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California post-2020 GHG Regulation Debate: Compromise Passed Both Houses with a Two-Thirds Vote

At a Glance...

To achieve its goals of reducing greenhouse gas (“GHG”) emissions linked to global warming, California relies upon a number of programs and policies, including a system of capping total GHG emissions from regulated source, but allowing the trading of GHG permits or allowances between regulated parties. As this “cap-and-trade” system is only authorized through 2020, the state faced several options regarding how best to extend the regulatory program beyond 2020, but in a way that achieves other public policies, including protecting the health of individuals in communities close to sources of GHG emissions.

Legislative leaders have just voted to extend the cap-and-trade program via two bills, [AB 398](#), which will extend the life of the program until 2030 and modify how the cap-and-trade market operates; and [AB 617](#), which aims to address concerns about air quality in communities proximate to large stationary sources by increasing monitoring and imposing stricter penalties on large sources. This is a major victory for Governor Jerry Brown that included rare bipartisan support for mitigating global warming (while compromising on other important public policy issues). This article briefly summarizes the bills and some potential impacts.

Background

California has set a goal of reducing the state’s greenhouse gas emissions back to 1990 emissions levels by 2020, and to 40 percent below 1990 levels by 2030 – despite increases in population and sources of pollution. To achieve these goals, the state partly depends upon its current “cap-and-trade” program, which:

(a) allows entities to purchase GHG emission “allowances” from the state in quarterly auctions (or by trading allowances in a secondary market); and (b) utilizing credits generated from “carbon offset projects” (e.g., forestry projects constituting carbon dioxide “sinks,” methane capture from manure management programs at livestock facilities, etc.).

The current cap-and-trade program runs through “at least” 2020. Lawsuits have called into question, however, whether the auction is a tax (which would have required legislative approval by a two-thirds vote in California). In a major win for the program, the California Supreme Court recently declined to consider appeals from the California Chamber of Commerce and the Pacific Legal Foundation, who considered the quarterly auctions to be an unconstitutional tax, and argued that ARB lacked authority to impose a tax to raise revenue (as such “taxes” must be passed by the state legislature with a two-thirds supermajority vote). A state appeals court rejected their arguments in April, but they appealed.

By declining to consider the appeal, the Supreme Court affirmed the legality of the program. Despite the state’s victory in court, many legislators, as well as the governor, have hoped that new legislation would clearly extend the auctions through at least 2030, and could eliminate any questions about impermissible GHG-related taxes by passing the legislation with a two-thirds vote (in both the Senate and the Assembly). To increase pressure on legislators to achieve this goal, Governor Brown had promised to reject any cap-and-trade extension bill unless it had a two-thirds vote in both legislative houses.

Assembly Bill 398 (AB 398), authored by Eduardo Garcia (D-Coachella), will extend the cap-and-trade program until 2030 and modify how the program’s market operates. Significantly, AB 398 will, among other things: (a) require regulated parties to reduce their maximum percentage allocation of carbon offsets in their total “compliance portfolio” to below 8 percent (the maximum under current law); and (b) require that no more than half of all surrendered offset credits be “sourced from projects that do not provide direct environmental benefits in state” - a mandate that does not currently exist. Assembly Bill 617 (AB 617), co-authored by Assemblywoman Cristina Garcia (D-Bell Gardens), Eduardo Garcia (D-Coachella), and Miguel Santiago (D-Los Angeles), will require stricter air-pollution monitoring around industrial facilities, and tougher penalties for violating pollution regulations.

The two bills are the product of weeks of discussions and horse trading between the administration and legislative leaders in both the Republican and Democratic parties, environmental justice advocates, environmental groups, utilities, industry and labor representatives, economists, agricultural and business organizations, faith leaders, and local government officials.

Summary of AB 398 and AB 617

[AB 398](#) will make several significant changes to how the cap-and-trade program operates, highlighted below.

Key highlights of AB 398:

- Give the California Air Resources Board (“ARB”) authority to set a ceiling on the price of carbon — which determines how expensive emissions permits will be — as a way to guard against price increases for businesses and consumers.
 - Establish two price containment points (aka “speed bumps”) at levels below the price ceiling. ARB must offer for sale certain amounts of allowances at those two price containment points. The price containment points shall be established using allowances from the state’s price containment reserve. Two-thirds of the allowances in the reserve as of December 31, 2017, shall be divided equally and used to support each of the two price containment points.
- To avoid “leakage” (i.e., companies leaving the state and moving their operations to states that do not have similar cap-and-trade requirements), the state will continue to allocate (limited) free GHG allowances to certain California companies in order to address competitiveness. Proponents of the free allowances argue that they are designed to keep businesses from leaving the state. Many of these free allowances issued at the beginning of the cap-and-trade program were set to expire, but under this bill, they will extend into the program’s new phase.
- Currently, regulated entities can meet their GHG compliance obligations by utilizing a portfolio of allowances and offset credits, with no more than 8 percent of the total coming from offset credits. AB 398: (a) decreases the future offset credit percentages allowed in a company’s compliance portfolio; and (b) sets a new obligations for California-based offset projects. From 2021-2025, a total of 4 percent of a regulated party’s compliance obligation may be met by surrendering offset credits. This percentage rises to 6 percent from 2026-2030. In both cases, no more than one-half of the offset credits may be sourced from projects “that do not provide direct environmental benefits in state.”
 - A potential positive of this development is the resulting increase in jobs within California, as new offset projects will likely be sited in-state. However, offset developers in general are opposed to the overall allocation reductions, meaning fewer overall projects.
- Create or influence the following state-run organizations:

- Establish the Compliance Offsets Protocol Task Force, to provide guidance to ARB in approving new offset protocols, making it easier to site more offset projects in state. California currently has a limited number of approved offset protocols compared with other regions, such as the European Union. As a means of attracting certain votes in the legislature, AB 398 directs the Task Force to prioritize projects that may benefit disadvantaged communities, Native American or tribal lands, and rural and agricultural regions.
 - Establish the Independent Emissions Market Advisory Committee, which would at least annually hold a public meeting and report to both ARB and the Joint Legislative Committee on Climate Change Policies on the environmental and economic performance of a specified market-based compliance mechanism, and other relevant climate policies.
 - Require the California Workforce Development Board to create and submit a report to the Legislature, no later than January 1, 2019, addressing, among other things, increased education, career technical education, job training, and workforce development resources or capacity, to help industry, workers, and communities transition to greenhouse gas emissions reduction goals.
- Require that current vintage allowances designated by ARB for auction that remain unsold in the auction holding account be transferred to the allowance price containment reserve after 24 months.
 - Designate ARB as the “state-wide” regulatory body responsible for ensuring that California meets reduction targets. This in essence is a pre-emption clause that will prohibit local air districts from adopting or implementing emission reduction rules for carbon dioxide from stationary sources (if they are also subject to the state cap and trade program). This has an immediate and significant impact in the San Francisco area, as the [Bay Area Air Quality Management District](#) was on the cusp of approving a new regulation (12-16) that would have limited GHG emissions from Bay Area refineries. That Regulation now appears to be pre-empted by AB 398.
 - Establish **allowance banking** rules that “discourage speculation,” avoid financial windfalls, and consider the impact on complying entities and volatility in the market. The current cap-and-trade program allows speculators to purchase and trade allowances as well as offset credits – although analyses has shown that the vast majority of parties purchasing and trading tend to be regulated compliance entities. Nevertheless, it remains to be seen how ARB will interpret this directive in terms of promulgating more restrictive regulations.

- Includes an extension of tax credits for business investments; and a repeal of the fire prevention fee on people in rural areas (which will now be funded by cap-and-trade funds instead).
 - Neither of these facets of AB 398 is directly “climate related.” However, they are evidence of the governor’s office offering incentives to certain legislators to garner sufficient votes to get to the two-thirds vote referenced above.

Use of GHG Funds. AB 398 does not explicitly say how the state will distribute money from the cap-and-trade auctions, but the legislation does offer a list of priorities, to include efforts to control toxic air pollution from mobile or stationary sources, low-carbon transportation projects, and sustainable agriculture programs. Significantly, the Legislature also passed [Assembly Constitutional Amendment 1](#) (aka the “Greenhouse Gas Reduction Reserve Fund), which places a measure on the 2018 ballot that will require a one-time, two-thirds approval in 2024 to spend money generated by cap-and-trade auctions. The proposal, written by Assembly GOP leader Chad Mayes (R-Yucca Valley), was a request from Assembly Republicans who hope it gives them more influence on how the cap-and-trade money is used.

Governor Brown sought and achieved a two-thirds vote on AB 398, which will guard the program against potential legal challenges.

[AB 617](#), highlighted below, will strengthen air quality rules across California. It will also address the concerns from Environmental Justice (“EJ”) advocates that cap and trade was not doing enough to protect communities from pollution.

Key highlights of AB 617:

- ARB will have to develop a uniform statewide system of annual reporting of emissions of criteria air pollutants and toxic air contaminants for use by certain categories of stationary sources. The bill will require those stationary sources to report their annual emissions of criteria air pollutants and toxic air contaminants.
- Require ARB to prepare a monitoring plan regarding technologies for monitoring criteria air pollutants and toxic air contaminants, and the need for and benefits of additional community air monitoring systems. ARB must select, based on the monitoring plan, the highest priority locations in the state for the deployment of community air monitoring systems.
- Require local air districts with high-priority stationary sources (e.g., a refinery) to adopt a community emissions reduction program.
- Require local air districts that are not in attainment for one or more criteria pollutants to adopt an expedited schedule for best available retrofit control technology for high-priority stationary sources.

- Create a statewide “clearinghouse” that identifies: (a) best available control technology; (b) best available retrofit control technology (for criteria air pollutants); and (c) related technologies for the control of toxic air pollutants.
- Increase the maximum penalties for violations of applicable air pollution laws from \$1,000 to tiers of up to \$5,000, \$10,000 and \$15,000 per day (as well as potential imprisonment), depending upon the severity of the alleged violation and other factors. The bill will annually adjust maximum penalties for violations of these laws based on the California Consumer Price Index.

The EJ community and its legislative allies support AB 617. Passage of this bill, as a companion to AB 398, was a required tradeoff that was necessary for sufficient stakeholders to support both bills as a package.

Future Planning

Businesses required to comply with [California Global Warming Solutions Act of 2006](#) [aka Assembly Bill 32 (AB 32)] or engaged in developing or funding offset projects, should be following the impacts of these bills closely, as their outcomes may dramatically impact your cost of doing business. We will continue to monitor and provide updates on matters related to these bills.

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