

## California's Sweeping New Climate Change Law

On September 27, 2006, California Governor Arnold Schwarzenegger signed into law the Global Warming Solutions Act of 2006, better known in California by its Assembly bill number, AB 32. At Schwarzenegger's side was a bipartisan coalition of California leaders (AB 32 was sponsored by Assembly Speaker Fabian Nuñez, D-Los Angeles, and Assemblywoman Fran Pavley, D-Agoura Hills), as well as Governor George Pataki of New York and U.K. Prime Minister Tony Blair via live video link. The signing ceremony was particularly symbolic, as the states, led by California, are taking the lead on addressing the international problem of global warming in a manner similar to that taken by the U.K. and much of the rest of the developed world with the Kyoto Protocol. AB 32 is likely to become the model for similar legislation in states across the country, and will put pressure on the federal government to adopt a uniform program that would bring the country into closer alignment with developed countries that are parties to the Kyoto Protocol. Thus, the importance of AB 32 cannot be underestimated - not only to companies doing business in California that will be directly affected, but also to those that operate throughout the country.

### The Key Elements of California's Global Warming Solutions Act

AB 32's major features are well known. The law:

- ◆ Mandates that by 2020 statewide greenhouse gas ("GHG")<sup>1</sup> emissions will be capped at 1990 levels, a significant reduction from current levels (Cal Health & Safety Code § 38550);
- ◆ Mandates the monitoring and annual reporting of GHG emissions by all sources "of significance"<sup>2</sup> (*id.* at §§ 38530(a) and 38505(i));
- ◆ Mandates the development and implementation of GHG emission reduction measures (*id.* at § 38560); and, perhaps most importantly, it
- ◆ Delegates broad authority to the California Air Resources Board ("CARB") to implement these mandates in accordance with an aggressive series of deadlines. (*Id.* at § 38510.)

Just as important is what AB 32 does *not* do:

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<sup>1</sup> Greenhouse gases include carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride. Cal Health & Safety Code § 38505(g).

<sup>2</sup>AB 32 is thus far broader than any other climate change initiative in the country; it could apply to a vast swath of GHG emission sources and source categories in the state. By contrast, the best-known effort to date, the Northeast states' Regional Greenhouse Gas Initiative ("RGGI") carbon emission cap-and-trade system, applies only to emissions from fossil-fuel power plants.

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- ◆ AB 32 does *not* mandate that CARB use a market-based system for complying with the carbon emission limits that are to be established; it expressly states that CARB *may* do so, and even if CARB does do so, the definition of “market-based compliance mechanism” allows for a system other than a carbon dioxide emission cap-and-trade system (*see id.* §§ 38562(c), 38570 and 38505(g));
- ◆ AB 32 does *not* specify what the 1990 baseline of GHG emissions is, what sources are significant enough to require monitoring and reporting, nor what the reduction measures will be. All of that is left to CARB to develop through rulemaking.

### CARB's Broad Authority and Aggressive Timetable

AB 32 grants broad authority to CARB to implement the law, and it establishes an aggressive series of deadlines by which its objectives must be met. Thus, to a great extent, AB 32 did not establish a new climate change regulatory regime so much as it fired the starting gun announcing CARB's race to develop such a regime. The new regulatory regime now being created will be sweeping in its scope, sweeping in its grant of authority to CARB, *and* sweeping in its likely influence beyond California.

Thus, the action has now shifted to CARB.<sup>3</sup> Those with a significant stake in the regulation of carbon dioxide emissions should get involved now so as to have a say in what sort of regulatory regime is created. There is little time to waste, for the deadlines by which CARB must implement the various aspects of AB 32 are aggressive:

- ◆ **January 1, 2007:** AB 32 goes into effect;
- ◆ **June 30, 2007:** CARB must publish “a list of discrete early action GHG emission reduction measures” (Cal. Health & Safety Code § 38560.5(a)); this list is not just advisory - the measures must be implemented by regulations by 2010;
- ◆ **January 1, 2008:** CARB must establish the 1990 baseline of statewide GHG emissions that will be the cap to be implemented by 2020 (*id.* at § 38550);
- ◆ **January 1, 2008:** CARB must also adopt regulations requiring the monitoring and annual reporting of GHG emissions from all significant sources (*id.* at § 38530);
- ◆ **January 1, 2009:** CARB must prepare and approve a “scoping plan” for

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<sup>3</sup> This is not to say that the legislative and judicial arenas are moot. There is talk of possible “clean-up” legislation, and certain aspects of AB 32 may be subject to challenge in court, much as AB 1493's auto emission limits are now being litigated. *See* footnote 5, *infra*. In addition, the U.S. Supreme Court's upcoming decision in *Massachusetts v. EPA*, No. 03-1361, may have an impact.

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“achieving the maximum technologically feasible and cost-effective reductions in GHG emissions from sources or categories of sources of GHG gases by 2020” (*id.* at § 38561); this scoping plan will be the template for the regulations that will be adopted by 2011;

- ◆ **January 1, 2010:** CARB must “adopt regulations to implement” the list of reduction measures that it publishes by June 30, 2007 (*id.* at § 38560.5(b));
- ◆ **January 1, 2011:** CARB must adopt regulations establishing “GHG emission limits and emission reduction measures” (*id.* at § 38562(a)); and
- ◆ **January 1, 2012:** the 2011 regulations must become operative. (*Id.*)

AB 32 does provide one “out” from this aggressive schedule: the Governor may extend the deadlines up to one year “in the event of extraordinary circumstances.” (*See id.* at §38599.)

