Senate Budget and Fiscal Review—Mark Leno, Chair
SUBCOMMITTEE NO. 2 **Agenda**

S. Joseph Simitian, Chair
Jean Fuller
Alan Lowenthal

Wednesday, April 25, 2012
2:30 pm or upon adjournment of Rules Committee
Hearing Room 2040

Consultant: Catherine Freeman

Departments Proposed for Vote-Only

Departments and Issues Proposed for Discussion

ITEMS PROPOSED FOR VOTE-ONLY

3930 Department of Pesticide Regulation

1. **Pest Management Research Grant**. The department requests two permanent positions and $713,000 from the DPR Fund ($711,000 ongoing) to expand its existing pest management grant program to also fund research projects that develop effective alternatives to fumigants and other pesticides. This coincides with the withdrawal by the manufacturer of the fumigant Methyl Iodide, a product intended to replace the phased out Methyl Bromide.

3960 Department of Toxic Substances Control

2. **Electronic Waste Recycling Fraud Case Development and Prosecution.** The department requests that $558,000 in expenditure authority and five positions from the Electronic Waste Recovery and Recycling Account be transferred from the Department of Toxic Substances Control to the Department of Resources Recycling and Recovery for Electronic Waste Recycling Fraud Case Development and Prosecution. Because this is a transfer of authority and positions, it adds no additional costs or positions.

3980 Office of Environmental Health Hazard Assessment

3. **Cumulative Impact Analysis to Support Community Revitalization.** The budget proposes one position and $131,000 from the Air Resources Board to develop methods to assess the cumulative impacts of multiple environmental contaminants in communities across the state. This coordinates existing activities that are required under multiple statutes.

Recommendation: APPROVE Items 1-3

Vote:

ITEMS PROPOSED FOR DISCUSSION

0555 Secretary for Cal-EPA

The Secretary for Cal-EPA is the cabinet level agency for the protection of human health and the environment. The Secretary coordinates the state's environmental regulatory programs and oversees programs to restore, protect, and enhance environmental quality. The Secretary directly oversees the Certified Unified Program Agencies, the California–Mexico border environmental efforts, and the Education and the Environment Initiative.

Items Proposed for Vote-Only

1. **Unified Program Electronic Reporting Implementation.** Request for an additional $5.7 million in Unified Program Account authority from funds in place and already collected to continue statutory program requirements. This will allow Unified Program participants (local governments and businesses) to report electronically under the Unified Hazardous Materials and Hazardous Waste Regulatory Management Program by 2013.

Recommendation: APPROVE Item 1

ITEM PROPOSED FOR DISCUSSION

Overview of the Secretary's Office

Background. The California Environmental Protection Agency Secretary's office budget is mainly derived from special funds, fees, and reimbursements from agency programs. The budget proposes expenditures of $20.7 million, an increase of about $230,000 from the previous year.

Positions at the Secretary's Office. During the discussion of the Secretary's office in May Revision last year the subcommittee raised the issue of the number of positions at the Secretary's office. An evaluation of these positions lead to a recommendation to reduce the Secretary's office by fourteen positions and a number of programs. The subcommittee deferred this issue but clearly requested the Secretary's office to evaluate its positions and return with proposals that reflect a leaner oversight agency. The Secretary's office has made some progress reducing positions and making consolidations.

Staff Comments. Given the high profile of the Agency Secretary's role in oversight, and the changing nature of the programs under its purview, it is still relevant to discuss the composition of programs at the Agency level. In addition to the overview of Cal-EPA, the Secretary should address current and future staffing at the Agency level.

Staff Recommendation: Information Item, no action necessary.

Vote:

3900 California Air Resources Board

The Air Resources Board has primary responsibility for protecting air quality in California, as well as implementation of the California Global Warming Solutions Act of 2006 (AB 32). This responsibility includes establishing ambient air quality standards for specific pollutants, administering air pollution research studies, evaluating standards adopted by the US Environmental Protection Agency and developing and implementing plans to attain and maintain these standards. These plans include emission limitations for vehicular and industrial sources established by the Board and local air pollution control districts.

The Governor's Budget proposes $555 million and 1,223 positions for support of the board. This is an increase of 19 percent over current year expenditures. This does not include proposed expenditures of up to $1.5 billion related to the auction of greenhouse gas emissions under the Cap and Trade Program (discussed further below).

Items Proposed for Vote-Only

1. **Increased Reimbursement Authority (AB 118).** Request for an increase in reimbursement authority of $10.8 million to allow ARB to administer, via interagency agreements, existing incentive programs that are oversubscribed by consumer demand. These include the Air Quality Improvement Program, Alternative and Renewable Fuel and Vehicle Technology Program, and Enhanced Fleet Modernization Program.

2. **Carl Moyer Program Technical Adjustment.** Request for a technical adjustment to the Air Pollution Control Fund for the Carl Moyer Incentive Program by shifting the $86.4 million dollars in incentive based funding from State Operations to Local Assistance.

Recommendation: APPROVE Items 1-2.

ITEMS PROPOSED FOR DISCUSSION

AB 32 and Cap and Trade Funding

BACKGROUND:

The California Air Resources Board (ARB), along with 35 local air pollution control and air quality management districts, protects the state's air quality. The local air districts regulate stationary sources of pollution and prepare local implementation plans to achieve compliance with federal and state standards. The ARB is responsible primarily for the regulation of mobile sources of pollution, greenhouse gas emissions (GHG), and for the review of local district programs and plans.

AB 32 establishes greenhouse gas reduction levels. Assembly Bill 32, enacted in 2006, established the goal of reducing statewide GHG emissions in California to 1990 levels by 2020. It also charged the ARB with monitoring and regulating the state's sources of GHGs and identified a timeline by which ARB is to complete specified AB 32-related implementation actions. This included developing a scoping plan encompassing a set of measures that, taken together, would enable the state to achieve its 2020 GHG-reduction target. The scoping plan's measures include a combination of direct regulations and mandated requirements affecting energy efficiency and consumption, along with actions to provide price incentives for energy efficiency and GHG reductions.

