

Details Will Bedevil As Calif. Cap-And-Trade Moves Forward

By **Keith Goldberg**

Law360, New York (July 20, 2017, 8:39 PM EDT) -- The 10-year extension of California's landmark cap-and-trade program poised to be signed into law by Gov. Jerry Brown will avoid the existential legal tests the original program endured, but experts say it still faces several regulatory and legal hurdles if it's going to ensure the Golden State meets its ambitious greenhouse gas emissions reduction goals.

The California state Legislature on Monday passed legislation that extends the California Air Resources Board's authority to administer the cap-and-trade program beyond its original 2020 expiration date to 2030. Crucially, the legislation received enough Republican support to secure a two-thirds majority, thereby mooting questions over whether cap-and-trade auction revenues are unauthorized taxes under state law. The original program recently survived a legal challenge on that issue, but it would have threatened the 2030 extension if two-thirds of state lawmakers didn't get on board, experts say.

But while the cap-and-trade program's long-term existence may be secure, implementing a successful extension will be a major chore, experts say. California has a mandated goal of slashing its greenhouse gas emissions by 40 percent from 1990 levels by 2030, and the cap-and-trade program, which is the linchpin of those efforts, will have to grapple with significantly steeper reductions to reach that goal than it did to reach the state's 2020 goal of reducing emissions to 1990 levels.

"You're looking at a program that's very complicated and will be very expensive no matter how you slice it," said Craig Moyer, who chairs Manatt Phelps & Phillips LLP's land, environmental and natural resources practice group. "The years between 2020 and 2030 will be challenging."

Among the issues facing CARB as it designs the cap-and-trade program for 2021 to 2030 are developing an emissions reduction curve that gets the state to its 40-by-2030 goal, dealing with a required 40 percent reduction in free emissions by 2030, a lower cap on carbon offset credits and a requirement that half the offsets come from in-state projects.

Initially, experts say the biggest issue for CARB will be setting a price ceiling on emissions allowances as required by the extension legislation, as well as two so-called price containment points below the ceiling at which CARB must offer some allowances for sale in order to prevent allowances from rapidly approaching the ceiling.

That will be a tricky and contentious exercise since CARB would have to make additional allowances available if demand ends up busting allowances prices through the ceiling.

“Where CARB establishes the ceiling and 'speed bumps' is going to be a regulatory feat that will be quite interesting,” Paul Hastings LLP energy and environmental partner Kevin Poloncarz said. “It becomes all that more critical when you have a ceiling that functions as a get-out-of-jail-free card for emitters and requires CARB to backfill to ensure the emission reductions are achieved.”

There's also the question of whether CARB will be able to craft a cap-and-trade extension that can help drastically reduce carbon emissions from the state's massive transportation sector, which is seen as crucial in meeting the 40-by-2030 goal.

“Will the CARB be able to achieve the goal for mobile sources and have drastic reductions?” asked Stoel Rives LLP partner Allison Smith, who is based in Sacramento, California. “The people that control those emissions are individuals, and those individuals can't be regulated directly like the owner of a refinery, power plant or manufacturing facility.”

Once you get past the regulatory challenges, experts say steps taken by CARB to implement the cap-and-trade extension, such as an updated scoping plan and cap-and-trade amendments, will likely face legal challenges as well, with the California Environmental Quality Act giving litigants a wide berth to scrutinize CARB's environmental reviews.

“The history of the implementation of cap-and-trade in California is a history of litigation,” Moyer said. “The two-thirds approval vote takes away the existential question ... but the litigation to date has not been limited to that tax question.”

Still, the legal and regulatory environment around California's cap-and-trade program is a lot more certain than it was before Monday's approval of the extension, experts say. Many environmental groups have decried the legislation preempting local or regional air regulators from imposing greenhouse gas emissions restrictions on sources covered by the cap-and-trade program, but it ensures that cap-and-trade will be the state's primary tool in trying to achieve its 2030 emissions reduction goals.

“The debates now are what to do under the hood and no longer existential debates about whether or not California continues to move forward along this path,” said Morrison & Foerster LLP senior adviser Ali Zaidi, a former climate change official in the Obama administration. “You've got regulatory certainty pinned down by a bipartisan vote on a long time horizon.”

And that could have impacts beyond California's borders, experts say.

The state has already linked its cap-and-trade program with programs run by Quebec and Ontario, Canada, and with its long-term future secure, neighboring, like-minded U.S. states that have been mulling cap-and-trade programs of their own could be encouraged to finally create them and link up with California.

Meanwhile, environmental groups are already pressing the nine Northeastern states that are part of the Regional Greenhouse Gas Initiative to strengthen their regional cap-and-trade program to keep up with California.

“All of the players agree that to have a broader cap-and-trade system makes the market work more effectively,” Smith said.

The larger out-of-state impact might be an economic one, experts say. Meeting California's steep emissions

reduction target will require significant investment in low-carbon and zero-carbon development, and resulting products and technologies could certainly be employed in other states, even ones that aren't as hawkish on climate change regulation.

“In California, the next gulf we need to cross is going to potentially involve a lot more reliance on innovation and the offsets space,” said Venable LLP environmental partner Bill Sloan, who is based in San Francisco. “If new technologies and new approaches to how we run our society are developed through that regulatory program, then those technologies could very well ripple outside the state and might not actually require another regulatory regime to bang other states over the head with.”

And California's mere clout as the sixth-largest economy in the world can't be discounted either, experts say.

“California gobbles up supplies and sells into markets that stretch far more broadly than its geographic corners,” Zaidi said. “This puts a downward pressure on carbon intensity in economies beyond California. The regulatory environment in California is going to cascade up and down the supply chain, both in terms of the products being made available to consumers and the types of supply chains that are going to become mainstream.”

--Editing by Christine Chun and Jack Karp.