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Steven Russo: Hello everyone and welcome back to Empire Environmental. I'm Steven Russo, a shareholder at Greenberg Traurig's New York City office. I am accompanied today by [00:00:30] my colleagues, Jane McLaughlin and Zackary Knaub, who both sit in New York's capital of Albany, New York. Say hello, Jane and Zack.

Jane McLaughlin: Hello.

Zackary Knaub: Hi, Steve.

Steven Russo: We got the band back together to talk today about cap and invest. A little bit of background and then we will get into it. At the end of last year, New York State, the Climate Advisory Committee, something set up under New York's Climate Law, came out with its framework [00:01:00] for how New York was going to achieve its extremely aggressive clean energy goals, looking to achieve net zero by 2050, and with an interim goal of 70% reductions by 2030, over 1990 baseline. One of the big marquee recommendations from the Climate Action Council was to implement a cap and invest program. And then this month, Governor Kathy Hochul made that a highlight of her State of the State address, implementing a cap and invest program as a way for [00:01:30] New York to achieve its very aggressive climate goals.

So before we get into it and discuss this, in case anybody doesn't understand what cap and invest is, cap and invest is kind of the latest nomenclature for what was also known as cap and trade or a carbon tax, though in the government, nobody likes to use the T word. But it is essentially creating a market where all emissions have to be accounted for and then paid for, so that [00:02:00] you must pay to emit carbon, and then the allowable levels of those credits get ratcheted down and supply and demand, as the allotment gets ratcheted down, the cost to purchase the credits goes up. And the concept is that the market is going to incentivize those who emit greenhouse gases to come up with new and innovative ways to either mitigate, reduce, or hopefully eliminate those [00:02:30] emissions. So it is a market-based solution to reducing emissions. This isn't a new concept in New York because New York is part of the regional Greenhouse Gas Initiative or RGGI.

RGGI was enacted in 2005 and currently has 12 states, from Maine to Virginia, participating in it. So it's, as it's named, a regional initiative, but it only applies to energy generating stations. So New York is [00:03:00] now proposing a RGGI like system with a couple of key differences. It's not going to be regional, it's just a New York State only program, and second, the concept here is that it's going to cover all emissions from all sectors of the economy, not just electric generating, which is already covered by RGGI. So that's the big difference here. DEC, the

New York State Department of Environmental Conservation, where, incidentally, all three of us once [00:03:30] worked, is going to be charged with developing this program.

Whether or not there's going to be legislative involvement is not clear, it was raised in the State of the State, which suggests that there might be legislation involved at some point, and we're going to get into that a little bit because there's some questions about whether or not DEC can administratively implement a cap and invest program, and can they do so entirely or only the fees and the structure, but that the spending would have to [00:04:00] happen from the legislature. There's a bunch of permutations there that are unresolved, and one of the reasons they're unresolved is because nobody challenged it in New York when New York joined RGGI. There was a challenge to RGGI, but it was late and it was dismissed on statute of limitations grounds.

So we've never really had a decision on the merits that would say whether or not the state can administratively impose a cap and invest, cap and trade program. The last thing I'll say before I turn it to our august panel, is that [00:04:30] the nomenclature cap and invest is because there were some issues, with some criticism of the concept of being able to pay to pollute and the idea that this would have an undue burden on disadvantaged communities, environmental justice communities that often have some of the most noxious emissions in their neighborhoods. So the idea here is that in any cap and invest program, the part of the money raised, a substantial part of the money raised would go to these communities that have historically [00:05:00] have had to bear what the state believes is an unfair burden for greenhouse gas emissions and other types of polluting emissions over probably the last 100 years.

So with that, Zack, what do you think about cap and invest in New York and I mean, do we think this is going to be challenged and if it's challenged, any idea what the grounds would be and what the arguments would be for and against?

Zackary Knaub: So this is a very broad economy-wide program that Governor [00:05:30] Hochul has proposed. It's not new, it's been out there, as you said, with the Climate Action Council proposing this as part of the scoping plan. So it's not a surprise, but it's very broad and it's going to encompass a lot of emission sources statewide. I think it raises quite a few questions that regulators are going to have to grapple with if they're going to do this. As you said, the first one is, does this involve legislation? Do they have to go to the legislature? [00:06:00] And we don't know what Governor Hochul intends to do. It seems as if this year, they're talking about taking stakeholder input about how to do this. That's going to be very broad, as I said, it's economy wide, so you've got every sector of the economy that's going to be interested in how this plays out.

