

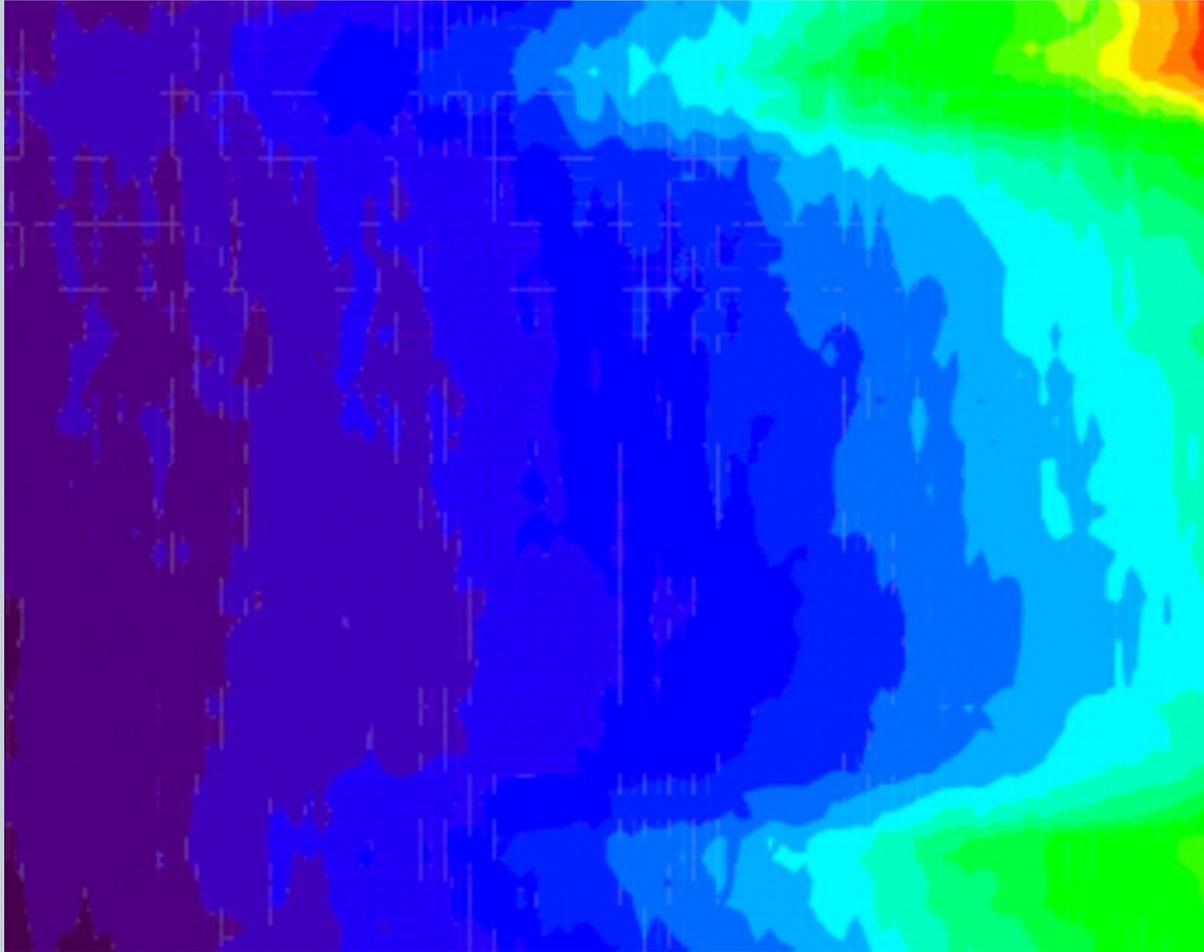
Outstanding Legal Issues for EAAC

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**COMPILED BY THE LEGAL ISSUES SUB-COMMITTEE
NOV. 18, 2009**

Climate Change Art

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Issues

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- CA budget restrictions
- Revenue from AB 32-related programs to General Fund
 - Auction revenue
- Sinclair restrictions
- AB 32 provisions for environmentally-impacted communities
- Linkages with other cap and trade systems
- Tax implications from free allowances vs. auction proceeds

General Budget Restrictions

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- State must balance budget, i.e., expenditures = revenues
- Borrowing restricted to \$300,000 annually unless specific law authorizes such
- Bonds can be issued for general or special funds, but General Fund “on the hook” for repayment

Revenue from AB 32-Related Programs to General Fund

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- Permitted, but subject to legislative appropriation and other constitutional requirements
 - *The state board may adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001. The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division.*
- General consensus that any programs must be related to greenhouse gas reduction efforts
- Auction revenue?
 - Arguments that ARB has no legal authority to auction without two-thirds vote of Legislature

Sinclair Restrictions

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- Significant barriers
- Program nexus
- Could limit programs to administrative costs only
- Nuñez letter to file: “any funds to be used solely for the direct costs incurred in administering this division.”

AB 32 Provisions for Environmentally-Impacted Communities

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- Obligation *not* to make things worse regarding co-pollutants (Section 38570):
 - *Prior to the inclusion of any market-based compliance mechanism in the regulations, to the extent feasible and in furtherance of achieving the statewide greenhouse gas emissions limit, the state board shall do all of the following:; (1) Consider the potential for direct, indirect, and cumulative emission impacts from these mechanisms, including localized impacts in communities that are already adversely impacted by air pollution.; (2) Design any market-based compliance mechanism to prevent any increase in the emissions of toxic air contaminants or criteria air pollutants.; (3) Maximize additional environmental and economic benefits for California, as appropriate.*
- Does not *prevent* steps to reduce co-pollutant levels

Linkages With Other Cap and Trade Systems

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- **Linkages with other states**
 - Compact Clause of U.S. Constitution provides agreements between states not effective unless reviewed, ratified by Congress
- **Linkages with a federal system**
 - Can be permitted in federal legislation
- **Linkages with EU**
 - Foreign powers doctrine provides federal government exclusive power
 - If no federal action, might be permitted but certain to be challenged
 - California could still accept EU allowances or certified reductions

Tax Implications from Free Allowances vs. Auction Proceeds

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- Many unsettled questions
- Under current IRS guidance, free allowances under acid rain program do not constitute income
- Revenue from auction proceeds generally constitute taxable income
- Purchase of allowances for businesses should be deductible