines as assigned by Ecology for calculating no-cost allowance allocation along with any adjustments made to align with program budgets or other objectives.
    b) **Re-establish allocation baselines for EITEs from 2035 onwards** using the most recently available emissions and production data. Under this option the existing approach to calculating carbon-intensity or mass-based baselines for EITEs would largely remain the same, but the input data would be updated using the most recent emissions years (e.g. average emissions intensity during years 2031-2033).
    c) **Transition EITEs to product-based benchmarks by 2035** and use output-based allocation with benchmarking from 2035 onwards. This would involve replacing the existing carbon-intensity baselines with product-based benchmarks (or energy-based benchmarks if product-based benchmarks are not feasible). This option would be contingent on the development of suitable product-based benchmarks for each industrial sector through engagement with facilities and industry experts.
    d) **Enable new EITE facilities to be benchmarked against a comparable EITE facility in Washington.** This would involve new EITE facilities being assigned an allocation baseline that is equivalent to the carbon-intensity baseline of a comparable EITE facility in Washington. This option would be contingent on new EITE facilities manufacturing comparable products that are produced by existing EITEs in Washington.
    e) **Require the consignment of a portion of EITE allowance allocation for each facility** with associated revenues to be returned to EITEs provided the funds are used for emission reduction projects. This option would be contingent on the development of suitable qualifying criteria, timeframes, and other processes for governing the use of the revenues associated with the EITE consigned allowances.
    f) **Apply adjustments to EITE allowance allocation based on anticipated efficiency improvements or technological advancements** from 2035 onwards. This option would involve incremental reductions to EITE allocation in a similar manner to the 'reduction schedule' in the CCA. This option would be contingent on the development of a suitable method for determining anticipated efficiency improvements or technological advancements and require consideration of whether adjustments should be differentiated based on the characteristics of different industrial activities (e.g. products with a high proportion of process emissions or low temperature heating requirements). Alternatively, it could also be based on minimal expected efficiency improvements, for example, based on historical industry data.

Align with program cap and emissions limits

17. Policies designed to mitigate leakage and maintain the competitiveness of EITEs, including the allocation of no-cost allowances, must align with the overarching goal of carbon pricing programs: to reduce emissions in line with emission reduction targets or limits.
18. In the case of the Cap-and-Invest Program the overarching goal is to ensure that greenhouse gas emissions are reduced by all covered entities, including EITEs, consistent with the statewide emission limits established in RCW 70A.45.020.[6] This means that the no-cost allowances provided to EITEs and electric and natural gas utilities, as well as the allowances distributed by Ecology via auction, must align with the annual allowance budgets establish by rule that limit emissions from all covered entities.[7]
19. Based upon the review of best practice policies (Document 1) staff have identified the following potential options to help achieve this objective:
    a) **Applying a cap adjustment factor to EITE allowance allocation from 2035 onwards** that is calibrated with annual allowance budgets and other forms of allowance distribution. This option requires identifying the rate at which EITE allowance allocation would need to be reduced each year to align with annual allowance budgets. For example, under the current rule annual allowance budgets will be reduced by 1.8% annually from 2035-2042, then 2.6% annually from 2043-2050.[8] However, the specific cap adjustment factor that would need to be applied to EITE allowance allocation must also account for the total number of allowances in each annual budget and other forms of allowance distribution (e.g. allocation to utilities and distribution via auction).
    b) **Establishing an annual cap on total no-cost allowance allocation from 2035 onwards** so that it does not exceed a certain proportion of each annual budget. This option would require identifying a suitable threshold, taking into account other forms of allowance distribution, and enabling Ecology to adjust EITE allowance allocation on a prorated basis each year to ensure that the total no-cost allowance allocation remains under the designated threshold. This option could be implemented with or without a cap adjustment factor.
    c) **Prioritizing allowance allocations for industries manufacturing products that are consistent with statewide net-zero emissions limits.** This option would involve the prioritization of diminishing annual allowances budget towards EITEs that manufacture products that are consistent with the achievement of Washington's statewide emissions limits, including the 2050 net-zero requirement, and associated plans and policies, such as the Comprehensive Climate Action Plan (due to be published in December 2025).[9] This option would require further work to develop criteria for determining consistency of products or facilities with 2050 emissions limits and to design a method for allocating allowances on this basis. This option could be implemented with or without a cap adjustment factor or a cap on total EITE allowance allocation.

[6] See RCW 70A.65.060(1) and RCW 70A.65.070(2).
[7] Annual allowance budgets are established by Ecology through rule – see WAC 173-446-210.
[8] As specified in WAC 173-446-210.
[9] Climate Pollution Reduction Grant Program (CPRG) – Washington State Department of Commerce.

