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California Extends GHG Cap-and-Trade Program

*By Megan Berge, Chris Carr, and Kevin Vickers**

The authors of this article discuss two new bills signed into law that extend California's greenhouse gas Cap-and-Trade Program by 10 years.

The California Legislature approved legislation that extends California's greenhouse gas ("GHG") Cap-and-Trade Program by 10 years. Governor Jerry Brown signed the two bills into law, and there is a proposed state constitutional amendment pending.

THE BILLS

Assembly Bill ("AB") 398 extends and slightly alters the Cap-and-Trade Program, and took effect immediately upon the Governor's approval. AB 617 focuses on localized emissions of criteria air pollutants and toxic air contaminants, and took effect January 1, 2018. AB 617 and Assembly Constitutional Amendment ("ACA") 1 accompanied AB 398 as part of a deal aimed at garnering enough political support to extend the Cap-and-Trade Program with at least two-thirds approval of legislators. ACA 1 will require approval by a majority of California voters to become effective.

Passage of AB 398, AB 617, and ACA 1 followed an expedited process in which wholesale amendments were made to already existing legislation in order to convert the existing legislation into the Cap-and-Trade-package. There were weeks of closed-door negotiations between the Governor, legislators, environmentalists, and other stakeholders. However, the public release of the deal came just one week before the approval votes of each chamber of the Legislature. Multiple rules of procedure were suspended in order to move the legislation quickly through the state Senate and Assembly. Since the Governor's announcement concerning AB 398 and AB 617 on July 10, 2017, only very minor changes were made to the bills. ACA 1 was added to the legislative package on July 14, 2017.

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In June, the California Supreme Court declined to consider an appeal of a lower court decision rejecting arguments led by the California Chamber (“CalChamber”) that the Cap-and-Trade Program amounted to an illegal tax. Under California law, a new tax must be approved by two thirds of the Legislature. To insulate the renewed program from a similar challenge by the CalChamber, Governor Brown stressed that he wanted a renewal of the Cap-and-Trade Program to be passed by a supermajority vote. Consistent with Governor Brown’s position, AB 398 was approved by more than two thirds of the Legislature.

The Cap-and-Trade Program is controlled by the California Air Resources Board (“CARB”), acting under its statutory authority. California statute requires that statewide GHG emissions be limited to the 1990-level of emissions by 2020. California statute also requires CARB to “ensure” that GHG emissions are reduced to at least 40 percent below the 1990-level by 2030. Additionally, Executive Order S-3-05 (issued by Governor Schwarzenegger) sets a target reduction of 80 percent below the 1990-level by 2050. Without the passage of AB 398, CARB’s authority to implement the Cap-and-Trade Program would have expired at the end of 2020. However, AB 398 extends CARB’s authority for the Program through December 31, 2030. CARB will use the Program in conjunction with other laws in its effort to meet the specified GHG emissions limits.

CHANGES THAT WILL OCCUR UNDER AB 617, AB 398, AND ACA 1

AB 617 is part of the political deal struck to gain support for passage of AB 398. The most notable components of AB 617 are the following:

- AB 617 requires increased monitoring and imposes stricter penalties for violations of emissions limits for criteria air pollutants and toxic air contaminants. Penalty limits for certain civil and criminal violations are increased from the current \$1,000 per day to \$5,000 per day, and penalty limits will increase annually based on inflation.
- AB 617 will change emissions reporting requirements for some industrial facilities, by requiring CARB to establish a uniform statewide system of annual reporting. CARB may require reporting of facility-level emissions data and third-party verification.
- AB 617 requires expedited schedules for implementation of best available retrofit control technology (“BARCT”) to stationary sources that are subject to the GHG Cap-and-Trade Program, except for emissions units that have implemented BARCT since 2007. The expedited schedules will be adopted by each air pollution control and

air quality management district that is in nonattainment for one or more air pollutants. The schedules will require implementation of BARCT by “the earliest feasible date, but in any event not later than December 31, 2023.”

- AB 617 requires CARB to establish a statewide clearinghouse that identifies best available control technology and BARCT for criteria air pollutants and related technologies for control of toxic air contaminants.

