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Climate Regulation in California: A State of Constant Change

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I. Introduction

Climate change regulation in California is in the midst of transformation. Last year, the Legislature voted to enact SB 32, extending California's greenhouse gas (GHG) reduction targets, which were set to expire in 2020, through 2030. The California Global Warming Solutions Act of 2006 (*AB* 32) called for a reduction in GHG emissions to 1990 levels by 2020, which California is expected to achieve. Under SB 32, California aims to reduce GHG emissions 40% below 1990 levels by 2030.

The California Air Resources Board (CARB) is poised to make sweeping amendments to California's Cap-and-Trade Regulation to fulfill that mandate, and the past few weeks have seen a flurry of activity: (1) CARB succeeded in defending a lawsuit that threatened to do away with a vital portion of the Cap-and-Trade program (allowance auctions), although an appeal to the California Supreme Court is expected; (2) in a separate case however, the Court of Appeal held that CARB failed to comply with the California Environmental Quality Act when adopting Low Carbon Fuel Standard (LCFS) Regulations; and (3) CARB released a second set of 15-day amendments to the Cap-and-Trade regulations as part of its larger Cap-and-Trade overhaul.

These developments merit taking a step back to see how these events fit together. The "grand scheme" for climate regulation in California is found within CARB's "scoping plan," a document outlining the agency's plans to address its mandates under the original AB 32, and the recently adopted SB 32. CARB released a Proposed Scoping Plan (PSP) in late January, describing how the agency envisions reaching California's climate change goals, which provides insight into how the agency views climate regulation in California shaping up over the next several years.

II. The Proposed 2017 Climate Change Scoping Plan

The PSP represents a continuation of important policy determinations, adjusted for the new 2030 GHG emissions target of 40% below 1990 levels established by SB 32. Most importantly, the PSP proposes to continue the Cap-and-Trade program. What is more, CARB used the PSP to help lay the groundwork for how it will potentially reduce GHG emissions to 80% below 1990 levels by 2050, a target set by Governor Schwarzenegger in Executive Order S-3-05, and reiterated by Governor Brown in Executive Order B-16-2012. Although the PSP proposes to continue the Cap-and-Trade program, it does anticipate evaluating certain program design changes, including:

- An unspecified reduction in the amount of offset credits that may be used by entities to comply from the 8% currently allowed;
- A redesigned allowance allocation strategy to reduce free allocations with the goal of driving technological GHG emissions reductions; and
- A reduction in allocations to entities that increase emissions of non-GHG pollutant above a currently undetermined baseline.

In addition to the Cap-and-Trade program, the PSP includes direct regulation of the refinery sector to reduce GHG emissions by 20% compared to 2014 levels, a measure driven by environmental justice initiatives and aimed at reducing emissions of all pollutants in disadvantaged communities, as required by AB 197.

The Cap-and-Trade program has several other crucial functions. It will continue to allow investment in the Greenhouse Gas Reduction Fund, which includes monies that are used in disadvantaged and low-income communities. It also aims to protect utility ratepayers and preserves current and provides for future linkages with other jurisdictions (such as Ontario, which is set to join California's program in 2018).

a. <u>The PSP vs. Alternative Measures</u>

The PSP also considers four alternatives to the Cap-and-Trade program, as follows:

- **Alternative 1: No Cap-and-Trade** - The no Cap-and-Trade scenario would include a 30% refinery GHG reduction measure and the known commitments.
- **Alternative 2: Carbon Tax** - The Carbon Tax alternative would tax GHG emissions and include a 20% refinery GHG reduction measure and the known commitments.
- **Alternative 3: All Cap-and-Trade** - All Cap-and-Trade would not include a refinery reduction measure, and would maintain the Low Carbon Fuel Standard's 2020 carbon intensity goal of a 10% reduction through 2030.
- **Alternative 4: Cap-and-Tax** - The Cap-and-Tax alternative is likely the most complicated of the group. It would include the known commitments and a 20% refinery GHG reduction measure. Individual covered entities would be covered by a decreasing annual cap, and would also be required to pay a tax for each MMT of CO_2e emitted each year.