And challenges to this program, if they do do it administratively, as you mentioned, there was a challenge to RGGI, the question was, is this an unconstitutional [00:06:30] tax? It was never answered. So we don't know if they can do it, if they're going to take that risk. I think this is going to touch so many sectors of the economy that there's a real chance somebody could challenge it.

Steven Russo: Okay. So you're saying we don't even really know, it's possible that they could say we are going to enact by legislation, but if they don't, then there's probably a pretty good likelihood that it'll be challenged as an impermissible tax. [00:07:00] And if that's the case, based on what I've heard, I think the state feels pretty comfortable that they could do this administratively. Maybe politically they will choose not to, but they think they could. What's the argument for, if you're the state, which you used to stand, you used to work for the state, used to work for the governor, what's the argument for it, that it's legal?

Zackary Knaub: So the Climate Leadership and Community Protection Act did give quite a few powers to the Department of Environmental Conservation [00:07:30] to enact the very dramatic climate reductions, the greenhouse gas reductions that the state wants to see. I think the state's argument, and probably their best one is, hey, we've got a mandate from the legislature in the CLCPA and we're going to do what it takes to enact it.

Steven Russo: Yeah. That basically you gave us this authority when you gave us these aggressive goals, you can't tie our hands to not do it. That makes some sense.

Zackary Knaub: But what's interesting, [00:08:00] Steve, and Jane might have some thoughts on this, is coming at a time when the governor is going to have a big power struggle with the legislature. It's her first year, her first real budget, and she had maybe a little bit of a misstep with the nomination of chief judge that the legislature rejected. She's going into budget discussions with a little bit of a power struggle, so it'll be interesting to see how that plays out with this particular [00:08:30] proposal.

Steven Russo: Yeah. That's a good point, Zack. And Jane, I have not forgotten you. What do you think, we're trying to read tea leaves, what if the state proposed an administrative program, how do you think the legislature would react?

Jane McLaughlin: The legislature and everyone is generally expecting that the foundation is going to be laid via administrative rulemaking. That is the expectation. So I don't [00:09:00] think that anyone is going to be shocked that DEC will come out with some sort of proposed rulemaking to establish cap and invest. The governor's acknowledged the need for legislative intervention, even in the State of the State, she talked about the creation of this climate action rebate. So that's going to direct the proceeds of cap and invest to New Yorkers. So there is an understanding that there's sort of a lot of moving parts here, but [00:09:30] it sounds like the nitty gritty is going to be established via rulemaking, whereas the actual funds, and-

Steven Russo: I'm spending it.

Jane McLaughlin: ... we spent, the legislature will have an opportunity to weigh in there. So both things I think will happen, and I don't think the legislature is going to balk when they see draft rulemaking coming out of DEC. I think that is the expectation generally.

Steven Russo: Yeah, and that's an interesting concept that could help in any attack. If in the end, [00:10:00] if they completely cut out the ledge, I think that there could be an argument, illegal tax, you don't DEC a state, you don't have the power to administratively spend this money that you collect, even though they do do that with RGGI. But if they created this administrative program and they collect these fees and then the legislature kind of signs off on that whole concept by then passing a law about how that money is spent, then there's a pretty good argument that the legislature [00:10:30] kind of signed off on the whole kit and caboodle. We'll have to see how this all plays out. But talking about that, I guess that's our role, is to speculate.

Here are the couple of things, Jane, and I know you follow the Climate Action Council a lot, and I'm curious about how much they grapple with this issue, which is okay, they don't want to call it a tax, they want to call it a fee, assessment, whatever it is. The fact of the matter is if you emit greenhouse gases, you're going to have to pay something into a fund. [00:11:00] You're going to pay money, and that money is going to go somewhere, but probably not back to you, discharger. So what am I going to do if I'm in business and I'm competing with, and this is what troubles me, RGGI was, it's 12 states that are next to each other, and it's about power plants that by definition really can't be in California, they got to be in the region to supply power.

This is very different if you're just going it alone, and the industry [00:11:30] in New York is competing with industries in Vermont or New Jersey or Connecticut or Virginia. Is there any recognition or plan to deal with how you don't destroy the state's economy, how the state competes if they're paying this money for carbon emissions that no other state in the union is paying?