Cap and Trade—One of Many CO2 Emission Reduction Measures. The state's overall goal for GHG emission reductions is the 1990 level of 427 million metric tons of carbon dioxide equivalents (MMT). The Cap and Trade program sets a statewide limit on the sources of greenhouse gases (GHGs) responsible for 85 percent of California GHG emissions. Under the cap and trade system, the ARB sets a cap on the amount of emissions (pollution) that will be allowed. After that, the ARB issues credits (license or permit to emit the pollutant), most of which are issued for free. The California Public Utilities Commission (CPUC) also will be issuing credits under this plan to the Investor Owned Utilities and has started a rulemaking proceeding for the expenditure of any proceeds. The number of credits issued establishes the level a given company may pollute. A certain amount of credits are held back to be sold. Finally, if a company pollutes under its cap, it may trade or sell its credits. If it needs to pollute over its cap, it must buy credits. Essentially, cap and trade programs establish a financial incentive for long-term investments by assessing a cost to emit a GHG. As shown in the following figure, the scoping plan estimates that cap and trade will create approximately 23 percent of the reductions needed to meet the state's reduction goals.

Scoping Plan's Greenhouse Gas (GHG) Emissions Reduction Measures

GHG Emissions in millions of metric tons of carbon dioxide equivalents.

Category of Measure [a]	2010 Analysis Target Reductions	Percent of total
Low carbon fuel standard	15	19%
High global warming potential gases [b]	6.5	8
Energy efficiency	12	15
Renewables portfolio standard (33 percent RPS) [b]	11.4	14
Pavley standards [c]	3.8	5
Other measures [b]	13.3	16
Cap-and-trade	18	23
Total	**80**	**100**

a) Source: Legislative Analyst's Office
b) Target excludes measures under this category which have not been updated for 2010 from 2008, and therefore does not reflect all measures contained in the 2008 Scoping Plan.
c) The Pavley standard refers to the state's fuel economy regulations, which are broken into two rules known as Pavley 1 and Pavley 2.

GOVERNOR'S PROPOSAL:

Governor's budget includes regulation and programs for GHG reductions. The Governor's budget includes funding for GHG reduction programs in multiple state agencies. Most of the programmatic activity is hosted at the ARB and state energy agencies including the California Public Utilities Commission. This is because ARB is charged with monitoring and regulating GHG emissions while CPUC and the Energy Commission (CEC) are charged with monitoring one of the largest sources of GHG emissions, the energy sector.

Annually, the Administration submits a cross-cut budget to help the Legislature evaluate its AB 32 activities, both compliance and direct regulation. In May 2011, the ARB submitted a required zero-based budget that detailed expenditures in each agency, complete with programmatic information and positions. A total of 181 positions and about $36 million are dedicated to AB 32 activities across state government in the budget. This does not include overlapping positions at the energy agencies that work on related programs. For example, the state has an existing law, the renewable portfolio standard (RPS), which mandates levels of renewable energy sources the state's energy sector may use. The goals of the RPS complement GHG reduction but the primary focus of this law is the reduction of traditional sources of pollution such as reduced dependence on coal-fired energy.

AB 32 Cross-Cut Budget [a]
(dollars in thousands)

Department	Fund Source	2011-12	2012-13	Total Positions
Secretary for Environmental Protection	AB 32 Cost of Implementation (COI) Fee	$1,821	$586	4
Department of General Services	Service Revolving Fund	416	416	5
Department of Housing and Community Development	AB 32 COI Fee	98	98	1
California Energy Commission	Energy Resources Program Account	590	590	5
Department of Resources Recycling and Recovery	AB 32 COI Fee	501	496	6
Department of Water Resources	State Water Project Funds/ AB 32 COI Fee	551	316	3
Air Resources Board (includes development of cap-and-trade regulations)	AB 32 COI Fee	32,932	32,932	155
State Water Resources Control Board	AB 32 COI Fee	535	555	2
Department of Public Health	AB 32 COI Fee	314	348	0
Subtotal AB 32 Cost of Implementation Fee		**$37,758**	**$36,337**	**181**
Unknown/Undetermined	Cap-and-Trade Revenues		Up to $1 billion	Unknown
California Public Utilities Commission	Cap-and-Trade Revenues		Unknown	Unknown

a) Does not include complementary programs such as RPS activities at the energy agencies.

Cap-and-Trade fee revenues are included in the budget. The ARB plans to begin auctioning GHG emission allowances as part of its market-based compliance measures in 2012. The ARB estimates that fee revenues from the first set of auctions will be $1 billion in the first year of the program which is included in the budget. These auction revenue estimates vary widely making specific budget expenditures uncertain. Actual revenues are not anticipated to be certified until late in 2012-13. A General Fund offset of $500 million is also included in the budget; however, there is no specific proposal for this expenditure. Rather than a detailed budget proposal, the budget provides general categories of spending from the proceeds of the auctions. These include:

- Clean and efficient energy
- Low-carbon transportation
- Natural resource protection
- Sustainable infrastructure development.

30-Day notification to the Legislature planned for expenditures. The budget provides that an expenditure plan for both the $500 million General Fund offset as well as the $1 billion will be jointly submitted by the Director of Finance and the Air Resources Board. The plan must include specific expenditure and will allow the Legislature not fewer than 30 days to review the plan before allocation of funding will begin.

Increased Accounting Workload and Program Expenditure Oversight. The budget includes a request for $939,000 from multiple funding sources to support existing planned workload to effectively track, record, and reconcile air quality and greenhouse gas reduction program expenditures, including anticipated necessary tracking and recording of Cap and Trade program revenues beginning in 2012-13.

Project-Level GHG Assessment Program. The budget includes a request for four limited-term positions and $643,000 (Air Pollution Control Fund) to meet increased workload from two new state requirements: AB 900 (Buchanan) and SB 292 (Padilla), Statutes of 2011. These statutes direct the ARB to evaluate greenhouse gas (GHG) emissions' impact of certain development projects to help determine eligibility for a streamlined judicial review process of California Environmental Quality Act (CEQA) challenges. The ARB has stated that they do not currently review project-level emissions analyses and does not have the resources to assess GHG emissions' impacts of individual developments at this time. The policy analysis of this issue indicated that workload for this proposal would be absorbable, and indeed given the first test of this bill, the ARB did absorb the workload and evaluated the GHG impacts using existing resources.