Other policy design considerations

20. In addition to the above options, staff have identified some other policy design considerations that are relevant to EITE allowance allocation policies in the Cap-and-Invest Program. These include:
    a) **Enabling EITE facilities with covered emissions below 25,000 MT to receive no-cost allowances as 'opt-in entities'**. This option would enable 'opt-in entities' classified as EITEs[10] to be eligible to receive no-cost allowances if their annual covered emissions are less than 25,000 MT CO^2e. This would have a twofold effect of expanding the availability of the leakage mitigation support (i.e. no-cost allowances) to more EITE facilities while also helping maintain incentives for existing EITEs to reduce their emissions below 25,000 MT CO^2e.
    b) **Expanding the consideration of environment justice impacts within EITE allowance allocation policies.** This could involve expanding upon the existing environment justice requirements in the CCA that are applicable to EITEs (see Appendix 1) to help ensure EITE allowance allocation policies are consistent with the environmental justice objectives of the CCA. This would require further analysis to identify and assess the environmental justice implications of existing EITE allowance allocation policies and what changes may be required to ensure consistency with the environmental justice objectives of the CCA. This would likely be contingent on the development of an objective approach for assessing the environmental justice impacts of EITE allowance allocation policies in the context of the Cap-and-Invest Program, for example impacts on jobs and air quality in local communities, and determining which policies would be most effective in directly addressing those impacts, taking into account existing policies within the CCA or other applicable state laws.

Section 3 – Illustrative examples of possible combination of options

21. As noted above, the options described in Section 2 are in most cases not mutually exclusive and different combinations of options could be utilized within an EITE allowance allocation policy. This section provides three illustrative examples or 'scenarios' of how these different options could be combined in the design of the EITE allowance allocation policy for 2035-2050.

Scenario 1 – Incorporating the four key design considerations

22. This scenario would involve a combination of 'best practice' options from across each of the four key design considerations identified in Section 2. It could include the following five options or variations of these options that achieve similar objectives:
    a) Continue providing no-cost allowances to EITEs from 2035 onwards using an output-based allocation method.
    b) Develop an official approach for assessing leakage risk for EITEs in Washington, including from purchased electricity.
    c) Apply an 'assistance factor' that provides differentiated levels of no-cost allowances to industrial sectors based on assessment of leakage risk.
    d) Transition all EITEs to product-based benchmarks by 2035 (where practicable).

[10] Either through NAICS codes as listed in RCW 70A.65.110 or by petitioning Ecology under WAC 173-446A.

e) Apply a cap adjustment factor to EITE allowance allocation from 2035 onwards that is calibrated with annual allowance budgets and other forms of allowance distribution.

Scenario 2 – Focus on cap alignment

23. This scenario would involve maintaining most of the design features of the current EITE allocation policies and adopting 'best practice' options to align with the overarching goal of the Cap-and-Invest Program. It could involve the following options:
    a) Continue providing no-cost allowances to EITEs using an output-based allocation method with facility-specific carbon-intensity baselines as currently prescribed in the CCA from 2035 onwards.
    b) Apply a cap adjustment factor to EITE allowance allocation from 2035 onwards that is calibrated with annual allowance budgets and other forms of allowance distribution. AND/OR
    c) Establish an annual cap on total no-cost allowance allocation from 2035 onwards so that it does exceed a certain proportion of each annual budget.

Scenario 3 – Consignment plus selected 'best practices'

24. This scenario would involve the introduction of consignment of EITE allowances plus selected 'best practices' from across the four key design considerations. It could include the following options:
    a) Continue providing no-cost allowances to EITEs from 2035 onwards using an output-based allocation method.
    b) Require the consignment of a portion of EITE allowance allocation for each facility with associated revenues to be returned to EITEs provided the funds are used for emission reduction projects.
    c) Re-establish allocation baselines for EITEs from 2035 onwards using the most recently available emissions and production data.
    d) Apply a cap adjustment factor to the EITE allowance allocation from 2035 onwards that is calibrated with annual allowance budgets and other forms of allowance distribution. This could be applied to the non-consigned portion of allowances to provide stronger incentives to decarbonize.

Appendix 1 – Summary of existing environmental justice requirements in the CCA that are applicable to EITEs

25. The CCA prescribes a number of environmental justice requirements that are applicable to EITEs. These include:
    a) Ecology is required to limit the use of offset credits for compliance by EITEs such that the quantity of no-cost allowances plus the provision of offset credits does not exceed 100% of the EITE's total compliance obligation over a compliance period as prescribed in RCW 70A.65.110(5).
    b) Ecology may further restrict the use of offsets by covered entities, including EITEs, if Ecology, in consultation with the Environmental Justice Council, determines that the covered or opt-in entity has or is likely to contribute substantively to cumulative air pollution burden in an overburdened community identified by Ecology as prescribed in RCW 70A.65.170(3)(d).
    c) Ecology must consider air quality in overburdened communities when making decisions on petitions for EITE designation under WAC-173-446A as prescribed by RCW 70A.65.110(2).
    d) Newly constructed EITE facilities must mitigate increases in particulate matter in overburdened communities due to its emissions as prescribed by RCW 70A.65.020(3).
26. Ecology has also initiated rulemaking (WAC 173-448) to determine processes and strategies for emissions reductions (criteria air pollutants) to achieve air quality targets in the 16 overburdened communities initially identified by Ecology as required by RCW 70A.65.020. This work would be expected to help inform whether Ecology would impose restriction the use of offsets by any applicable EITE facilities.