Jane McLaughlin: Yeah, one of the pillars of the CLCPA is the creation of a sustainable green economy in New York State, [00:12:00] and even in the governor's State of the State, you'll see that they have sort of committed to designing it in a way that creates new jobs, instead of driving jobs and driving industry out of state. It's part of this goal to sort of transform the economy and make it more green. So that is the solution. [00:12:30] If the money is invested appropriately, then it will actually create more jobs that are actually sustainable and they can help communities across the state.

So they're going into this, they don't have their head in the sand, they know that losing jobs and hurting the economy has been raised throughout the development of [00:13:00] the scoping plan. But the solution, from the governor's perspective and from those that are involved in the development and implementation of the scoping plan, is actually no, we're just simply changing the economy in a way that will create more jobs and be greener and more sustainable. So there is an acknowledgement there, it's just, they're contemplating the use of that, the funds [inaudible 00:13:25] through the economy.

Steven Russo: Let's get a little more granular though, I mean, one of the things I'd take it [00:13:30] that would be covered by this, would be gasoline that emits fossil fuels, we all think gasoline is going to be somehow swept into this, I guess.

Zackary Knaub: That's an interesting question, Steve, because you also have things like the low carbon fuel standard and other proposals that the Climate Action Council has made, but the governor has yet to really endorse as her policy. The interplay between those kinds of things will [00:14:00] be interesting to see. How does that play out, and what do they do with sources that are paying for RGGI credits? Will there be some kind of offset for the power generating sector? We have to assume so. And gasoline, diesel, heating oil, all of those things, will they fall under some sort of low carbon fuel standard that will be part of this? We don't know yet.

Steven Russo: All right. Because otherwise it would seem to me, I mean, are we looking at, gas is [00:14:30] $3.29 a gallon in Vermont and $4.89 in New York, when you cross the border, and are we looking at that with this program?

Zackary Knaub: I think we're going to be looking at some increases in prices economy-wide. I don't see how this doesn't pass through to consumers. And when you look at gas prices in states that have similar economy-wide cap and trade or cap and invest programs, you tend to see higher prices, especially at the pump.

Steven Russo: You're talking California. California. So [00:15:00] California, I mean, I think gas is markedly much more expensive than it is in neighboring states. What about Jane, if I deliver pizzas and I drive in my pizza car and now gas is $5 a gallon in New York, I'm going to have to raise my price for pizza delivery, aren't I?

Jane McLaughlin: One of the goals, and again, it's a goal, so the devil's [00:15:30] in the details, is to avoid regressive impacts. And that was a concept that came up quite a bit in these discussions, especially amongst lower income households who spend a lot of their own income on transportation costs, heating costs, electricity, et cetera. And so they talked about a rebate funded by the revenues to help offset that burden on lower income households. [00:16:00] There's an understanding that the state, they're looking to avoid it hitting consumers.

Steven Russo: But of course, if you do that, if you completely offset the financial impacts, then the whole program doesn't work. The whole idea is the product costs more, so somebody figures out a way to do it better, so they can avoid paying as much or paying the tax at all, and therefore [00:16:30] they have a competitive advantage and they win in the marketplace. But I'm competing, if I somehow ... I have an electric car and I'm delivering my pizzas and somebody else isn't, but everyone is getting a pizza delivery rebate to soften the burden, then what's the point of the program?

Zackary Knaub: It goes to the invest side of the cap and invest and where those funds are going is going to be key to how [00:17:00] this functions. The investment is intended for what the Climate Action Council called disadvantaged communities. And so I think what you'll see, at least in the first pass of this proposal, is money going into those disadvantaged communities. In other words, the less fortunate New Yorkers will see the biggest benefit, while the middle and the upper class New Yorkers [00:17:30] are going to see less of a financial benefit and end up probably paying more. That is a progressive taxation idea that you're seeing playing out in this proposal, but it's also going to be very difficult for the state to manage how those funds are invested and do it without a lot of blow back from consumers.

Steven Russo: Well blow back from consumers, Zack can also leakage, because we're not in a regional initiative. [00:18:00] I mean, they're literally-

Zackary Knaub: That's right.