ISSUES TO CONSIDER:

Planned emission reductions from Cap and Trade Program were adjusted downward. The role for cap-and-trade to fill the gap between the total target and the emission reductions planned from traditional command and control measures have been reduced. The 2008 Scoping Plan initially was expected to provide 34.4 million metric tons (MMT) of carbon dioxide equivalent reductions. Revised expectations in 2010 now show a reduction of 18 MMT of emission reductions proposed from cap-and-trade. The majority of reductions will be from traditional command and control measures including to some extent existing programs in renewable energy investment and clean car standards. According to the Legislative Analyst's Office, these figures are still likely overstated because the board has not comprehensively scored the emission reductions planned to come from other complementary measures.

Cap and Trade Program is complex and subject to potential gaming of the system. Carbon markets are, by their very nature, complex. In general, the more complex the markets are, the more susceptible they become to manipulation and fraudulent activity. The cap and trade program as designed by ARB is particularly complex in that it has a multitude of design features that are intended to address various policy objectives. These policy objectives include the ARB's desire to reduce the potential for economic activity to leave the state as a result of the program implementation. In addition to this, there is no national or state oversight agency to monitor and regulate trading of compliance instruments on the spot market.

30-Day Notification means short review and little oversight of potentially $1 billion in new program spending and budget backfills. The Governor's proposal provides the Legislature with a 30-day notification to expend funds from the auction proceeds. The auction of carbon credits is highly speculative—with estimates ranging from $350 million to over $1 billion revenues in the first year. This notification would be the first time Legislators would see the Governor's detailed expenditure plan. There is no detail provided in the budget indicating specifically where funding would be directed from the proceeds, what types of grant or loan programs would be created, or what state programs would be offset. Legislative oversight of the funds related to fee nexus, GHG emission reduction achievement, and overall program selection would be extremely shortened under the Governor's plan.

Western Climate Initiative and Linkage Issues. The administration continues to move forward with a proposal to "link" auctions to the Quebec Cap and Trade system. This would allow for more credits to be auctioned in multiple jurisdictions however it poses a number of questions about the intent of the state program. In order to facilitate this multi-government auction, the ARB assisted in the creation of Western Climate Initiative, Inc. (WCI), an independent nonprofit that would develop compliance, tracking, and market monitoring functions for jurisdictions participating in the auctions. The WCI is incorporated in Delaware and both the Executive Director of ARB and Secretary for Cal-EPA sit on the board of WCI. According to ARB, no funding was paid by the state to WCI over the past several years, however this is not accurate. Through the Western Governors Association, funding was directed specifically from the State of California to WCI to facilitate this startup agency. The administration proposes to direct $3.7 million to this agency through December 2013.

LAO Analysis:

The Global Warming Solutions Act of 2006 (Chapter 488, Statutes of 2006 [AB 32, Núñez/Pavley]), commonly referred to as AB 32, established the goal of reducing greenhouse gas (GHG) emissions statewide to 1990 levels by 2020. In order to help achieve this goal, the California Air Resources Board (ARB) recently adopted regulations to establish a new cap–and–trade program that places a "cap" on aggregate GHG emissions from entities responsible for roughly 80 percent of the state's GHG emissions. The ARB will issue carbon allowances that these entities will, in turn, be able to "trade" (buy and sell) on the open market.

As part of its plan to issue allowances, ARB will hold quarterly auctions at which time a portion of these allowances will be made available for purchase. For 2012–13, ARB's auctions are estimated to generate roughly $660 million to upwards of $3 billion. The Governor's budget for 2012–13 assumes that the state will receive $1 billion from such auctions. Of this amount, the budget assumes that $500 million of the total revenue will be used to offset existing General Fund costs of current GHG mitigation activities, and the remaining revenues will be used on new or expanded programs intended to reduce GHG emissions.

Given the state's fiscal condition, we believe that the Legislature should first use the revenues in 2012–13 to offset General Fund costs of existing programs designed to mitigate GHG emissions. Since the Legislature will need to decide which General Fund costs to offset as part of the 2012–13 budget process, such decisions are best made this spring. In addition, the Legislature will need to begin the process of determining how effectively to allocate the remaining auction revenues on new or expanded programs. However, these latter decisions, which require an array of information to make, do not need to be done as part of the 2012–13 budget process.

Staff Recommendation: Staff recommends the following actions:

1. REJECT Control Section 15.11 which allows the administration to expend up to $1 billion from auction allowance proceeds with now fewer than 30-day notification to the Legislature.
2. APPROVE language in concept (Air Pollution Control Fund, auction revenues)
   a. Authorize spending of Cap and Trade revenues for purposes of AB 32 greenhouse gas emissions reduction activities to achieve at least $500 million in General Fund savings.
   b. Stipulate that any additional expenditure related to greenhouse gas emissions reductions be made pursuant to future legislation.

3. APPROVE as budgeted Accounting Office Workload: Program Expenditure Oversight budget proposal.

4. REJECT Project-Level GHG Assessment Program proposal.

Vote:

8660 California Public Utilities Commission

The California Public Utilities Commission (CPUC) is responsible for the regulation of privately owned "public utilities," such as gas, electric, telephone, and railroad corporations, as well as certain video providers and passenger and household goods carriers. The PUC's primary objective is to ensure adequate facilities and services for the public at equitable and reasonable rates. The PUC also promotes energy conservation through its various regulatory decisions. The Governor's Budget proposes $1.4 billion to support the CPUC in the budget year.

Items Proposed for Vote-Only

1. **State Electricity Regulators Assistance Project (ARRA).** Request for continuation of four limited-term positions and $372,000 from the Federal Trust Fund through December 31, 2014 to address various electricity regulatory issues. Authority for positions is currently scheduled to expire on June 30, 2012.

2. **Deaf and Disabled Telecommunications Program (AB 136).** Request for an increase of 4.5 two-year limited-term positions and $6.2 million from the Deaf and Disabled Telecommunications Program Administration Fund. Chapter 404, Statutes of 2011 (AB 136, Beall) requires the CPUC to expand the program to include speech generating devices for eligible telecommunications subscribers by January 1, 2014.

