

CALIFORNIA'S GREENHOUSE GAS CAP-AND-TRADE REGULATIONS: WHO IS SUING AND WHO ISN'T

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By 2013, California electrical power generators and utilities, as well as other greenhouse gas (GHG) emitters, must comply with an emissions cap mandated by new regulations adopted by the California Air Resources Board (CARB). The regulations are perhaps the most ambitious effort by any government anywhere to regulate GHG emissions. Conventional wisdom would suggest that such an effort would face a multitude of legal challenges. So far, however, conventional wisdom has been wrong. Even more curiously, most of the legal challenges have been brought by environmental justice groups. With the exception of a recently filed case, the regulated business community has been surprisingly quiet.

CARB's GHG Cap-And-Trade Regulations

California's Global Warming Solutions Act of 2006 requires a reduction of GHG emissions to 1990 levels by the year 2020. The Act vests considerable power in CARB to adopt policies and regulations. The Act itself does not mandate a cap-and-trade program, but it does require CARB to consider market-based mechanisms when drafting regulations. After considering the options, including a carbon tax, CARB opted for a cap-and-trade approach that includes a gradually declining GHG emissions cap. The new regulations cover major GHG emission sources, including power plants, refineries and major factories. These sources will be allocated emission allowances, which at the end of specified compliance periods must be surrendered in amounts equal to emissions. Business can buy and trade allowances. Indeed, the first allowances auction is scheduled for November 14, 2012. The first compliance period begins in 2013.

Challenges From The Environmental Justice Community

Most of the legal challenges to CARB's cap-and-trade regulations have come from environmental justice organizations. These groups support the Act's mandate to cut GHG emissions, but favor a

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carbon tax or command-and-control style regulation of emissions over a cap-and-trade regime. The consensus within the environmental justice community is that cap-and-trade favors industry, is subject to gaming, cannot be adequately monitored, and furthers the disproportionate burden on poor communities and communities of color from industrial pollution. The larger environmental community, however, is by no means united in opposition to cap-and-trade. Indeed, several national groups, including the Environmental Defense Fund, the Natural Resources Defense Council, and The Nature Conservancy, support CARB's cap-and-trade approach.

A state appellate court in June upheld CARB's overall blueprint for implementing the Act, known as the 2009 Climate Change Scoping Plan. The Scoping Plan was mandated by the Act, and its purpose was to outline strategies for achieving GHG emission reductions. Among the recommendations in the Scoping Plan was the development of a cap-and-trade program. An environmental justice group known as the Association of Irrigated Residents (AIR) challenged the Scoping Plan on a variety of grounds, including that it did not comply with the Act. Most of the arguments AIR raised were technical: (i) CARB did not consider the maximum technologically feasible reductions, as required by the Act; (ii) CARB failed to apply a cost-effectiveness standard, as required by the Act; and (iii) CARB failed to include direct regulation of agriculture and industry in the Scoping Plan. The Court, however, found that the California legislature had granted CARB broad discretion in implementing the Act. The Court further found that CARB's Scoping Plan was based upon extensive technical expertise and review, as to which the Court afforded deference.

Courts will most likely find that CARB was given broad discretion in writing the cap-and-trade regulations and, thus, will defer to the agency. A state court will have that opportunity soon, because two environmental justice groups have brought a legal challenge to the cap-and-trade regulations that is set to be heard in November. The case – brought by Citizens Climate Lobby and Our Children's Earth Foundation – challenges the offset protocols adopted by CARB as part of the cap-and-trade regulations. Offsets are voluntary GHG emission reductions made by entities not otherwise required to participate in the cap-and-trade program, such as a farmer planting trees that he would not have otherwise planted. Offsets are permitted under the Act, but they must result in reductions that are in addition to GHG emission reductions already required by law or that would otherwise occur under normal conditions. This is referred to as the “additionality principle.” The suit challenges whether the offset protocols adopted by CARB meet the additionality requirement.

Offsets are a significant issue, because electrical generators and utilities in particular expect offsets to be a key tool in meeting compliance requirements. Several of California's investor-owned utilities – Southern California Edison, PG&E, San Diego Gas & Electric, and Southern California Gas Co. – have intervened in support of CARB. The Environmental Defense Fund, an advocate of cap-and-trade and offsets, also intervened in support of CARB, as have a number of entities who hope to profit in the offsets market. If CARB is enjoined from using offsets, compliance with the emissions cap will become more difficult. A decision either way by the Court will almost certainly be appealed, so it may be some time before this issue is resolved.

The other pending challenge is an administrative proceeding before the U.S. Environmental Protection Agency brought by, among others, the Center on Race, Poverty & the Environment. People living within six miles of facilities regulated under cap-and-trade are disproportionately poor and people of color. The plaintiffs contend that if GHG emissions from these facilities were directly regulated, there would be a reduction in co-pollutant emissions (particulate matter, nitrogen oxides and volatile organic compounds) which are a threat to public health. The complaint argues that co-pollutant emissions could even increase as a result of the use of offsets and, thus, cap-and-trade disparately and adversely effects communities of color.

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Potential Challenges from Regulated Industries

Other than to intervene in one action to support CARB, the regulated community has mostly taken a wait-and-see approach. If GHG gas emissions must be regulated, industry apparently prefers cap-and-trade to a carbon tax or a command-and-control brand of regulation. The California Chamber of Commerce, however, just recently filed a suit challenging CARB's ability to reserve to itself some carbon allowances that it will then sell at auction. The lawsuit claims that (i) the statute does not authorize CARB to sell allowances, and (ii) the revenues raised by the auction amount to an unconstitutional tax because the Act was not passed by the required two-thirds vote of the legislature needed for tax increases. The Chamber of Commerce lawsuit only challenges the revenue raising component of the regulations and not the use of cap-and-trade as a regulatory approach.

If industry were to mount additional challenges, they would likely be premised on the so-called "dormant Commerce Clause" or preemption. A dormant Commerce Clause challenge to the cap-and-trade regulations would argue that CARB is improperly attempting to regulate electrical power generation *outside* California. A similar argument was successfully employed in a federal district court to challenge California's Low Carbon Fuel Standards, which CARB also enacted to reduce GHG emissions. This district court ruling is on appeal to the Ninth Circuit Court of Appeal. Another issue is whether CARB's efforts to regulate GHG emissions from electrical power providers is preempted under the Federal Power Act. There are other potential state law challenges as well, such as whether CARB complied with California law in promulgating the new regulations. But with the first compliance period beginning in January 2013, these challenges have yet to surface.

What Is Going to Happen?

A successful assault on CARB's cap-and-trade regime would simply send CARB back to the drawing table, either to modify the existing regulations or to formulate a new approach. The mandate to significantly reduce GHG emissions is not going to change. The environmental justice community wants to force CARB to reconsider a more draconian approach to reducing emissions. The regulated community, on the other hand, appears to prefer cap-and-trade to any of the alternatives. The events of the next few months should be interesting.

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