

January 2007

## California Greenhouse Gas Regulation

*“The economic reality is that some companies will win from a carbon constraint and some companies will lose, depending on how the regulation is written.”*

*The Wall Street Journal, January 11, 2007*

In keeping with its historical role as an environmental trendsetter, California has become the first state in the nation to mandate comprehensive reductions in greenhouse gas (GHG) emissions and take specific steps to reduce directly the amount of carbon emitted into the atmosphere from fuels and manufacturing facilities. And, it is anticipated that the federal government will adopt a similar but perhaps less ambitious program in the not too distant future.

Acting to implement the California Global Warming Solutions Act of 2006 (also known as “AB 32”), which has as its goal the reduction of GHG emissions in California to 1990 levels by the year 2020, Governor Schwarzenegger issued an Executive Order on January 18 that establishes the world’s first GHG emission standard for transportation fuels. The Order additionally sets a goal of reducing the carbon intensity of transportation fuels sold in California by at least 10% by the year 2020, and directs the state’s Air Resources Board (ARB) to consider adopting for such fuels a Low Carbon Fuel Standard (LCFS) that could be met using market-based emission reduction trading credits. The Governor has proposed that the LCFS be one of the early-action measures that, under AB 32, must be identified by June 30 of this year. Other early-action measures under consideration include methane controls on landfills and dairies, caps on electrical power generation and cement production emissions, tighter diesel exhaust controls, and port and other goods-movement regulations.

On a related front, environmental advocacy groups and major California industries, including cement, steel and petroleum product manufacturers, are engaged in a public debate over the need for an early emission reduction credit program. Such a program would allow companies that voluntarily reduce carbon dioxide and other GHG emissions before regulations are adopted to bank the reductions as marketable credits. The credits, in turn, could be used to satisfy future requirements or be sold to others that are having difficulty achieving the required reductions. Environmental groups contend that credits should not be given for reductions that are likely to eventually be required in any event. Industry asserts that, without such credits, companies may delay making such improvements until required to do so (in 2010 or later), thereby slowing the emission reduction process. This issue is expected to be a central focus of upcoming ARB workshops and hearings on the early-action measures to be identified by June 30.

## Legal Alert

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At the same time, the California Public Utilities Commission (CPUC) and the California Energy Commission are moving to implement SB 1368, another piece of carbon regulation legislation that was also adopted in 2006. SB 1368 prohibits the state's three investor-owned utilities and their local publicly owned counterparts from entering into long-term supply contracts with baseload generators unless the generators are in compliance with a GHG emission performance standard established by the CPUC. The CPUC has defined that standard as 1,000 pounds of carbon dioxide per megawatt hour, which is roughly equivalent to the amount of GHG emissions produced by a combined cycle natural gas power plant. The purpose of SB 1368 is to assure that both in-state and out-of-state power generators use relatively clean generation technology and to discourage the construction of additional coal-fired power plants.

These efforts to implement AB 32 and SB 1368 raise a number of complex legal issues, including the propriety of blocking out-of-state coal-fired power plants from access to the California market and of the Governor's use of executive power to shape the manner in which AB 32's broad goals are to be implemented. Beyond such legal issues, individual companies that generate GHG emissions in their operations have much to gain or lose by the manner in which California's carbon regulation program is constructed and the emerging regulations, based on vague and, as yet undefined, legislative requirements, are crafted. This is true not only for operations within California, but also in terms of the blueprint the program may establish for other states. At the same time, the risk that actions taken by companies to comply with or benefit from the California program could be nullified by preemptive federal legislation and the perceived need for national uniformity must also be considered.

For affected industries and companies, the time to focus attention on these issues is now. Indeed, some of the deadlines for establishing initial components of the California program—the early-action measures and baseline 1990 GHG emission inventories for different industrial sectors—are rapidly approaching, and some Congressional leaders are pushing to have national legislation in place by the middle of the year.

Mayer, Brown, Rowe & Maw LLP is closely following implementation of the California legislation, as well as federal proposals that may affect companies operating in the state. It has put together a California Greenhouse Gas Regulation Team with emphasis on developments in California's pioneering GHG efforts, but coordinating with attorneys in our Brussels, London, Washington and other offices who are tracking climate change-related issues in the EU and on the federal level. Together, we will assist our global and local clients that may be impacted by these converging regulatory efforts. The California Team members include the former Majority Leader of the California State Assembly and one of the primary authors of AB 32, other California Government Practice partners with strong contacts in the Governor's Office and at the various agencies involved in implementing the enabling legislation, Energy and Environmental Law practitioners with decades of experience representing trade groups for, and members of, the major industries affected by carbon regulation, Litigation specialists who are involved in several of the current lawsuits challenging state efforts to impose unique local GHG emission controls on the transportation industry, including auto manufacturers and rail carriers, and attorneys in other related disciplines.

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