3. **Community Choice Aggregation.** Request for an increase of 4.0 two-year limited-term positions and $421,000 from the CPUC Utilities Reimbursement Account to implement Chapter 599, Statutes of 2011 (SB 790, Leno) which directs the Commission to institute a rulemaking proceeding for the purpose of adoption of rules for electrical corporations relative to community choice aggregation.

4. **Funding for Outside Legal Counsel for Energy Crisis Litigation**. Request for one-year extension of the liquidation period for continued assistance by outside counsel and economic consultants as expert witnesses in litigation by the CPUC before the FERC, which seeks refunds for overcharges during the 2000-2001 energy crisis for California Consumers in excess of $1 billion.

5. **State Broadband Data and Development Program (April Letter).** Request for continuation of four limited-term positions and $314,000 from the Federal Trust Fund through September 2014 for continued work on a federal grant under the National Telecommunications and Information Administration's State Broadband Data and Development Program.

Recommendation: APPROVE Items 1-5

Vote:

ITEMS PROPOSED FOR DISCUSSION

Cap and Trade Auction Revenues

Background (LAO). The Cap and Trade proposal (discussed earlier) assumes $650 million in California Public Utilities Commission (CPUC) directed revenues. The administration expects that these revenues will be generated in 2012-13 as a result of the free allocation of cap-and-trade allowances to the state's IOUs. The ARB plans to give 65 million allowances to IOUs, which, as a condition of the free allocation, are then mandated to sell those allowances in ARB's auction.

The CPUC, which regulates the state's IOUs, has produced estimates of potential 2012–13 revenues using both ARB's auction floor price of $10 per ton (which would generate $650 million) and its own internal estimated price of $16 per ton (which would generate roughly $1 billion). We note, however, that if allowances were sold at ARB's ceiling price of $40 per ton, revenues could be much higher—potentially up to $2.6 billion.

The CPUC has opened an official proceeding to determine how IOUs should use the above revenues. While the commission has yet to decide how these revenues should be spent, it has indicated that it believes, in general, that the funds should be used in ways that benefit electricity consumers in California (such as to augment investments in energy efficiency and renewable energy). The CPUC expects to issue a decision in April 2012.

LAO Recommendation.

> **Plan on How IOU Revenues Will Be Allocated.** The Legislature will also want to ensure that the cap–and–trade auction revenues are used in coordination with the use of the IOU cap–and–trade revenues, particularly in order to avoid unnecessary duplication of efforts. Thus, the Legislature will want to obtain information on how the CPUC intends to allocate the IOU revenues prior to approving an expenditure plan for the auction revenues. This would help ensure that these revenues are used in accordance with an overall statewide plan to mitigate GHG emissions.

Staff Comments. Staff concurs with the LAO recommendation.

Staff Recommendation: Hold Open

Vote:

Electricity Procurement Investment Charge (EPIC)

Background. In December 2011, funding for the state's Public Goods Charge (PGC) on electricity ratepayers expired. Efforts to continue the surcharge, which requires a 2/3 vote of the Legislature failed. The PGC funded energy efficiency research and development and renewable energy programs. The charge constituted about a quarter of the total energy efficiency programs funded by the state and energy utilities. Funds were collected on a volumetric basis (per kilowatt-hour) by customer class from all utilities (public and investor-owned). The benefits of these programs were then distributed generally, thus the surcharge was considered a tax for voting purposes.

In September 2011, the Governor sent a letter to the CPUC requesting that the Commission take action under the commission's authority to ensure that programs funded like those funded under the PGC would be continued, but with respect to modifications legislators discussed during the PGC renewal deliberations.

In December 2011, the CPUC initiated a rulemaking (essentially started a pathway to an new policy) to attempt to continue the programs of the PGC with a sole focus on the investor-owned utilities (IOUs). The Commission plans a two-phased deliberation. The first phase addresses the appropriate funding levels for renewables and research and development. The second phase will create a detailed program.

EPIC Draft Proposal. The Governor's budget does not include a proposal for EPIC, rather this is being done solely through the Commission's ratemaking processes which are in themselves not subject to legislative approval. As such, it is conceivable that the Legislature will not have any fiscal or budget review of the proposal unless the Commission chooses to enter into a memorandum of understanding with the California Energy Commission to continue any of its work related to the Public Interest Energy Research (PIER) or similar programs, or requests funding and position authority for administration of the program at the CPUC.

The draft proposal, as laid out by CPUC staff during the initial rulemaking, totals $142 million across four, high level areas (including Administration):

- **Applied Research—$55 million**. Research activities that relate to the development of next generation clean energy technologies, as well as related to the impacts and implications of climate change, clean energy deployment, on energy system operations and the environment.

- **Demonstration—$50 million** (at least $10 million of which is allocated to bioenergy projects). Demonstration involves providing the technical viability of a technology scaled in an operating environment that reflects real-world conditions.

- **Market Facilitation—$15 million.** Activities that address non-price, non-technical barriers that may impede technology adoption despite the technical and economic viability of a given technology.

- **Administration—$21 million for the California Energy Commission (CEC) and $7 million for CPUC staffing.** This covers the CEC's costs and incremental CPUC costs associated with overseeing all of the various program elements as proposed.

Staff Comments. The development of a rulemaking on energy efficiency at the CPUC on its surface is not problematic and is part of the regular course of work conducted by the Commission. However the Commission's current rulemaking raises a number of concerns. As a basic issue, the continuation of programs that were determined to be a tax for voting purposes without legislative review or approval is a major concern. However, other concerns have been raised by potentially impacted ratepayers and outside interests including:

1. The EPIC staff proposal is vague and does not specify what programs would be included or not in the final outcome making review of the proposal difficult.

2. The proposal seems to increase overall research and development revenues, and includes funding to the Energy Commission. Why are only investor-owned utilities paying for this when the benefit is extended to all state energy ratepayers (including publicly-owned utilities)?

3. The proposal does not include a clear investment plan that specifies how this proposal benefits ratepayers of investor-owned utilities.

4. The proposal does not clearly specify funding priorities and any balance with overall state or federal funding for these programs. For example multiple state programs are proposed to fund energy efficiency efforts including auction revenues from the Cap and Trade program. If this is the case, do we need EPIC?

