



METROPOLITAN
TRANSPORTATION
COMMISSION

Agenda Item 5a

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Memorandum

TO: Legislation Committee

DATE: June 1, 2012

FR: Executive Director

W. I. 1131

RE: Cap-and-Trade: Update & Legislative Advocacy Principles

Background

As part of its implementation of AB 32 (the Global Warming Solutions Act of 2006), the California Air Resources Board (ARB) has adopted regulations to establish a new cap-and-trade program to cap the emission of greenhouse gas emissions (GHG) statewide. Producers of about 80 percent of the state's GHG emissions are subject to the cap, which reduces emissions by about 20 percent compared to business-as-usual, at a rate of two percent per year in 2013 and 2014 and three percent per year through 2020. Motor vehicle fuels will be subject to the cap starting in 2015. The remaining 20 percent of emissions derive from smaller entities, such as agriculture and forestry, and are referred to as the "uncapped" sectors. The first auction is scheduled to be held in November 2012, with subsequent auctions to be held in February and May 2013.

What's At Stake? Cap-and-Trade Revenues in FY 2012-13

As part of the regulation establishing the program, ARB has set a floor price of \$10 per ton and a ceiling of \$50 per ton. Based on the 66 million allowances that ARB plans to sell in FY 2012-13, this will generate between \$660 million to \$3.3 billion in FY 2012-13. Consistent with Governor Brown's budget request, the Assembly and Senate budget subcommittees have each adopted language that would dedicate "at least \$500 million" towards eligible General Fund (GF) expenditures in order to help reduce the deficit. However, both houses rejected the Administration's proposal to appropriate the balance of funds to an expenditure plan that would be developed by the Administration at a later date on the grounds that it denied the Legislature the opportunity to adjust the expenditure plan. Instead, the draft budget includes language stating that the appropriation of additional funds beyond those used to offset GF expenditures will be contingent upon the enactment of future legislation.

Next Steps: Competing Legislative Approaches Proposed

Rather than rush through legislation that spells out use of the non- GF relief share of cap-and-trade revenues generated in FY 2012-13 in this year's budget, there appears to be a consensus that the Legislature will enact legislation *this* year that lays out a process for developing an expenditure plan, but will defer adoption of an expenditure plan and appropriation of funds until next year, for inclusion in the FY 2013-14 budget. There are two primary cap-and-trade bills pending in the Legislature:

- AB 1532 (Perez) would assign development of a three-year expenditure plan to the ARB, with input from an advisory body consisting of the secretaries of the Natural Resources Agency, the California Environmental Protection Agency, the Department of Food and Agriculture and the Business, Transportation and Housing Agency. The board would submit

the expenditure plan to the Legislature, which would have the ability to modify it before final adoption by ARB. The Legislature would be required to include appropriations for the final investment plan in its annual budget. The bill specifies that transportation projects and sustainable development would be eligible, among other categories.

- SB 1572 (Pavley) would require the Governor to submit a draft expenditure plan to the Legislature but assigns final development of the plan to state agencies designated by the Governor. While the Legislature would *receive* the draft expenditure plan, it would have no authority to make changes to the plan. The bill further requires that funds appropriated from cap-and-trade revenue would be spent in accordance with the final plan.

Legal Restrictions on Use of Cap-and-Trade Revenue

According to Legislative Counsel, revenue generated from the allowances is considered mitigation fee revenue subject to the legal nexus test established in the 1997 California Supreme Court case known as *Sinclair Paint, Co. v. State Board of Equalization*. Therefore, such revenue may only be used to mitigate GHG emissions or the harms caused by GHG emissions. In addition, according to an analysis conducted by the University of California Los Angeles (UCLA) School of Law, given that AB 32 is focused on reducing emissions to a certain level by 2020, a project will have a stronger legal justification if it reduces GHG emissions prior to that year, though reductions beyond 2020 are also considered eligible. Transportation projects that can meet this nexus requirement are widely viewed as an eligible category of expenditures, as indicated by the Brown Administration's original proposal to fund "low carbon transportation" projects, including public transportation and high-speed rail.

A Significant New Funding Opportunity for Transportation

Considering that transportation comprises about 40 percent of the state's share of GHGs, it is reasonable to assume that low-carbon transportation improvements should receive a substantial share of the proceeds from the cap-and-trade program. In addition, in view of SB 375 (Steinberg, 2008), which directs metropolitan planning organizations (MPOs) to work with local governments to reduce transportation-related GHG emissions by specified state targets by 2020 and 2035, staff believes it is appropriate that a significant share of the cap-and-trade revenues that are designated to transportation be distributed via formula to the MPOs on the basis of each area's share of GHGs. In partnership with local governments, MPOs would be responsible for ensuring that expenditures are limited to those that mitigate GHG emissions or the harms they cause.

In order for cap and trade to have the greatest impact, it is critical that California establish a model that other states and nations seek to replicate. By investing this revenue in transportation projects, the state will provide tangible benefits to California residents that will help generate public support for the cap-and-trade program.

Staff recommends adoption of the legislative advocacy principles in Attachment 1 to guide MTC's advocacy with regard to the current legislative session as well as the development of the expenditure plan next year.



Steve Heminger

Legislative Advocacy Principles for the State's Cap-and-Trade Program

1. A multi-year expenditure plan for the use of cap-and-trade revenue should be developed by the Administration, with ample opportunity for public input. The Legislature should be empowered to make adjustments to the plan before final adoption by the Air Resources Board.
2. In addition to meeting the legal nexus requirement, the expenditure plan should seek to maximize other benefits to California, including improved mobility, livability, public health and social equity.
3. Given that transportation contributes almost 40 percent of the state's GHG emissions, a similar share of the allowance revenue (remaining after General Fund-eligible expenditures are offset) should go towards projects that reduce emissions from the transportation sector.
4. To help implement SB 375, cap-and-trade revenue funds dedicated to transportation — other than those of a statewide nature, such as high-speed or intercity rail — should be distributed to MPOs to help them achieve the GHG reduction targets included in each region's Sustainable Communities Strategy (SCS).
5. Each region's share of allowance revenue should be determined on a formula basis that reflects a geographically equitable distribution of funds.
6. Project eligibility in the transportation sector should include any transportation project that can meet the legal nexus test for fees, including projects that reduce GHG emissions as well as those that mitigate the *effects* of GHG emissions, (such as climate adaptation projects). MPOs would be responsible for ensuring that projects funded by allowance proceeds satisfy all legal requirements.
7. Projects funded by MPOs must be consistent with each region's SCS. Project selection should be done competitively with priority given to projects that reduce GHG emissions in the near term, while also supporting other key state and regional goals.