AB 398 extends and slightly alters the Cap-and-Trade Program. In order to implement changes made by AB 398, CARB will institute a future rulemaking for the post-2020 Cap-and-Trade Program. The timing and details of CARB’s future rulemaking are not yet set. The most notable components of AB 398 are the following:

- AB 398 extends CARB’s authority for the Program through December 31, 2030.
- AB 398 requires CARB to include specified price ceilings, price containment points, offset credit compliance limits, and industry assistance factors for allowance allocation.
 - A specific price ceiling is not set by the bill. In setting a price ceiling, CARB must consider certain factors, such as the “need to avoid adverse impacts on resident households, businesses, and the state’s economy.” In order to effectuate the price ceiling, CARB must offer for sale as many allowances as are needed for covered entities to meet their compliance obligations.
 - The “price containment points” will be two prices set below the price ceiling. CARB must offer for sale certain amounts of allowances at those two price containment points.
 - Currently, offsets may be used for up to eight percent of a covered entity’s compliance obligation. AB 398 will reduce that to four percent from 2021 through 2025 and six percent from 2026 through 2030. Half of all offsets used for compliance from 2021 through 2030 must come from projects that have “direct environmental benefits” in California.
 - Under the current Program, CARB uses “industry assistance factors” as one component of formulas that are applied to each covered entity to determine how many compliance allowances are provided to the covered entity for free. Providing some allowances for free is intended to ease the compliance burden and reduce the chance that a business will simply move its

operations out of the state in order to avoid the Cap-and-Trade Program. AB 398 requires CARB to set the industry assistance factors for the post-2020 Program at the same levels that are applicable to the 2015 through 2017 compliance period.

- AB 398 directs CARB to “apply a declining cap adjustment factor to industry allocation[.]” The “cap adjustment factor” is another component of the free-allowances formulas. So, as with the current Program, the post-2020 Program under AB 398 would slowly reduce the number of free allowances given out. The Governor’s office asserts that reducing the cap adjustment factor as specified in the bill will decrease free allowances by 40 percent by 2030.
- AB 398 establishes the “Compliance Offsets Protocol Task Force” to provide guidance to CARB in approving new offset protocols for the purposes of increasing offset projects with direct environmental benefits in the state while prioritizing disadvantaged communities, Native American or tribal lands, and rural and agricultural regions.
- AB 398 establishes the “Independent Emissions Market Advisory Committee” to report to CARB and the Joint Legislative Committee on Climate Change Policies on the environmental and economic performance of the Cap-and-Trade Program and other relevant climate policies.
- AB 398 requires the Legislative Analyst’s Office to annually report to the Legislature on the economic impacts and benefits of specified GHG emissions targets.
- Pre-AB 398 law continuously appropriates 60 percent of the annual moneys from the Program for transit, affordable housing, sustainable communities, and high-speed rail purposes. AB 398 declares the intent of the Legislature that moneys be appropriated in accordance with a specified order of priorities, but the bill does not specifically dictate how the moneys will be used.
- Pre-AB 398 law expressly does not limit or expand the existing authority of air pollution control and air quality management districts. This has raised concern among business interests because the Bay Area Air Quality Management District has indicated a desire to impose additional GHG limits on facilities within its jurisdiction. AB 398 prohibits, until January 1, 2031, an air district from adopting or implementing an emission reduction rule for carbon dioxide from stationary sources that are also subject to the GHG Cap-and-Trade

Program.

- Pre-AB 398 law exempts from sales and use taxes, on and after July 1, 2014, and before July 1, 2022, the gross receipts from the sale of, and the storage, use, or other consumption of, certain tangible personal property for use primarily in manufacturing or other specified activities (such as research and development activities). AB 398 extends that exemption through July 1, 2030, and additionally exempts from those sales and uses taxes certain tangible personal property used primarily in the generation or production, or storage and distribution, of electric power.
- AB 398 repeals a fire prevention fee that primarily affects rural landowners.

ACA 1, if approved by a majority of California voters at the June 5, 2018, election, will require that two thirds of legislators approve the first appropriation of any money collected from the sale by CARB of Cap-and-Trade allowances after January 1, 2024. After the first appropriation of such money, subsequent appropriations of money collected from the sale of Cap-and-Trade allowances will require only a majority vote of the Legislature.

The intent of ACA 1 is to establish a one-time supermajority vote requirement, about halfway into the 10-year period of the extended Cap-and-Trade Program, to give legislators a chance to revisit the uses of revenues generated by the Program. ACA 1 contains a mechanism that will place considerable pressure on legislators to reach political compromise regarding use of the revenues (and, potentially, other revisions to the Program). The sales and use tax exemption that was extended and amended by AB 398 will be suspended until the Legislature can muster two-thirds support for an appropriation of Cap-and-Trade revenues.