Staff Recommendation: Hold Open

Vote:

Safety Programs and Proposals (Consumer Safety Division)

Background. The Governor's budget includes four proposals for enhancement of the Consumer Safety Division. This is above and beyond the additional 12 positions and about $671,000 approved by the Legislature in the 2011 budget process.

LAO Analysis.

Background. The California Public Utilities Commission (CPUC) regulates, among other things, the safety of both large and small natural gas transmission and distribution facilities, natural gas storage facilities, propane gas systems, and mobile home park master-metered gas systems. Currently, California's gas system serves about 11 million customers through 100,000 miles of gas distribution mains and 10,000 miles of gas transmission pipelines, with more than 2,300 miles of transmission pipelines located in "high-consequence" areas (meaning adjacent to significantly high population or frequently used by the public). Some of these pipeline systems were built as early as the 1920s.

On September 9, 2010, a 30-inch-diameter natural gas transmission pipeline owned and operated by Pacific Gas and Electric ruptured in a residential area in the city of San Bruno. The accident killed eight people, injured many more, and caused significant property damage in the area. The released natural gas caused a fire that destroyed 37 homes and damaged 18 other homes. In the wake of this accident, the CPUC, federal regulators, the Legislature, and Congress have undertaken a comprehensive evaluation of natural gas pipeline safety. This review has resulted in new laws and regulations for all California pipeline operators. For example, the CPUC authorized an independent review panel of experts to review the commission's Gas Safety Program and recommend actions to reduce the likelihood of future incidents. Similarly, the National Transportation Safety Board and the Pipeline and Hazardous Materials Safety Administration issued an investigation report that identified the need for additional activities and resources at both the state and federal level to better ensure pipeline safety.

Governor's Proposal. In response to the above reports, as well as recent legislation that directs the CPUC to take certain actions regarding pipeline safety, the Governor's budget for 2012-13 includes various requests that in total would provide the CPUC with $6.5 million in increased funding to support 46 additional positions in its Consumer Safety Division.

Proposals Raise Concerns. The Governor's proposal raises some concerns. First, our analysis indicates that the Consumer Safety Division currently has 31 vacant positions (out of a total of 217 positions). Moreover, we note that the CPUC, as a whole, currently has a total of 135 vacant positions. At the time of this analysis, the commission has not provided a plan on how it will address its vacancies. Given the CPUC's current vacancy rates, the requested funding may not be spent as proposed in the budget year to the extent that the requested positions for the Consumer Safety Division are not filled. In addition, the CPUC has not provided adequate information to justify the requested 46 positions on a workload basis.

LAO Recommendation. In view of the above concerns, we recommend that the Legislature reject the Governor's 2012-13 budget proposals that would provide the CPUC with a total of 46 additional positions, as well as appropriate $6.5 million to support these positions. We further recommend that the Legislature require the CPUC to provide a plan this spring on how it plans to fill its current vacancies.

Staff Comments. Staff generally concurs with the LAO analysis of the issues. In the time between the release of the LAO analysis (which was derived from information provided by the Commission) and this hearing, the Commission has provided new information on its vacancy rate in the Division, projecting only eight vacant positions. An update to the workload justification was not included in this update.

Staff generally supports the legislative proposals that were vetted through the policy process in 2011. In addition to these proposals, the CPUC also received positions to directly address the natural gas pipeline safety program in the 2011 budget. However, staff believes the CPUC should consider using existing resources and shifting program priorities to enact systematic changes to its Global Safety and Enforcement Programs as it has on numerous other occasions related to energy and climate regulation. It would seem that the most important change that needs to occur is a cultural change where the department re-focuses its efforts on safety using its current administrative resources. To the extent that the department can demonstrate this priority first, then incremental proposals, particularly those vetted through the policy process would be more appropriate.

Staff Recommendation:

1. REJECT: Global Safety and Enforcement Programs proposal (Global Safety and Enforcement Programs ($5.9 million, 41 positions).

2. APPROVE Legislative Proposals (Below, three items).
   - Chapter 520, Statutes of 2011 (SB 44, Corbett): Gas Pipeline Emergency Response Standards ($217,000, two positions).
   - Chapter 522, Statutes of 2011 (SB 705, Leno): Natural Gas Service and Safety ($102,000 and one position).
   - Chapter 519, Statutes of 2011 (AB 56, Hill and SB 216, Yee): Gas Corporations Rate Recovery-Pipeline Safety Expenditures ($322,000 and two positions).

Vote:

3360 Energy Resources Conservation Development Commission (California Energy Commission)

The Energy Resources Conservation and Development Commission (commonly referred to as the California Energy Commission or CEC) is responsible for forecasting energy supply and demand; developing and implementing energy conservation measures; conducting energy-related research and development programs; and siting major power plants.

Governor's Budget. The Governor's Budget includes $393 million (no General Fund) for support of the CEC, a decrease of approximately $161 million, due primarily to the phasing down of the Public Interest Energy Research (PIER) Program and the Renewable Resources Trust Fund (RRTF) as a result of the failure to reauthorize the Public Goods Charge.

Items Proposed for Vote-Only

1. **Smart Grid Policy Implementation.** Request to continue one existing limited-term position for two additional years to continue to support the Commission's technical analysis and standards coordination needed to implement Chapter 327, Statutes of 2009 (SB 17, Padilla). This proposal also includes activities related to renewable energy and distributed generation.

2. **Energy Information Demands of California's Energy Market.** The budget requests authority to redirect one existing Energy Resources Programs Account (ERPA) funded permanent position from the Siting, Transmission and Environmental Protection Division (Siting Division) to the Information Technology Services Branch (ITSB) to develop technical expertise in a civil service employee and address critical support needs to build energy-related information systems.

Recommendation: APPROVE Items 1-2

ITEMS PROPOSED FOR DISCUSSION

ERPA and RRTF Funded Program Requests

Background. Under current law, the CEC is authorized to impose and adjust the Energy Resources Program Account (ERPA) surcharge. At the November 8, 2010 business meeting, the commission approved an ERPA surcharge increase which became effective January 1, 2011. The rate was increased from $0.00022 to $0.00029, which was expected to generate $16.9 million in 2011-12.

