

Policy Alert

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California Doubles Greenhouse Gas Emission Reduction Targets

Ten years after adopting the nation's first program to reduce statewide greenhouse gas (GHG) emissions, California is doubling its GHG emission reduction goals while adopting new measures to reduce short-lived climate pollutants. However, the future of California's embattled Cap-and-Trade program remains up in the air.

Deeper GHG Emission Cuts

California Gov. Jerry Brown (D) has signed SB 32 legislation mandating deeper cuts in GHG emissions. Gov. Brown is also expected to sign SB 1383 addressing short-lived climate pollutants.

SB 32 directs the California Air Resources Board (ARB) to cut GHG emissions to 40 percent below 1990 levels by 2030. Current state law mandates a 20 percent cut of GHG emissions below 1990 levels by 2020 under the landmark Global Warming Solutions Act of 2006 (AB 32).

"This is big, and I hope it sends a message across the country," Gov. Brown said as he signed the measure.

Passage of SB 32 represents a major political victory for Gov. Brown, who will retire in 2018 after serving a record eight terms as governor and who views leadership on climate policy as a major part of his legacy. In 2015, Gov. Brown signed legislation (SB 350) boosting California's renewable-energy procurement goals and issued an executive order directing regulators to look at ways to reduce GHG emissions 40 percent below 1990 levels by 2030. However, passage of SB 32 was stalled in the legislature for a year due to heavy lobbying by the oil industry and concerns by some democratic legislators about the costs of climate change programs to poor communities.

Short-Lived Climate Pollutants

Gov. Brown also supported passage of SB 1383 to reduce emissions of black carbon, fluorinated gases and methane, which are considered potent contributors to climate change and dangerous to public health. Because these pollutants have atmospheric lifetimes of only days to a decade and a half, they are referred to as **short-lived climate pollutants**. The measure requires the ARB to develop a comprehensive strategy to reduce emission of methane by 40 percent, of hydro fluorocarbons by 40 percent and of black carbon by 50 percent below 2013 levels by the year 2030 operations.

Renewable Gas Infrastructure and Incentives

SB 1383 also seeks to foster the development of renewable gas from landfills, digesters and renewable hydrogen. The Brown administration secured language in SB 1383 to require the California Energy Commission, ARB and California Public Utilities Commission to develop recommendations for the

development and use of renewable gas as part of the state's long-term energy policy strategy. The measure requires regulators to consider how to create incentives for development of renewable gas through a multitude of existing state programs, including the Renewable Portfolio Standard, Low Carbon Fuels Standard, waste diversion, and Cap-and-Trade. SB 1383 also authorizes a series of pilot projects to help dairies harvest methane from manure operations and interconnect to natural gas transportation pipelines.

While California's renewable natural gas industry had advocated for stronger language requiring gas utilities to procure renewable biogas from landfills, anaerobic digesters and renewable hydrogen, the SB 1383 language undoubtedly represents a major step forward for the nascent industry. Renewable gas developers and the utilities will be watching closely as state energy regulators formulate a strategy to encourage increased injection of biomethane into gas pipelines.

Impact on Regulated Industries

What do the new measures mean for regulated industries? It seems clear that many of California's existing GHG emission reduction policies will play an important role in moving the state toward the bigger goals, although SB 32 does not spell out how state regulators will meet the newly doubled GHG reduction goals. California is already a leader in renewable energy, energy efficiency, and promotion of zero and near-zero emission vehicles. However, given that many of those measures are calculated to help California meet current 20 percent GHG reduction targets, more aggressive measures will be needed if the state is to double its GHG emissions reductions.

Last year, California boosted utility renewable energy procurement goals from 33 percent to 50 percent. The Public Utilities Commission and Energy Commission are currently working on implementing the broader targets. The transportation sector is also likely to be singled out for additional regulation since it accounts for one-third of California's GHG emissions. Gov. Brown has called for a 50 percent reduction in petroleum use by 2030. Earlier this year, the ARB proposed spending \$150 million in Cap-and-Trade auction proceeds on incentives to replace older diesel-powered, heavy duty vehicles with low carbon emission engines in addition to expanding the number of zero-emission passenger vehicles on the road. California will likely look to expand the state's innovative Low Carbon Fuels Standard, which allows low carbon transportation fuel producers and vendors to generate credits that can be sold to high carbon fuel producers. The program has come under fire from the petroleum industry, which has sought its elimination.

SB 1383 will bring new regulation to California's dairy and livestock industry and waste disposal industries. According to the ARB, agriculture accounts for 60 percent of California's methane emissions, and 80 percent of those emissions are associated with enteric fermentation and manure management from dairy and livestock operations. Landfills, meanwhile, account for 20 percent of statewide methane emissions. SB 1383 would require the ARB to set new rules for dairy and livestock manure management practices to reduce methane emissions from manure up to 40 percent below 2013 levels by 2030,

provided that those practices are technologically and economically feasible. It would also require a 75 percent reduction in organic waste disposal in landfills from 2014 levels by 2025.

