

Update on Western Carbon Programs and Energy Markets

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Overview

- Washington Cap and Trade Program
 - Overview
 - Linkage?
 - Allowance Price Expectations
- Impact of Washington Program on Mid-C Hub
 - Imports at Mid-C
- WSPP Mid-C Wheel-Through Product

Washington Climate Commitment Act (Cap & Trade)

Program Overview

- Multi-sector cap and trade program
 - Similar coverage to California, including electricity imports
 - Electric sector reporting begins in 2022 for 2022 transactions
 - Covered entities begin to incur compliance obligations as of 1/2023
 - 4-year compliance periods
 - First retirement autumn of 2024
 - Washington utilities receive free allowances
 - All other electricity market participants must purchase at auction or in secondary market
 - First auction not currently planned until early 2023

Electric Import Rules

- Similar to California for Tagged imports
 - Responsible importer is PSE on leg of physical path that crosses state border
 - Must sink within BAA located entirely within Washington, or at scheduling point in BPA system registered to specific customers
 - Importer must be generator owner/operator or have specified contract to report with specified emission factor
 - Default EF same as California, but includes transmission losses
- Power that sinks in BPA or multi-state utility BAA not considered an import
 - Imports assigned to these entities based on Washington customer load
- BPA has not yet determined whether it will be a covered entity
 - If not, next PSE will be considered importer

Linkage?

- Washington's program designed to facilitate, but not likely for first compliance period
 - CARB must assess environmental integrity of program
 - Rules for electricity sourced from centralized markets won't be resolved for several years
 - Both states must have public process to approve linkage
- Separate allowance markets until linkage
- Possibility of reciprocity to avoid double assessment of carbon costs for electricity transacted between Washington and California?
 - Not likely for 2023, as would have to be addressed in separate rule-makings in both states

Allowance Price Expectations

- Ecology proposes very aggressive rate of emissions decline
 - 7% annually compared to California's 2-3%
- Washington program one fifth the size of WCI (California and Quebec markets)
- Most allowances freely allocated to utilities and EITEs
- Tight allowance market, prices likely to be higher than California's right out of the gate
 - Ecology analyses suggests \$40/ton assuming linkage in 2025
 - \$58/ton if no linkage until 2030
 - No price discovery until 1st auction

Impacts on Mid-C Hub

- In-state gen and potential importers price carbon into energy offers after January 2023
 - At \$40/ton increases prices by \$17/MWh for unspecified energy
 - Drives up index and cost of physical energy for both Washington and non-Washington buyers
 - Loss of liquidity if non-Washington buyers move off screen to avoid paying carbon costs
 - Possible issues for entities with MtM financial reporting obligations to SEC
- What we're seeing
 - Thin offers beyond Cal 22 as CPs already going off-screen
 - Uncertainty in pricing as to whether Carbon is contemplated in prices or not.

WSPP Mid-C Wheel-Through Product

- Contracts sub-committee developing a new Washington “wheel-through” agreement
- Wheel-through confirm provides for carbon cost liquidated damages (LDs) if the energy is sunk in WA by buyer or a buyer from buyer, etc.
 - Buyer pays seller the cost of allowances incurred by importing seller if power sinks in Washington
 - Carbon LD can be passed up daisy-chain of transactions to importing seller
 - Carbon LD only payable if importing seller actually incurs carbon obligation
- Both Wheel-Through and Standard physical product trade at Mid-C
 - Entities that elect new product can transact both
 - Offer same MWs – 1 gets lifted, the other cancels
 - Buyers can compare prices on screen
 - New index tied to Wheel-through product
- ICE to provide functionality to turn-on counterparties for new product at Mid-C
 - WSPP maintains master list of signatories