The ERPA fund supports many of the basic programs of the CEC, including its siting and energy forecasting functions. State law directs electric utilities (both privately and publicly owned) to collect a state energy surcharge from all electric customers (this is a separate surcharge from the Public Goods Charge). The Board of Equalization collects the surcharge from the utilities.

The Renewable Resource Trust Fund as a fund that is continuously appropriated, with exceptions for administrative expenses, to support renewable energy resources through the public goods charge. The main source of funding for this program ended in December 2011 (see discussion under the California Public Utilities Commission).

Program Audit. In the 2011 budget, the Legislature directed $200,000 of the Commission's budget to a review of the ERPA Account and the Renewable Resources Trust Fund (RRTF). This was later narrowed to avoid duplication of a pending audit of the RRTF. As anticipated, the auditors were challenged to specify positions that were not working under current mandates because of the nature of the statute that established the Commission's work, the Warren-Alquist Act of 1974. As such, when one position is no longer used for a single purpose established by a budget proposal or otherwise, the position, under current law, often could be shifted within the broad program umbrellas given by the originating act.

The audit did report a number of mandated activities that were not being performed during the audit period including those related to AB 32 greenhouse gas emissions, technology export, energy efficiency technical assistance, and loan recipient reporting.

Budget Proposals. The Governor's budget includes two requests that impact ERPA funding:

1. **Establishing an Audit and Investigation Unit**. Request to redirect three existing permanent positions funded from the Siting Division to establish an audit and investigation unit. This unit will provide audit oversight to ensure federal and state funds across all programs are spent in accordance with applicable federal and state requirements and guidelines to prevent fraud, waste and abuse. These positions would be funded by the ERPA.

2. **Implementation of Renewable Energy Development Grants Under ABx1 13.** The budget requests two limited-term positions for one year to develop and administer $7 million in grants mandated by Chapter 10, Statutes of 2011 (ABx1 13, Perez). Grants would be issued to qualified counties for the development or revision of rules and policies that facilitate the development of eligible renewable energy resources and their associated electric transmission facilities, and the processing of permits for eligible renewable energy resources.

Staff Comments. The future organization of funding at the department is currently difficult to determine given the loss of the public goods charge as discussed earlier under the California Public Utilities Commission. A number of major structural changes have been discussed in policy committees regarding the Commission, including some that focus on future use of funds that may not be available unless alternative funding sources are identified. Ongoing discussions about how to fund the Emerging Renewables Program and the New Solar Homes Partnership Program raise questions about where funding to the agency should be directed. Funding reductions may also impact the administrative functions of the agency, the use of the Renewable Resources Trust Fund, and other grant and research functions.

According to the audit, because of the broad mandate given to the department, it is up to the Legislature to now determine how the commission must reduce its scope of work, provide specific directives, and deliverables. This discussion is better left to the policy committees to sort out, however, as the budget moves through, it is important to not hamper these future discussions by over-appropriating funding for programs that may not be the highest priority of the Legislature given the very recent discussions of the Public Goods Charge and the new Electricity Improvement Procurement Charge.

Staff Recommendation: Hold Open

Vote:

3500 Department of Resources Recycling and Recovery (Cal Recycle)

The Department of Resources Recycling and Recovery (CalRecycle) was created pursuant to Chapter 21, Statutes of 2009 (SB 63; Strickland) and is largely the merger of the Waste Board (minus the board members and associated support staff) and the Department of Conservation Division of Recycling. As such, CalRecycle protects public health and safety and the environment through the regulation of solid waste facilities, including landfills, and promotes recycling of a variety of materials, including beverage containers, electronic waste, waste tires, used oil, and other materials. CalRecycle also promotes the following waste diversion practices: (1) source reduction, (2) recycling and composting, and (3) reuse. Additional departmental activities include research, permitting, inspection, enforcement, public awareness, market development to promote recycling industries, and technical assistance to local agencies.

Governor’s Budget. The Governor’s Budget includes $1.4 billion (no General Fund) for the department, including $1.2 billion for the Beverage Container Recycling and Litter Reduction Program, and about $200 million for the Waste Reduction and Management Program (the old Waste Board).

Items Proposed for Vote-Only

1. **Carpet Stewardship Program.** Request for 2.75 positions and $205,000 to implement the carpet stewardship law pursuant to Chapter 681, Statutes of 2010 (AB 2398, Perez). This law establishes a private-sector designed and managed statewide Carpet Stewardship Program that provides industry with anti-trust protection. Statute allows for the collection of assessments to fund the program and for the state to be reimbursed for state oversight of the program.

2. **Architectural Paint Recovery Program.** Request for 2.75 positions and $205,000 to cover the full costs of administering and enforcing the Architectural Paint Recovery Program as established by Chapter 420, Statutes of 2010. This legislation established an industry-supported revenue stream to support the architectural paint recovery program which places primary responsibility for end-of-life paint recovery and management on the paint manufacturer, or paint stewardship organizations, and limits the state role to oversight.

3. **Electronic Waste Recycling Fraud Case Development and Prosecution.** Request for a transfer of $558,000 in expenditure authority and five positions from the Electronic Waste Recovery and Recycling Account from the Department of Toxic Substances Control to the Department of Resources Recycling and Recovery. Because this is a transfer of authority and positions, it adds no additional costs or positions.

4. **Out-of-State Beverage Container Importation Monitoring Program.** Request to annually redirect $1.4 million of existing authority to fund an Interagency Agreement with the California Department of Food and Agriculture (CDFA), border protection stations to combat Beverage Container Recycling Program fraud associated with illegal CRV redemption of beverage containers imported to California from out-of-state. The subcommittee approved a corresponding proposal at the CDFA on March 21.

Recommendation: APPROVE Items 1-4

ITEM PROPOSED FOR DISCUSSION

Special Fund Reductions for the Spring Budget Process

Background. During the 2011 budget deliberations, the Legislature passed language requiring the department to convene a monthly working group with legislative staff and the LAO related to administrative and operating issues stemming from reorganization at the department. At the time, the department's reorganization proposal did not meet statute and was in the process of being modified to meet statutory requirements. The Governor vetoed this budget bill language.

