SUMMARY OF CALIFORNIA'S EXTENSION OF ITS CAP-AND-TRADE PROGRAM

CENTER FOR CLIMATE AND ENERGY SOLUTIONS

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On July 26, 2017, California Governor Jerry Brown signed into law a bipartisan bill that extends the state's cap-and-trade program to 2030. Cap and trade is a key part of California's plan to reduce greenhouse gas emissions 40 percent below 1990 levels by 2030. The enacted bill makes design changes to the post-2020 carbon market, such as including a price ceiling, price containment points, additional limits to the number and location of offset credits, limits on who can set greenhouse gas emission requirements, and specifics on industry assistance factors. This document summarizes these program changes.

INTRODUCTION

Market-based policies offer a cost-effective way to reduce greenhouse gas emissions by creating financial incentives for covered entities to emit less pollution. Eleven U.S. states and many jurisdictions outside the United States have established market-based programs to reduce greenhouse gas emissions.

California was the first multi-sector cap-and-trade program for greenhouse gases in North America. The program was part of a suite of policies aimed at complying with state law AB 32 that required the state's emissions to return to 1990 levels by 2020. The existing cap-and-trade program covers nearly 85 percent of the state's total greenhouse gas emissions. California's program initially imposed an overall greenhouse gas emission limit that decreased 2 percent—below the emissions level forecast for 2012—annually from 2013 to 2014, and 3 percent annually from 2015 through 2020.

AB 398, the bill extending the program for 10 years passed with bipartisan support and more than two-thirds majorities in both the state Assembly and Senate. It authorizes the California Air Resource Board (CARB) to continue its cap-and-trade program to reduce emissions from 2021 to 2030, with the changes described below.

PRICE CEILING

The bill directs CARB to establish a price ceiling, which is a standing offer to sell additional allowances into the program at a specified price. It's one way to provide certainty that an allowance price will never exceed a certain (ceiling) price. The existing program has a "soft price ceiling" in the form of the Allowance Price Containment Reserve. This reserve is filled with allowances from each year of the 2013–2020 program. If auction prices go above specified levels, the reserve allowances are auctioned, which provides some cost containment function, but does not absolutely guarantee an upper limit on prices. To date, reserve allowances have never been auctioned because prices have remained well below the specified levels.

To implement the new "hard price ceiling," CARB will use remaining allowances in the Allowance Price Containment Reserve at the end of 2020. If these allowances are exhausted, CARB will offer covered entities additional allowances at the price ceiling as needed to cover compliance.

The bill does not explicitly specify a price ceiling, but instead directs CARB to establish this price level — through the regulatory process—based on factors such as: the need to avoid adverse impacts on households and businesses, the social cost of greenhouse gases, the allowance price, auction floor price, the 2020 prices of the Allowance Price Containment Reserve, and potential for environmental and economic leakage.

PRICE CONTAINMENT POINTS

The bill establishes two price containment points below the price ceiling and directs CARB to offer covered entities nontradable allowances at these containment points. The price containment points are similar to the existing Allowance Price Containment Reserve in that they are designed to help constrain compliance costs. However, the price containment points differ in that the prices will be made relative to the price ceiling while the strategic reserve has three tiers at specified prices and escalation rates. The price tiers were $40, $45, $50, in 2013, rising 5 percent annually above inflation. As of June 2017, the tier prices were ($50.69, $57.04, and $63.37).[1]

Each of the price containment points will be made up of one-third of available allowances in the price containment reserve at the end of 2017. In addition, allowances that are unsold for more than 24 months will be transferred to the Allowance Price Containment Reserve.

OFFSET CREDIT LIMITS

The bill limits the overall quantity of offset credits and the use of out-of-state credits. An offset credit is generated from a project not covered by the cap-and-trade program or required by any other program. These credits must demonstrate ownership and have verifiable greenhouse gas emission reductions. After CARB approval, these credits can be transferred and used by regulated sources to meet their greenhouse gas emission reduction obligations. Under the current cap-and-trade program, offset credits can make up as much as 8 percent of the total amount of allowances used for compliance by a covered entity. AB 398 reduces this amount. From 2021 to 2025, up to 4 percent of a covered entity's compliance obligation can be met by offsets and half of these must be in-state or "provide direct environmental benefits" to California. From 2026 to 2030, up to 6 percent of a covered entity's compliance obligations can be met by offsets but again, at least half must benefit California.

INDUSTRY ASSISTANCE

The current regulation includes a provision for providing free allowances to manufacturing facilities in the state. The number that each facility receives is determined by its historic emissions performance relative to industry benchmarks, its exposure to trade competition from jurisdictions without carbon pricing, and other factors. The free allocation assistance began at a high level, to allow the industrial sector time to adjust its operations to the carbon price, and was to phase out after 2020. The program extension removed the phase out, and keeps industrial assistance at current levels through 2030.

USE OF REVENUES

The bill states that it is the intent of the legislature that revenues collected from the cap-and-trade program be used in accordance to specified orders of priorities, but the bill does not define how revenues should be used.

Existing laws require revenues collected from the current cap-and-trade program be deposited into the Greenhouse Gas Reduction Fund, and continuously appropriate 60 percent of the annual revenues for: transit, affordable housing, sustainable communities, and high-speed rail purposes.

Under the post-2020 program, revenues from the cap-and-trade program should prioritize:

1. Air toxics and criteria air pollutants from stationary sources
2. Low- and zero-carbon transportation
3. Sustainable agricultural practices that promote the transition to clean energy, water efficiency, and improve water quality
4. Health forests and urban greening
5. Short-lived climate pollutants
6. Climate adaptation and resiliency
7. Climate and clean energy research

A companion bill, ACA 1, was also signed into law in July 2017. ACA 1 will put a ballot measure to state vote in June 2018 that will amend the state constitution to require a two-thirds vote in the legislature on appropriating revenues from the cap-and-trade program starting in 2024.[2]

SCOPING PLAN

The bill requires CARB to update its Scoping Plan by 2018 on how the state plans to achieve greenhouse gas reductions through 2030. The bill requires all greenhouse gas rules and regulations adopted by CARB to be consistent with the Scoping Plan. The existing law requires CARB to update its Scoping Plan every five years.

LOCAL AIR POLLUTION

AB398 prohibits the state's air pollution districts from adopting or implementing a carbon dioxide emission reduction regulation for stationary sources that are already covered by the state's cap-and-trade program.

Local air pollution issues are addressed in a companion bill, AB 617, which was signed into law alongside AB 398 in July 2017.[3] AB 617 increases monitoring of criteria air pollutants and toxic air containments, implements community air monitoring systems in disadvantaged communities, requires an expedited schedule for best available retrofit control technology at major emitting facilities, and imposes stricter penalties for those violating air pollutant regulations.

ENDNOTES

1 California Air Resources Board, *2017 Annual Allowance Price Containment Reserve Notice* (Sacramento, CA: California Department of Environment, 2016), https://www.arb.ca.gov/cc/capandtrade/reservesale/2017_reserve_sale_apcr_notice.pdf.

2 Assembly Constitutional Amendment 1, Session 2017–2018, Chap. 105, Statues of 2017, https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180ACA1.

3 Assembly Bill No. 617, Session 2017–2018, Chap. 136, Statues of 2017, https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB617.

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