



Calif. Cap-And-Trade Laws Still Hazy On Project Funding

By Erin Coe

Law360, San Diego (October 04, 2012, 11:00 PM ET) -- The recent approval of two cap-and-trade spending bills brings California one step closer to doling out \$1 billion in revenues expected from the program, but it remains unclear which projects will qualify for funding, and challenges over whether the winners meet the criteria could end up in court, experts said Thursday.

Gov. Jerry Brown on Sunday signed into law the measures — A.B. 1532, introduced by Assemblyman John Perez, D-Los Angeles, and S.B. 535, introduced by Sen. Kevin De Leon, D-Los Angeles — which give guidance on how funds raised by the California Air Resources Board's cap-and-trade auctions, the first of which is slated for Nov. 14, are likely to be spent.

The cap-and-trade program sets a cap on how much of a certain pollutant can collectively be emitted and allows under- and over-polluters to buy and sell allowances among themselves. It is part of the 2006 California Global Warming Solutions Act, also known as A.B. 32, which requires the state to reduce greenhouse gas emissions to 1990 levels by 2020.

While the measures provide some structure to the program by setting up a legislatively required process for how to use the cap-and-trade funds, they don't reach any conclusions on how that money will be spent, according to Jon Welner, a partner at Jeffer Mangels Butler & Mitchell LLP.

"The legislation represents a decision to put off most of the decision-making until later," he said. "This defines the process by which the decision-making will happen, but it doesn't do anything to advance the issue of how the funds really will be spent."

A.B. 1532 directs California's Finance Department to consult with the state to develop a three-year investment plan to use the funds to reduce greenhouse gas emissions.

Investments would target areas including clean energy, low-carbon transportation and infrastructure, natural resource protection, and research and development.

Meanwhile, S.B. 535 requires the Finance Department to set aside 25 percent of the Greenhouse Gas Reduction Account to projects benefiting disadvantaged communities, and at least 10 percent of that fund should go toward projects located in disadvantaged communities.

The Finance Department is required to issue a three-year investment plan specifying projects eligible for funding raised by cap-and-trade auctions in the spring of 2013, and its plan will be subject to public input and approval by California lawmakers.

A.B. 1535 authorizes money to be allocated for the purpose of cutting greenhouse gas emissions through investments that may include projects focusing on energy efficiency, water use and supply, sustainable infrastructure, and other categories. This list of projects that may reduce greenhouse gas emissions creates broad criteria for how money can be spent, according to Paul Hastings LLP partner Kevin Poloncarz.

“It establishes a very loose process at this time for how one goes about giving up these funds, and the funds are going to become political,” he said. “It doesn’t narrowly circumscribe how funds can be used enough to avoid politics from playing a role.”

He noted that A.B. 1532 and S.B. 535 focus only on a percentage of the auction revenues, since most of the auction revenues for 2013 allowances will be dealt with based on mandates by the California Public Utilities Commission for Pacific Gas & Electric Co. and other investor-owned utilities, which must use most of the proceeds to benefit their retail customers. Publicly owned utilities also stand to collect auction revenues that will go toward ratepayer relief, and the spending of those proceeds will be determined by each utility’s governing board.

Although the two measures put in place a process for spending cap-and-trade auction proceeds, serious questions remain about whether the cap-and-trade program itself is going to be subject to legal challenges, according to Poloncarz.

“CARB is planning on [the plan] going forward, but there are a lot of rumors out there about folks intending to file lawsuits,” he said. “CARB and the state are being very bullish about

moving forward with the plan for the proposed cap-and-trade program and moving forward with the plan on spending the money [raised by the program].”

By ensuring that the auction revenues will be spent on reducing greenhouse gas emissions or mitigating the impact of climate change, A.B. 1532 reduces the risk that money could be spent in a way that enables it to be characterized as a tax on companies instead of a fee, according to Welner. In order to be a fee, agencies must spend money on projects that are closely related to the source of the funds, such as cutting greenhouse gas emissions in this case, but if the funds are used to balance the general fund, they would be seen as a tax, he said.

However, once the Finance Department issues its report on how auction proceeds are going to be spent, there could be litigation alleging that certain projects that are eligible for receiving funds don’t help cut greenhouse gas emissions and that the allowances companies must buy constitute a tax, according to Welner.

“If funds are used in manner that appears to be unrelated to the reduction of greenhouse gas emissions, that increases the likelihood of a lawsuit claiming that they are a tax,” he said.

Businesses are bracing for when CARB implements the cap-and-trade program and delegates what actual projects will be funded, according to Peter Weiner, head of Paul Hastings’ environmental and energy practice.

“The legislation represents further specificity on how A.B. 32 is going to work,” he said.

“A.B. 32 is a grand experiment and is one of the most far-reaching environmental laws we’ve seen. We’re all trying to proceed in an orderly and smart fashion, and a lot depends on the wisdom and reason of those implementing the law.”

--Editing by Elizabeth Bowen and Richard McVay.

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