The subcommittee raised the following issues in May 2011:

a) Separation of the Division of Recycling from the former waste board functions.
b) Co-mingling between Beverage Container Recycling Fund and waste divisions.
c) Unnecessary CEA positions that duplicated Governor's appointee functions.
d) Fostering of expertise in subject areas and a return to functional programs by policy area.

Budget Proposal. The Governor's budget requests an abolishment of two CEA positions for a total reduction of $236,000 spread over multiple funds. This is part of a state-wide request by the Governor for special fund budgetary reduction plans targeted to reduce administration and program support, and is not unique to CalRecycle.

Staff Comments. The organization of the department is critical to the ability of the department to effectively manage its mandates as laid out in statute. In 2011 it was clear that the organization of the department was creating barriers both for the ongoing management of funding at the department, a long-term issue, as well as the effectiveness of personnel in their relationship with stakeholders. Because of this the subcommittee's questions regarding the solvency of the department's main funding source, the Beverage Container Recycling Fund, as well as management of individual mandates, were not sufficiently addressed in hearings.

The subcommittee may wish to have the department address the following issues:

1. What is the status of the reorganization plan?
2. Does the reduction of these CEA positions follow a statewide plan or direction from the subcommittee to reduce the possible overlap of CEA positions with Governor's appointees?
3. How has the functional expertise in subject areas changed in the past year and has the department returned to a more manageable structure of functional programs by policy area?

Staff Recommendation: Approve as budgeted.

Vote:

Beverage Container Recycling Fund

Background. The Beverage Container Recycling Program covers the majority of disposable beverage containers sold in the state. The program encourages the voluntary recycling of certain beverage containers by guaranteeing a minimum payment (termed California Redemption Value [CRV]) for each container returned to certified recyclers. In 2010-11, over 20 billion containers covered by the program were sold and about 17 billion were recycled, reflecting an 85 percent recycling rate.

The CRV is the primary source of funding for the Beverage Container Recycling Fund (BCRF). For each beverage container subject to the CRV sold to retailers, distributors make redemption payments that are collected by the department and deposited into the BCRF. This CRV cost is passed on to retailers who collect the CRV from consumers for each applicable beverage container sold. Consumers can recoup the cost of the CRV by redeeming empty recyclable beverage containers at a recycler. Recyclers are in turn reimbursed by the department for redeemed CRV.

The BCRF's expenditures fit into two main categories: (1) CRV reimbursements to recyclers and (2) program expenses (including for administration, grant programs, and education and outreach) that are funded from unredeemed CRV.

Over a number of years, the BCRF program has developed a structural deficit. Chapter 5, Statutes of 2010 (ABx8 7, Evans) addressed shortfalls in the BCRF in 2009-10 and 2010-11 by (1) accelerating the collection of CRV revenues, (2) capping some program expenses, and (3) restricting future borrowing from the BCRF. Even given these shortfall solutions, the fund has a $100 million per year structural deficit. A basic analysis would suggest the BCRF could only sustain a 60-70 percent recycling rate, while we currently have a close to 85 percent rate.

BCRF Solvency and General Fund Loan Repayment. Consistent with the recommendation in the recent CalRecycle report on the BCRF, budget trailer language is needed in order to maintain the existing "60 day" beverage distributor CRV payment schedule which otherwise sunsets. Without this language change, the Beverage Container Recycling Fund (BCRF) could potentially experience a cash shortfall of as much as $100 million during the 1st quarter of the 2012-13 fiscal year. Adoption of this language would ensure that the proposed General Fund loan payback for 2012-13 could be reduced by as much as $80 million, and paid in quarterly increments through the year as proposed.

In a recent report, CalRecycle made the following recommendation:

> "CalRecycle recommends preserving the existing bimonthly redemption Payment schedule going forward and amending Public Resources Code Section 14574 to remove the July 1, 2012 sunset provision. Additionally, further consideration should be given to adjusting reporting periods toward concurrent posting of revenue and expenditures."

Staff Comments. The subcommittee may wish to have the department address the following issues:

1. What recycling rate are we currently receiving and what can the fund sustain?
2. Statute requires some mandatory payments. Are there ways to simplify how we pay out from the BCRF without impacting programs?
3. What will happen when accelerated payments cease?
4. What is the impact of adopting the trailer bill language as proposed by CalRecycle?

Staff Recommendation: Adopt Trailer Bill Language to preserve the existing bimonthly redemption payment schedule.

Vote:

3940 State Water Resources Control Board

The State Water Resources Control Board (State Water Board) and the nine Regional Water Quality Control Boards (Regional Boards or Water Boards) preserve and enhance the quality of California's water resources and ensure proper allocation and effective use. These objectives are achieved through the Water Quality and Water Rights programs.

Governor's Budget. The Governor's Budget includes $713 million and 1,502 positions for support of the Board. Decreases in funding are largely due to reductions in bond expenditures.

Items Proposed for Vote-Only

1. **Funding for Billable Legal Services Conversion.** Request for a shift of $1 million to complete a billable legal services conversion imitated in the 2011 Budget Act. The Water Board has determined that increasing the Waste Discharge Permit Fund expenditure authority by $600,000 and Water Rights Fund expenditure authority by $450,000 to cover the Department of Justice General Fund expenditures for activities billable to these special funds.

2. **GAMA Program Fund Shift.** Request for a funding shift of $233,000 and 1.5 positions in 2012-13 and $400,000 annually thereafter from Proposition 50 bond funds to the Waste Discharge Permit Fund for the Groundwater Ambient Monitoring and Assessment (GAMA) Program.

3. **Bond Position Reduction.** The budget requests to eliminate two positions and $212,000 from the State Revolving Fund Subaccount to align positions with resources. This is necessitated by a reduction in the availability of bond funds which requires fund decreases and reduction to be made to ensure resources are properly aligned.

4. **Watershed Management Initiative Program Elimination.** The Governor requests to eliminate the Watershed Management Initiative Program resulting in a reduction of 6.8 positions and $1.3 million from the Public Resources Account. The purpose of the initiative has been fulfilled and the work product is now in use by the regional water boards.