One big unanswered question is what role California's embattled Cap-and-Trade program will play in meeting the higher targets. Adopted in 2013, Cap-and-Trade is the centerpiece of the ARB's implementation of AB 32. The program was envisioned as a way to provide a cost-effective way to reduce GHG emissions from key sectors and is the ARB's primary mechanism for meeting its GHG emissions targets. It features a declining cap on GHG emissions from affected sectors accompanied by allocation and auction of emission allowances by the ARB. The agency controls the auction by setting a floor for allowance pricing. Under the program, regulated sectors are allowed to sell allowances that they do not need to participants whose emissions exceed allowance levels. Revenues generated by the auction are statutorily required to be spent on initiatives that reduce GHG emissions. The nonpartisan Legislative Analyst office estimated that the allowance auctions would generate \$2.4 billion in revenues in fiscal year 2014-15.

Many analysts view Cap-and-Trade as an essential part of any strategy to achieve deeper GHG reductions in California. However, legal and political attacks on Cap-and-Trade threaten to complicate matters for the Brown administration going forward. Business interests filed suit, alleging that the Cap-and-Trade allowance auction exceeds the authority delegated to the ARB under AB 32 and that the auction revenue constitutes an unconstitutional tax because the statute was not adopted by a two-thirds vote of the legislature as required by Art. xii (a) of the state constitution for a tax levy. *California Chamber of Commerce v. California Air Resources Board, Morning Star Packing Co. v. California Air Resources Board* (Sacramento County Superior Court Case No. 34-2012-8001313). A Sacramento Superior Court judge denied the petitions, but conceded that "it is a close question" on whether the allowance charges were a "tax" or a "regulatory" fee because the charges have attributes in common with both. *Chamber of Commerce v. California Air Resources Board*, id. at p. 16. Petitioners have appealed, and a decision is expected this fall from the California Court of Appeals. While the ARB has expressed confidence that the trial court ruling will be upheld, questioning by the justices during oral arguments appeared hostile to the trial court's holding that the auction fees are more like traditional regulatory fees than taxes.

An adverse decision on Cap-and-Trade would not only be a setback for California's GHG emission reduction efforts, but it could also punch a huge hole in the state budget. Auction revenues currently fund a wide variety of GHG reduction initiatives, including a controversial high-speed rail system championed by Gov. Brown. If the courts find that the allowance auction is unconstitutional, future funding for many GHG initiatives could be jeopardized, and the state could be required to refund billions collected from participants.

Gov. Brown and Cap-and-Trade advocates are seeking to blunt the legal and political attacks on the program. Some are concerned that legal and political uncertainty over the future of Cap-and-Trade is responsible for the dramatic decline in allowance purchases in the past two quarters. While allowance auctions initially attracted strong interest and generated billions for state GHG reduction initiatives, recent

auctions have fallen flat. In May, only 11 percent of the permits offered for sale were purchased. In August, only 30.8 million of 96 million available carbon credits were sold. A continued slide in auction revenues would jeopardize funding of GHG reduction projects across the state.

It is too early to write off the Cap-and-Trade program. Even if the courts strike down the auction, the legislature could authorize continuation of the program with a two-thirds vote, or California voters could sanction the program through a statewide ballot measure. Gov. Brown has vowed to protect the program. In August, Gov. Brown opened a committee to raise funds for a possible 2018 initiative campaign while seeking a two-thirds legislative vote on SB 32. Although SB 32 did not receive a supermajority vote, its passage puts enormous pressure on the legislature and the administration to ensure that Cap-and-Trade continues to serve as a mechanism to meet GHG reduction targets and as an alternative to more restrictive and costly command and control measures.

In a possible hedge, or an indication of future approaches to climate policy in California in light of the litigation, a recent nonbinding California Assembly Joint Resolution emphasized the critical role that putting a price on GHG emissions through a carbon tax can play in the United States and globally. A “national carbon tax would make the United States a leader in mitigating climate change and the advancing clean energy technologies of the 21st Century, and would incentivize other countries to enact similar carbon taxes, thereby reducing global carbon dioxide emissions without the need for complex international agreements.” *California AJR 43*.¹ California urged Congress to “enact a national carbon tax on fossil fuels, based on the amount of carbon dioxide the fuel will emit when burned.”

In sum, meeting California’s new deeper GHG reduction targets will require more aggressive measures impacting the dairy, waste disposal, transportation and electricity sectors. Many of these reductions will come through existing initiatives. Some, like reduction of methane, will require new incentives and infrastructure programs. Despite legal and political challenges, California’s Cap-and-Trade program will likely continue to be a centerpiece of GHG reduction strategy.

¹ https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201520160AJR43

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