

The Global Warming Solutions Act (AB 32): Raising the Temperature of California Business

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Editor's Note: CEI has been reporting on the state's greenhouse gas emissions cap legislation (AB 32) since its initial inception and adoption last year. However, that reporting has been piecemeal. We thought it was a good idea to summarize the law and its ramifications and update our readers on its implementation in one Special Report. We were fortunate enough to obtain the agreement of two veteran environmental lawyers from the Sheppard, Mullin law firm to write the Report for us. After this initial publication the Report will be placed on our website CEIToday.com, and regularly updated as AB 32 implementation progresses.

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California Has Passed Major Climate Change Legislation That Will Impact the Economy and Business in This State.

In recent years, "global warming" has vaulted into the mainstream, becoming arguably the most significant economic and social issue of our time. Declaring that "global warming poses a serious threat to the economic well-being, public health, natural resources, and environment of California," the California legislature passed the Global Warming Solutions Act of 2006 (otherwise known as AB 32), which requires that California reduce its emissions of greenhouse gases to 1990 levels by 2020. This new law changes "business as usual" for virtually all sectors of the California economy. The business community should be aware of the law and its requirements, and should prepare itself for the coming array of new regulations that will impact business decisions ranging from equipment purchases, real estate development practices, oil and gas exploration, marine and port practices, manufacturing processes, product design decisions and countless others.

Though AB 32 defines the emission reduction goal, the law itself is relatively short and does not include enforceable limits on greenhouse gases. Instead, AB 32 grants a broad mandate to the California Air Resources Board (CARB) to create the rules and regulations that will affect emissions from all economic sectors, including construction, transportation, oil and gas, electricity, and agriculture. Indeed, virtually any source of greenhouse gases is covered by the law, so long as CARB determines that the emissions from that source "are at

a level of significance ... that its participation in the program ... will enable the state board to effectively reduce greenhouse gas emissions and monitor compliance with the statewide greenhouse gas emissions limit."

This article provides a detailed description of AB 32 and its requirements, including a discussion of the studies, programs and draft regulations currently under consideration by CARB that will affect California businesses. One of the effects on business may be the creation of a "cap and trade" system whereby greenhouse gas emissions would be traded on the open market, potentially creating a new model for reducing emissions.

California's global warming laws may also impact fuel standards, development and land use policies, and electricity generation - all of which will have a significant impact on how businesses operate.

Because the law in this area is still in development, environmental officers and technicians that work for and with California businesses have an incentive to follow and comment on the draft regulations issued by CARB. Public participation is required by law and CARB regularly hosts forums, discussions and meetings to discuss the proposals and regulations it is considering pursuant to AB 32. CARB's website, at www.arb.ca.gov/cc/cc.htm, is an easy-to-use resource that is regularly updated with information on new proposals, dates for meetings, and requests for on-line comments.

All potentially regulated entities are encouraged to participate in crafting the rules that the California business world will soon have to live by.

AB 32: A General Overview of the Law and a Timeline of Coming Events

AB 32's overarching purpose is simply stated: By the year 2020, statewide emissions of greenhouse gases (carbon dioxide,

methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulfur hexafluoride) must be equivalent to 1990 levels. Businesses will have to begin complying with certain regulations in 2008, more regulations in 2010, and a full gamut of regulations in 2012.

AB 32 establishes dates for specific acts that must CARB must undertake in order to satisfy its mandate of reducing greenhouse gas emissions. [Cal. H&S Code 38505(g)]. The following is a chronological timeline of the required actions:

Date (action must be taken on) or by date specified	Action
June 30, 2007	CARB shall publish and make available a list of "discrete early action measures" to reduce greenhouse gases.
July 1, 2007	CARB shall convene an Environmental Justice Committee and an Economics and Technology Advancement Committee in order to advise CARB on implementing programs to reduce greenhouse gases.
January 1, 2008	CARB shall complete an inventory to determine what California's greenhouse gas emissions were in 1990, which will be used as a baseline for achieving 2020 reductions.
January 1, 2008	CARB shall publish and make available a list of "discrete early action measures" to reduce greenhouse gases.
January 1, 2009	CARB shall approve a "scoping plan" indicating how emissions will be achieved from greenhouse gas emissions sources via regulations, market mechanisms, and other sources.
January 1, 2010	"Discrete early action measures" previously adopted take effect.
January 1, 2011	CARB adopts major regulations and market mechanisms aimed at meeting the 2020 emissions goal.
January 1, 2012	Greenhouse gas rules adopted by CARB take effect and become fully enforceable.
December 31, 2020	Greenhouse gas emissions reduced to 1990 levels.

As can be seen from the above timeline, the full range of greenhouse gas regulations will be in effect by January 1, 2012, with certain limited regulations in place by 2010. Businesses will have to start reporting 2008 emissions by 2009.

Though mandatory climate action regulations are not yet in effect, businesses are encouraged to join the California Climate Action Registry, which is a voluntary registry for greenhouse gas emissions. The Registry assists businesses in establishing greenhouse gas baselines against which future emissions reductions will be measured, and encourages companies to take voluntary steps to reduce emissions.

Businesses are not required to participate, however, by statute California "has a responsibility to use best efforts to ensure that organizations that voluntarily reduce their emissions receive appropriate consideration for emissions reduction made prior to the implementation of any mandatory programs." H&S 42800(b). Because voluntary efforts will be positively considered by the State in rule-making and enforcement, businesses should consider participating in the Registry before the mandatory regulations are effective. More information and details on joining the Registry can be found at www.climateregistry.org.

A Closer Look at the Requirements of AB 32

[CARB has Proposed Several Early Action Measures to Cut Emissions Which Will be Enforced by January 1, 2010](#)

CARB was required to propose early action measures by June 30, 2007 "in furtherance of achieving the statewide greenhouse gas emissions limit." H&S Code 38560.5(c). These "discrete early actions" will be enforceable by January 1, 2010. They are intended to start the process of meeting AB 32's emissions reduction goal in advance of the major regulations in 2012.

CARB has approved nine discrete early action measures, and has estimated each measure's expected emissions reduction benefit (see chart below).

In addition to these nine statutory discrete early action measures which will be enforceable by January 1, 2010, CARB has proposed 35 additional early action measures which, if implemented, will reduce greenhouse gas emissions by more than 42 million metric tons by 2020 (25% of the total needed to meet AB 32's goal of reaching 1990 levels by 2020). A full listing of these proposed measures can be found on CARB's website. These measures affect transportation, oil and gas, agriculture, real

estate land use, electricity and various other segments of the economy. Some of the major proposals are listed below:

- Reducing diesel emissions from off-road equipment, equipment used in ports, and from on-road trucks
- Improving agriculture manure management
- Electrification of stationary agricultural engines
- Changes in fueling of marine tanks
- Improving cement blending and efficiency of cement facilities
- Reduction of sulfur hexafluoride in electricity generation

- Strong enforcement of anti-idling laws for trucks

- Alternative fire suppression

- Reduction of venting and leaking from oil and gas systems

- Cool communities programs (such as requiring light colored-pavement and green roofs in development)

Public hearings regarding the feasibility of these and other early actions will take place over the course of the next few years, and businesses interested in particular measures should be aware of the proposals and submit comments to CARB for consideration at those hearings.

Date Approved	Early Action Measure	CO2 equivalent¹
6/20/07	Establishment of a low-carbon fuel standard	10-20
6/20/07	Reduction of HFC emissions from non-professional (i.e., "do-it-yourself") motor vehicle air conditioning systems	1-2
6/20/07	Improved landfill methane capture	2-4
10/25/07	Banning use of sulfur hexafluoride from non-essential applications if viable alternatives exist	TBD
10/25/07	Establish standards to reduce aerosol emissions, tire inflator emissions, and emissions from electronic cleaners and dust removal products	0.3
10/25/07	Require existing trucks and trailers to be retrofitted to reduce aerodynamic drag	1.3
10/25/07	Require tune-up and oil change mechanics to ensure proper tire inflation as part of regular service	0.2
10/25/07	Reduce emissions of perfluorocarbons in the semiconductor industry	0.5
10/25/07	Require docked ships to shut off auxiliary engines by plugging into electrical outlets onshore	0.5
	Total Estimated Reduction Based on Early Action Items	17.8-28.8 million metric tons