### CARB's Rulemaking Process and What Will be at Issue

In the next eight to fourteen months, CARB will be developing the key documents that will shape the climate change regulatory regime. ***This process will begin in November 2006 with the first workshops.*** In California, workshops are not merely discussion groups, but are the core mechanism of the rulemaking process. Regulations developed in workshops rarely change when later promulgated for notice and comment. Participating in these early workshops is critical if one wishes to have a role in shaping the development of the regulations, for it is there that one has a voice.

The key issues to be determined in the rulemaking process include the following:

- ◆ How will the 1990 baseline be determined? The California Energy Commission (“CEC”) has estimated that California’s total net GHG emissions in 1990 were 360 million metric tons, and that the total in 2004, the last year for which it has prepared estimates, was 410 million metric tons.<sup>4</sup>
- ◆ What sources and source categories will be deemed “significant” for the purpose of requiring GHG emission reporting? The CEC’s “top-down” inventory has numerous categories; for example, “transportation” accounted for 188 of the 410 million metric tons in 2004. Which sources in which Industry sectors will be deemed significant?

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<sup>4</sup> In separate legislation known as AB 1803 adopted a few months before AB 32, the CEC’s responsibility to develop a statewide inventory of GHG emissions was transferred to CARB. (AB 1803 at §§ 43 & 53.) The CEC is presently updating its inventory and will conduct a workshop in November 2006. This will be the CEC’s last inventory before passing the baton to CARB on January 1, 2007.

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- ◆ Will a market-based compliance mechanism be adopted, and if so, what will it look like? (*See id.* at §§ 38562(c), 38570 and 38505(g).)
  - ◇ On October 17, Governor Schwarzenegger issued Executive Order S-20-06, designating Cal-EPA as the lead for developing market-based compliance mechanisms with the assistance of a Market Advisory Committee. Cal-EPA is to make recommendations to CARB by June 30, 2007, and CARB is directed to collaborate with Cal-EPA “with the goal of creating a program that permits [emissions] trading with the European Union, [RGGI] and other jurisdictions.”
  - ◇ As noted above, however, AB 32 does not mandate such a system, and Assembly Speaker Nuñez immediately blasted the Executive Order as a betrayal of the Act. In the end, CARB will decide the issue, and historically it has been one of the most independent of state agencies.
- ◆ What sort of fees will be imposed? (*See id.* at §38597.) Will CARB opt for a “carbon tax” or only more traditional administrative fees?
- ◆ What sort of enforcement mechanisms will be adopted? (*See id.* at §38580.)
- ◆ What methodologies will be developed to quantify voluntary GHG emission reductions? (*See id.* at § 38571.)
- ◆ How will CARB implement the auto emission caps that AB 32 requires it to develop if AB 1493 is enjoined?<sup>5</sup> (*See id.* at § 38590.)
- ◆ What will be the role of carbon sequestration projects in CARB’s scoping plan? (*See id.* at §38561(f).)
- ◆ What measures will be taken to minimize leakage? (*See id.* at § 38562(b)(8).) “Leakage” is defined as in-state reductions in GHG emissions that are “offset” or undermined by increases in GHG emissions outside of the state. (*See id.* at § 38505(j).) Will those measures avoid potential judicial challenges based on the Commerce Clause?
- ◆ What role will other agencies have? Several agencies, such as the CEC and the Public Utilities Commission are already involved in California’s climate change initiative pursuant to Executive Order S-3-05.

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<sup>5</sup>AB 1493 placed caps on GHG emissions from cars and has been followed by ten other states; it is being challenged in court. *See Central Valley Chrysler-Jeep, et al. v. Catherine E. Witherspoon, et al.*, CV F 04-6663 AWI LJO (E.D. Cal.). Two days before AB 32 was signed into law, the court issued an order denying the State’s motion for judgment on the pleadings. The court’s opinion suggests that AB 1493 may be invalidated on preemption grounds.

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- ◆ What will CARB borrow from the other climate change regulatory regimes? AB 32 obligates it to consult with other states, the federal government, and other nations when developing its regime. (*See id.* at § 38564.)

Clearly, there is much to be done.

### Preparing for California's New Climate Change Regulatory Regime

There are two major things that companies can do to prepare for California's new climate change regulatory regime.

**First**, companies should consider documenting their voluntary reductions in GHG emissions, as CARB is required to give "credit for early voluntary reductions." (*See id.* at § 38562(b)(3).) One way to do that is to register with the California Climate Action Registry **by the end of this year**. Companies that enroll by December 31, 2006 and develop a GHG emission reporting program with the Registry "shall not be required to significantly alter their reporting or verification program" when later complying with the monitoring requirements that CARB establishes. (*See id.* at § 38530(b)(3).) While AB 32's language gives CARB discretion to overrule this waiver, it is likely that those with voluntary GHG emissions reporting programs approved by the Registry will have those programs grandfathered, which could be a significant advantage. One potential advantage is that it may enable a company to establish its baseline GHG emissions in advance of the regulatory regime.<sup>6</sup>

**Second**, companies should consider getting involved in the rulemaking process by which CARB develops the new climate change regulatory regime. That process is now underway.

Engagement in these programs and rulemaking processes as they are developing offers the best chance to preserve and enhance a company's competitive posture. Doing so also offers the best chance to increase the options available for ensuring compliance with a minimum of cost and disruption. For example, under a cap-and-trade program, a company's initial baseline allocation is often the critical factor in determining success. And early engagement in the rulemaking process can be even more important, given the large number of key issues that are to be resolved in that process.

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<sup>6</sup> AB 1803 also provides that the Climate Action Registry, which is not now a branch of the State government, is to "be transitioned" to the Government if AB 32 is passed. (*See* AB 1803 §44.)