5. **State Water Pollution Control Revolving Fund Administration Redirection.** The budget proposes an increase of $2.8 million in State Operations authority for the State Water Pollution Control Revolving Administration Fund and a corresponding decrease of $2.8 million Federal Funds.

6. **Small Disadvantaged Community Wastewater Projects Planning, Design, and Construction Grants.** The budget proposes $11 million in local assistance authority for the State Water Pollution Control Revolving Fund Small Community Grant Fund for fiscal year 2012-13 to provide grants to help small disadvantaged communities achieve compliance with water quality regulations, protect surface and groundwater quality, and to help eliminate threats to public health.

7. **Underground Storage Tank Cleanup Fund Orphan Site Cleanup Fund Re-Appropriation**. The budget proposes a one-time reappropriation of $2.3 million local assistance authority from the Underground Storage Tank Petroleum Contamination Orphan Site Cleanup fund for unspent funds from the current year.

8. **SB 424—Beach Water Quality Monitoring Program.** Request for $1.0 million from the Waste Discharge Permit fund for local assistance to support best management practices and to determine beach monitoring protocols among other requirements per Chapter 592, Statutes of 2011 (SB 482, Kehoe).

9. **Continued Staff Support for Water Rights Statements of Water Diversion and Use.** Request for position authority shift to process statements related to the Water Rights division.

Staff Comments. These proposals are consistent with statute and the direction the board has taken over previous years. Item 9 is recommended to be denied without prejudice in order for the board to review its overall proposal and return in next year's budget with a proposal consistent with program direction.

Recommendation: APPROVE Items 1-8. Deny Item 9.

ITEMS PROPOSED FOR DISCUSSION

Reorganization of the Regional Water Quality Control Boards

Background. The Governor proposes trailer bill language to reorganize the regional water boards to address a number of issues including retaining quality board members on the boards. The proposals include:

- **Consolidate Regional Boards.** The Governor proposes to eliminate the Colorado Regional Water Quality Control Board and to shift its functions to both the Lahontan and San Diego regions.

- **Reduce the Number of Board Members.** The Governor proposes to reduce the number of board members on a given regional board from nine to seven.

- **Eliminate Categorical Board Members Associations.** The proposal removes categorical spots on the regional boards including those for water supply, conservation, production, irrigation agriculture, industrial water, local government, or general members of the public.

- **Regional Water Board Chair Selected by the Governor.** The proposal allows the Governor to appoint the chairperson of the regional boards rather than the board members selecting from amongst themselves.

The reorganization proposal is a product of several years of attempts to reconcile the ability of the state to attract and retain quality board members who have expertise in the field. The review of complex permits and basin plans requires a level of expertise that generally comes from those with a great deal of experience within the water quality field. There are a few issues that were included in the overall general proposal that were not included specifically in the trailer bill language. These include:

- **Conflict of Interest Rules.** Current law prohibits regional board members from acting on proposals that involves the board member or any permittee where the board member has a position of authority or financial interest. The proposal had included language to conform the Water Code to the Political Reform Act as applies to all other state officials.

- **Increased Per Diem for Regional Board Members**. The proposal had included an increase in the per diem compensation from $100 per day to $500 per day, and an increase in the annual cap from $13,500 to $60,000. This was intended to address, among other issues, the time spent by board members evaluating complex permits during board deliberations, and to attract and retain quality board members.

Staff Comments. Staff have reviewed the proposal and in general concur with the proposals to change the constitution of the regional boards, including those proposals that were not included in the trailer bill language. However, staff have some concerns with the proposed consolidation of the regional boards. It is unclear why the Colorado Regional Board was selected for elimination rather than consolidation of urban Southern California boards (such as Santa Ana and San Diego). Staff recommends reconsideration of the board consolidation proposal to ensure the proposed consolidation achieves the goal of increasing government efficiency and reducing programmatic expenses at the regional board level.

Staff Recommendation:

1. APPROVE Trailer Bill Language (including conflict of interest and per diem elements).
2. HOLD OPEN regional board consolidation (elimination of the Colorado Regional Board).

Vote:

San Diego Regional Board Office Location

Budget Proposal. The Water Board is requesting additional funding to relocate the San Diego regional office. At this time the Water Board is requesting $2.8 million (various special funds) on a one-time basis for relocation expenses and $505,000 (various special funds) on an annual basis for the anticipated rent increase. The Department of General Services has been engaged to obtain more detailed information and refine cost estimates.

According to the Administration, relocation is necessary because the current location is directly next to an industrial solar panel manufacturer that emits toxins into the air. Regional Board employees have complained and submitted Workers Compensation claims regarding headaches and nausea believed to be related to toxins entering the building. As of this date, all of these claims have been settled without litigation.

Staff Comments. The relocation of the board is expensive and the board should be directed to use all means to reduce costs during the move. That said, it is likely the relocation is necessary and should be funded. However, funding for future rent increases is not justified at this time. During an economic downturn, the board should be able to negotiate a favorable rental agreement at or close to the current rental agreement. Therefore until a new rental agreement is signed, the subcommittee should not approve an increase in rent for future years. The subcommittee should be given an opportunity to review the rental agreement achieved by the board with the Department of General Services in budget discussions next year.

Staff Recommendation:

1. APPROVE one-time relocation expenses ($2.8 million)
2. DENY ongoing future increased rent expenses ($505,000)

Vote:

Funding for Water Recycling

Background. Chapter 700, Statutes of 2010 (SB 918, Pavley) requires the State water Resources Control Board to enter into an agreement with the Department of Public Health (DPH) to investigate and report to the Legislature on the feasibility of developing uniform water recycling criteria for direct potable reuse, among other issues. Funding for this item was inadvertently diverted to other purposes in the 2011 budget including for ongoing litigation defense funding. Due to an impending water board settlement related to water quality in Hinkley, funding is now available for the purposes of this statute and should be directed to its use.

Staff Comments. Staff recommends the subcommittee require the board to fund this statutory requirement out of the existing Waste Discharge Permit Fund (as proposed in the original bill).

Staff Recommendation: Approve budget bill language in concept to direct funding to the State Board and Department of Public Health not to exceed the reasonable cost of the program or $700,000 (as specified in the fiscal analysis of the bill) from the Waste Discharge Permit Fund.

Vote: