

Cost Recovery Mechanism Concept  
for Gas Utility Allowance Purchases under the Climate Commitment Act

**Purpose:**

The intent of this concept is for the Commission’s cost recovery treatment for allowances purchased by gas utilities for compliance with the Climate Commitment Act to: (1) incentivize gas utilities to reduce emissions consistent with the allocations determined by the Department of Ecology as necessary to meet statewide greenhouse gas emissions limits (or a similar adjusted baseline as appropriate); (2) ensure that gas utilities are able to recover 100% of prudently incurred costs for allowance purchases that are within a baseline determined to be reasonable by the Commission; (3) ensure that customers only pay fair and reasonable costs for CCA allowances through a combined shared cost and savings mechanism, or performance incentive mechanism.

**Background:**

During the first 4-year compliance period, the Department of Ecology uses 2015-2019 average covered emissions to determine the baseline for the purpose of no-cost allowance allocation to natural gas utilities. The 2015-2019 average for each gas company is as follows:<sup>1</sup>

Natural Gas Utility	2015-2019 Average Covered Emissions (MT CO2e)	Date of Verification
Avista	1,054,370	6/14/2023
Cascade Natural	1,785,373	5/23/2023
NW Natural	487,445	5/23/2023
Puget Sound Energy	5,275,444	5/23/2023

The amount of no-cost allowances allocated to natural gas utilities declines by 7 percent every year of the 2023-2026 compliance period, in alignment with the trajectory necessary to meet the statewide greenhouse gas emissions limits.<sup>2</sup> For the 2023-2026 compliance period, the no-cost allowance allocation schedule for each gas company is as follows:<sup>3</sup>

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<sup>1</sup> <https://ecology.wa.gov/Air-Climate/Climate-Commitment-Act/Cap-and-invest/Auctions-and-market>

<sup>2</sup> RCW 70A.45.020

<sup>3</sup> <https://apps.ecology.wa.gov/publications/documents/2302074.pdf>

Summary of Allowance Allocations to Natural Gas Utilities for 2023-2026

NGS Name	2023	2024	2025	2026
Avista Corporation	980,564	906,758	832,952	759,146
Cascade Natural Gas	1,660,397	1,535,421	1,410,445	1,285,469
City of Ellensburg	38,036	35,173	32,310	29,447
City of Enumclaw	21,147	19,556	17,964	16,372
NW Natural Gas	453,324	419,203	385,082	350,960
Puget Sound Energy	4,906,163	4,536,882	4,167,601	3,798,320

*These values are calculated as provided in WAC 173-446-240(2)(a) based on the definition of covered emissions per WAC 173-446-040. Additionally, reports are submitted to Ecology per WAC 173-441-122.*

Pursuant to RCW 70A.65.130, 65 percent of no-cost allowances must be consigned to auction and 35 percent remain available for compliance in 2023. The percentage of allowances consigned to auction increases by five percent each year until a total of 100 percent is reached. For the 2023-2026 compliance period, the allowance consignment schedule is as follows:

	2023	2024	2025	2026
No cost allowances consigned to auction	65%	70%	75%	80%
No cost allowances available for compliance	35%	30%	25%	20%

As a result of this inclining consignment obligation, gas utility customers are exposed to increasing allowance price risk over the course of the compliance period, as the utility must purchase a greater proportion of its allowance allocation at auction each year.

**Proposed CCA Allowance Cost-Sharing Mechanism Concept:**

Application: In order to capture the greatest benefits and incentivize emissions reduction during the compliance period, the mechanism should apply to CCA allowance costs incurred during the entirety of the first compliance period (2023-2026).

Baseline: First, a forward-looking emissions baseline should be established. We recommend using the baseline established by the Department of Ecology’s no-cost allowance allocation (see above). However, the Commission should consider whether reasonable adjustments should be made to account for more recent emissions data, weather variability, feasibility, or other factors.