Steven Russo: We border Vermont, Connecticut, it's New Jersey. I mean, we used always drive to New Jersey to get cheaper gas, and then New Jersey raised its tax and we lost that. But people, I mean, you literally could send New York consumers to purchase products, maybe not a pizza, if you don't live close to another state, but to the extent they can, [00:18:30] consumers are going to go to other states, which concerns me about its potential impact. It's different if you're doing it region wide or nationwide, but statewide seems like a challenge.

Zackary Knaub: And if you're a manufacturer and you're in a competitive industry where you're competing against manufacturers in other states or other countries even, and then you're adding another layer of tax on, there's only so much pass through [00:19:00] you can do to consumers. And I've got to think you might start looking beyond New York's borders for where you might be able to manufacture more cheaply.

Steven Russo: Right. And energy costs are often a critical component for manufacturing. New York does try to have incentives where they give people hydropower generated by NYPA, but that's a finite resource, that can only go to so many people, so many entities.

Jane McLaughlin: On that leakage point, that did come [00:19:30] up and was noted in the final plan. And so the thought was that by allocating allowances to these energy-intensive industries, based on a benchmarking approach, that that sort of reduces or helps reduce potentially the risk of leakage and the CLCPA-

Steven Russo: What does that mean, Jane, benchmarking approach? What does that mean in practice?

Jane McLaughlin:	[00:20:00] Practically speaking, right now, conceptually what was highlighted in the final plan, was setting these sorts of goals for each industry and it's phased out over time. That's generally what they're talking about with benchmarking.
Steven Russo:	Right. And also it seemed to me that there was some suggestion that when this first thing gets rolled [00:20:30] out, the allowances aren't going to cost a lot. That would be another way to kind of mitigate, of course, also its effectiveness, but mitigate its financial impact, is if the allowances don't actually, there's a lot of them and they don't cost a lot, which is a little bit how RGGI started, and then get ratcheted down over time, maybe after Kathy Hochul's not governor, I don't know. It would seem like, I guess, that's another way you could mitigate the impact, is if you have enough allowances that they [00:21:00] don't cost-
Jane McLaughlin:	Yeah, people don't feel like they're getting a bucket of ice water dumped on their head.
Zackary Knaub:	You might see some targeted carve outs. You wonder, for example, agriculture, you have some significant greenhouse gas emissions from big dairy farms, but do you really want to hit dairy farms and farmers and agriculture with a carbon tax?
Steven Russo:	Competing with Vermont, competing with Wisconsin, competing with ... Our dairy farms are selling their products not just to New Yorkers, they're selling them all over the country. Well, these are some of the things that are going to be grappled with, it seems like the kind of thing, my own editorial view, that the legislature should have to sign on the dotted line, the people who answer to the voters, if the voters want this, there's an argument for why this is necessary. But it would seem like the voters should sign off [00:22:00] on it knowingly, through their representatives. I don't mean by plebiscite, but I mean, through the votes of the people they've sent to Albany. But that's just my two cents. Zack, any final observations about what to look for in 2023? How long is this going to take? What do you think we're going to see in calendar 2023 on this cap and invest?
Zackary Knaub:	I think the big thing to follow is going to be the stakeholder input this [00:22:30] year. That's going to be key to shaping this program. And if you're an interested source in New York State's economy, then now's the time to weigh in and make your voice heard to the people who are putting this program together, because once it starts, it's going to be tough to change it.
Steven Russo:	Yeah. The electric car will have left the station. Jane, you can have the last word.
Jane McLaughlin:	[00:23:00] More to come, I mean, the devils in the details here. The Climate Action Council's laid out some broad concepts and sort of explained why the cap and invest was favored over a tax. And it's due to the certainty that is provided through a cap and invest strategy, certainty on emissions reductions, and then certainty amongst members [00:23:30] of industry that are paying for those

allowances. So everybody knows what they're getting their themselves into. But the devil, again, it's in the details, and folks on all sides of the spectrum are going to be looking at what the agency puts out there, for different reasons. Environmentalists are going to be looking at equity and making sure that we're not actually diverting pollution burdens [00:24:00] to disadvantaged communities. And then folks on the industry side are going to want to make sure that they're not going to be clobbered unnecessarily and contemplate picking up and moving elsewhere. So a lot of different stakeholder interests here and we'll have to see what the agency comes out with.

Steven Russo: Indeed, Jane McLaughlin and Zackary Knaub, my Greenberg Traurig Albany colleagues. I'm Steven Russo from Greenberg [00:24:30] Traurig New York City office. Thank you for listening.