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PERSPECTIVE

Bills leave unresolved cap-and-trade issues

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California has extended its cap-and-trade program to 2030, a critical action needed to meet its ambitious greenhouse gas reduction goals. Last year, under Senate Bill 32, California increased its greenhouse gas reduction goal to 40 percent below 1990 levels by 2030. The cap-and-trade program is anticipated to result in almost one third of the 2030 reduction goal. The existing program has been controversial, subject to several legal challenges, and was set to expire in 2020. The uncertainty of the future of the cap-and-trade program was creating numerous problems, including affecting the value of allowances for greenhouse gas emissions issued under the program and impeding the development of measures under the Scoping Plan Update to accomplish the 2030 greenhouse gas reduction target.

The cap-and-trade program extension is included in a three-bill package needed to secure support for its passage. The three measures are AB 398, AB 617 and ACA 1 (a proposed constitutional amendment). The bill package included various provisions to address concerns raised by environmental, business, industrial and regulatory groups. The main issues addressed, apart from the cap-and-trade program extension, are: (1) measures to address local air quality issues in the state's most polluted communities, a priority of environmental justice advocates, (2) restrictions on local air district regulation of pollutants regulated under the cap-and-trade program, (3) a requirement for future legislative approval of the use of cap-and-trade funds, and (4) tax cuts.

Brief Overview of Cap-and-Trade Program

The cap-and-trade system requires certain regulated industries to obtain permits (called allowances) to emit greenhouse gases.

New York Times

Emissions from an oil refinery are seen in orrance, Sept. 10, 2010.

Regulated industries include power plants, refineries and other entities that emit over a certain amount of greenhouse gases per year. Under the system, a cap on greenhouse gas emissions will be established that will set an initial number of allowances. Each year, the cap will be decreased, and the number of allowances reduced, resulting in a corresponding reduction in permitted greenhouse gas emissions. The annual allowances are a mix of free allocations and those sold by the state at quarterly auctions. The allowances can be traded, which will force emitters to decide whether it is more cost-effective to reduce emissions or to buy more allowances from entities that have reduced their own emissions and no longer need their allowances. The auctions generate revenue for the state which is used to fund certain programs.

Cap and trade also allows greenhouse gas emitters to obtain certain types and amounts of offsets for their emissions. The original cap-and-trade program took effect in 2012 and is set to expire in 2020. It was subject to several legal challenges alleging it was an illegal tax and the use of the funds for certain types of programs was illegal because the programs did not relate to greenhouse gas reduction. A recent court of appeal decision ruled that the original cap-and-trade program was not a tax that would have required a two-thirds vote for passage. *California Chamber of Commerce v. State Air Resources Board*, 10 Cal. App. 5th 604 (2017).

Assembly Bill 398

AB 398 is the central element of the legislative package. It extends the cap-and-trade program to 2030 and changes some elements of the existing program. The bill was passed by a two-thirds supermajority vote in order to eliminate any challenge to the program as an illegal tax. It takes effect immediately as an urgency measure. Key changes to the program include: setting a stricter price "ceiling" for allocations; keeping free allowances, but eliminating over 40 percent of free allowances by 2030; and reducing the use of offsets and requiring half of a company's offsets to provide direct environmental benefits to California. The price ceiling on allocations was a significant issue for industry. It guards against price spikes that might occur as the number of allowances is reduced to meet the 2030 greenhouse gas reduction target. The continuation of free allowances also was a win for industry groups.

Subject to some controversy, AB 398 also prohibits local air districts from regulating carbon dioxide emissions from stationary sources subject to the cap-and-trade program. Instead, the California Air Resources Board (CARB), a state agency, will have the exclusive power to enact these types of regulations. The bill also requires CARB to complete the Scoping Plan Update by Jan. 1, 2018. The Scoping Plan Update identifies strategies and measures to meet the state's 2030 greenhouse gas reduction goal. Cap-and-trade is a central greenhouse gas reduction measure under the draft Scoping Plan Update.

Assembly Bill 617

AB 617 was enacted to address regulation of the localized effects of air pollutants. The bill authorizes regulations to reduce localized pollution emissions that cause public health problems. Environmental justice and public health advocates wanted the legislation to address these impacts on local communities because greenhouse gas reduction to prevent climate change is a global issue. Under AB 617, CARB will develop programs to address pollutants from industrial facilities, particularly toxic air contaminants which increase cancer risk. The bill also requires annual emissions reporting and the development of an air quality monitoring plan to identify communities most impacted by pollution. CARB is directed to prepare a statewide strategy to reduce pollutants in high-impacted communities. AB 617 also imposes stricter financial penalties for noncompliance with emissions regulations.

Assembly Constitutional Amendment 1

ACA 1, a proposed constitutional amendment, addresses the use of cap-and-trade funds. This issue has been an ongoing source of contention resulting in several legal challenges, with particular attention on the potential use of funds for California's high-speed rail project. ACA 1 requires voter approval to become effective. It will be on the ballot in June 2018. If passed, any allocation of cap-and-trade funds after 2024 will require a two-thirds vote by the Legislature.

Unresolved Issues and Implications

The extension of the cap-and-trade program is a major milestone for the state's greenhouse gas reduction program. However, it leaves some important issues unresolved. Two of the main open issues are: (1) the types of programs that may be funded by cap-and-trade revenue and (2) how CARB will regulate industrial emissions to address health impacts on adjacent communities. The use of cap-and-trade funds will require future legislative approval by a two-thirds vote giving the minority party more of a say. CARB will now begin the lengthy public process of developing the regulatory regime to implement the specifics of the cap-and-trade program and its companion measures, including regulation of local effects of pollutants.

The cap-and-trade program also presents some challenges and risks. The program is complicated and expensive. CARB faces the challenge of controlling the cost of allowances, so the price does not escalate too rapidly as allocations are reduced. The program's costs will likely be felt by the general public in the form of higher gasoline prices. The state legislative analyst found the existing program accounted for an 11-cent increase in per gallon prices for gasoline. Although the legislative analyst has not evaluated the effect of the extension, some experts predict prices for one gallon of gas could increase anywhere from 24 to 73 cents by 2030.

Despite these challenges, the significance of the passage of the cap-and-trade extension should not be underestimated. It was accomplished through a bipartisan agreement. The program will serve as a test case that may be used as a model in other states and nations. California has a long history of taking the lead on innovative environmental regulations that are later adopted by other states or the federal government. It remains to be seen whether the extended and revised cap-and-trade program can be successfully implemented and become a key component of the state's aggressive greenhouse gas reduction goals.

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