In comparing the viability of the PSP to the alternatives, CARB included consideration of "known commitments" (policies either developed or proposed in the past two years with target dates of 2030) that are expected to reduce GHG emissions. These "known commitments" include:

- 18% fuel carbon intensity reduction in the Low Carbon Fuel Standard;
- Increased renewables and energy efficiency standards under the Clean Energy and Pollution

Reduction Act of 2015;

- The Mobile Source Strategy, aimed at increasing zero emissions vehicles and cleaner trucks and transit;
- The Sustainable Freight Action Plan, seeking increased freight efficiency and zero emissions freight technology; and
- CARB's Short-Lived Climate Pollutant Reduction Strategy to satisfy the SB 1383 mandate to cut black carbon by 50% and hydrofluorocarbon and methane emissions by 40%.

The known commitments come short of reaching the 2030 GHG emissions target, and CARB found that the alternative approaches would fail to bridge the gap. The PSP identifies the refinery measure and Cap-and-Trade as the best strategy to fill the gap between known commitments and California's emissions reduction goals. Importantly, CARB sees Cap-and-Trade as a flexible mechanism, capable of ratcheting up stringency in case other measures (including the known commitments) fail to reach their projected reductions, and serving as a backstop for the entire plan. This places a heavy amount of reliance on the success of Cap-and-Trade to reach California's 2030 GHG emissions target.

b. <u>Rounding Out the PSP</u>

The remainder of the PSP is dedicated to analyses of the PSP and the measures included therein, including evaluations under AB 197. CARB also identified six "key sectors" under the PSP: low carbon energy, industry, transportation sustainability, natural and working lands including agricultural lands, waste management, and water. For each of these, CARB also included potential future policies. The plan closes out with a summary of policies and measures that CARB will implement under the PSP:

- Develop Integrated Natural and Working Lands Action Plan to secure California's land base as a net carbon sink by 2018;
- Develop Utilization of Biomass and Waste Plan by 2019;
- Implement SB 350, achieve 50% Renewable Portfolio Standard, and double energy efficiency savings by 2030;
- Reduce carbon intensity by at least 18% under the Low Carbon Fuel Standard by 2030;
- Implement Short-Lived Climate Pollutant Reduction Strategy by 2030;
- Increase stringency of SB 375 Sustainable Communities Strategy (2035 targets);
- Implement Mobile Source Strategy (Cleaner Technology and Fuels);
- Implement California Sustainable Freight Action Plan;
- Adopt a post-2020 Cap-and-Trade Program with declining annual caps; and
- Adopt a regulation to achieve a 20% reduction in GHG emissions from refineries in California

by 2030.

III. Additional Recent Developments

Recent litigation developments have not upset this long-term plan. As noted above, CARB succeeded in fending off an attack on Cap-and-Trade in the Third District Court of Appeal. *California Chamber of Commerce et al. v. State Air Resources Board*, Case No. C075930. Absent an expected appeal to the California Supreme Court resulting in a reversal, the Cap-and-Trade program is "safe" for now, at least on that front. And although CARB technically lost in a suit attacking the LCFS, the Fifth District Court of Appeal's filed opinion has ordered a relative slap on the wrist in terms of the remedy: the LCFS will continue in effect with an edict to CARB to fix its analytic failures. See *POET, LLC et al. v. State Air Resources Board*, Case No. F073340.

The most current development in CARB's process for amending the Cap-and-Trade Regulation, however, is of particular significance to those industrial sector entities who have compliance obligations under the program. CARB released a set of 15-day amendments to the regulation on April 13, 2017, eliminating its previously proposed "assistance factors" and other allocation-related provisions for the industrial sector post-2020. In eliminating the proposed assistance factors (used to calculate how many free allowances are allocated), CARB cited industry concerns over the studies backing up CARB's calculations, and forecasted a future rulemaking to decide the issue.

IV. Key Takeaways

The programs described in the PSP will play intersecting and important roles in how California continues to battle climate change. Their success likely will have implications for how CARB implements these and other programs to achieve the GHG emissions targets set by AB 32 and SB 32. Recent developments have not affected the PSP overall, but the pace of change is rapid and merits close attention in the coming months as CARB works to shape the future of the Cap-and-Trade Program and other climate policies.

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