## Attachment A – Cost Recovery Mechanism Concept

Cost sharing: Costs are incurred when a utility consigns no-cost allowances and must purchase back that portion of their allocation. Utilities may choose to bid on allowances at any auction during the compliance period and are not required to bid at every auction. Costs are also incurred when a utility purchases allowances above its no-cost allowance allocation in order to cover its compliance obligation. Customers pay 100% of costs for allowance purchases *until the total number of allowances purchased and retained by the utility equals the utility's no-cost allowance allocation*. Once the total number of allowances purchased and retained by the company exceed the no-cost allowance allocation, customers will pay a portion of allowance purchases above the no-cost allowance allocation, as follows:

### Tier 1:

- 0-5% above baseline: 50/50 split
  - If *the number of allowances purchased and retained by the company* are 0-5% above baseline, customers will pay half of the costs of the above-allocation allowances. This allows for some variation in costs associated with weather and allows for some sharing of allowance price risk between the utility and customers.

### Tier 2:

- 5-10% above baseline: 10/90 split
  - If *the number of allowances purchased and retained by the company* are 5-10% above baseline, customers will pay 10 percent of the costs and the company will pay 90 percent of the costs. This provides a strong incentive for the company to reduce emissions and ensures that customers only fair and reasonable costs for the utility to meet its compliance obligation.

The customer contribution for allowance purchases that exceed 110% of baseline is zero.

Performance incentive: If allowance purchases are less than the no-cost allowance allocation for the calendar year, the company may retain a portion of the savings, subject to the treatment required by the earnings test in RCW 80.28.425(6).<sup>4</sup> The company may retain savings as follows:

### Tier 1:

- 0-5% below baseline: 80/20 split
  - If the number of allowances purchased and retained by the company are 0-5% below baseline, the company may retain 20% of the savings.

### Tier 2:

- 5-10% below baseline: 70/30 split
  - If the number of allowances purchased and retained by the company are 5-10% below baseline, the company may retain 30% of the savings.

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<sup>4</sup> See discussion of “allowance price forecast” for a description of how savings may be generated and eligible for this treatment.

**Other considerations:**

Seasonality: If rate adjustments are more frequent than annually, the baseline could be adjusted to reflect anticipated differences in seasonal emissions – as long as the integrity of the annual baseline is maintained.

Allowance Price Forecast: It is possible to structure the mechanism using an allowance price forecast, in which the costs are collected in rates based on a forecasted allowance price, subject to a true-up for actual costs incurred. If a forecasted allowance price is used, the best reference price may be the most recent auction settling price. However, there may be other options for reference prices which are just as valid. If this forecast method is used, the timing of rate adjustments for surcharges or credits will be an important consideration (see discussion of “rate adjustments”, below).

We also note that using a forecasted allowance price would enable the application of a performance incentive mechanism if emissions savings were achieved. Since consignment revenues must be used for the benefit of customers, we assume those revenues are not eligible for retention by the utility as a performance incentive.

Rate Adjustments: Given the narrow scope of the tariff, it is appropriate to establish a regular schedule by which rate adjustments will go into effect. More frequent rate adjustments adhere more closely to the matching principle, and reduce regulatory lag and (in the event of a surcharge) and return benefits to customers more frequently (in the event of a credit). Less frequent rate adjustments would reduce rate volatility and administrative burden, but potentially complicate review of filings if they span multiple auctions with different settling prices.

- *Option 1:* Annually (i.e. Jan. 1 for the prior calendar year)
- *Option 2:* Semi-annually (i.e. Jan. 1 and July 1)
- *Option 3:* Quarterly, after each auction (See table below for an example)

Auction Event	Auction Notice Published	Auction Date	Auction Summary Report Released	<i>Example: Rate Adjustment Effective Date</i>
February 2023	Dec. 20, 2022	Feb. 28, 2023	March 7, 2023	<i>April 1, 2023</i>
May 2023	March 31, 2023	May 31, 2023	June 7, 2023	<i>July 1, 2023</i>
August 2023	June 30, 2023	Aug. 30, 2023	Sept. 6, 2023	<i>Oct. 1, 2023</i>
December 2023	Oct. 6, 2023	Dec. 6, 2023	Dec. 13, 2023	<i>Jan. 1, 2024</i>