¹Greenhouse gas reductions are often measured with reference to a "CO2 equivalent." CO2 is the most prominent greenhouse gas, so all other greenhouse gases are measured according to its properties. As defined by AB 32 CO2 equivalent means "the amount of carbon dioxide by weight that would produce the same global warming impact as a given weight of another greenhouse gas, based on the best available science, including from the Intergovernmental Panel on Climate Change." H&S Code section 38505(c).

Businesses Will Have to Report all 2008 Greenhouse Gas Emissions Starting in 2009

Pursuant to its AB 32 mandate, CARB recently issued draft final regulations which are scheduled to be adopted on December 6, 2007 (and will be effective January 1, 2008) that will require California businesses across most major economic sectors considered to have high greenhouse gas emissions to account for and report on their greenhouse gas emissions. CARB estimates that the sectors which will be required to report emit 94% of the total greenhouse gases produced in California from industrial and commercial stationary sources.

Businesses in the following sectors will be required to provide detailed reports of their greenhouse gas emissions (carbon dioxide, nitrous oxide and methane) starting in 2009 (which will cover 2008 emissions):

- Cement Manufacturing;
- Electric Power Sector: Electric Generating Facilities, Retail Providers and Power Marketers (in addition to carbon dioxide, nitrous oxide and methane, the electric power industry must also report on hexafluoride and hydrofluorocarbons);
- Cogeneration Facilities;
- Petroleum Refineries, Hydrogen Plants, and Oil & Gas Production; and
- Other Stationary Industrial Sources That Emit More Than 2,500 Metric Tonnes of CO₂. This “catch-all” category is broad and covers many industries. Examples include the following:
 - Natural Gas Transmission;
 - Industrial Gases;
 - Paperboard Manufacture;
 - Colleges and Universities (however, primary and secondary schools are explicitly exempt from the reporting requirements);
 - Glass Container Manufacture;
 - Food Processing;
 - Steel Foundries;

- Mineral Processing; and
- Malt Beverage Production.

Reporting is facility-specific, which means that each individual facility must report its own emissions and a company owning many facilities cannot simply issue one report on all of its operations. The entity with “operational control” of a regulated facility (i.e., the entity with the authority to introduce and implement operating, health & safety and environmental policies) is responsible for providing the yearly emissions report.

Under the draft final regulations, the first emissions reports are due in 2009 (by April or June of that year, depending on the facility) and will cover 2008 emissions. Because 2009 is the first year of reporting, the 2009 reports do not need to be verified. However, starting in 2010 and continuing thereafter, reports will require a verification by a third party essentially serving as an emissions auditor. For most facilities, a full verification (consisting of site visits, sampling, review of data management systems and other requirements) will be required every third year of reporting, with a less-intensive verification submitted in interim years. The verifier must issue an opinion that states that reported emissions are within 95% of the true greenhouse gas emissions, and that all applicable methodologies were followed.

All verifiers must be accredited after a formal application and review process by ARB. The verifier must demonstrate technical and educational competence, must attend ARB-approved training courses, pass an exam, and have no conflicts of interest with any facilities for whom it provides verification services.

The draft final regulations, and an informative report which explains their purpose and effect, can be found at www.arb.ca.gov/regact/2007/ghg2007/isor.pdf.

In Order to Establish a Baseline From Which to Measure the Progress of AB 32, CARB is Preparing an Inventory of 1990 Greenhouse Emissions

One of CARB’s most important tasks is the creation of an inventory of 1990 emissions, which will be used as the standard on which to measure 2020 emissions. The inventory must be complete by January 1, 2008.

CARB prepared a first draft of the 1990 emissions inventory in August 2007, taking into account all economic sectors, including oil and natural gas drilling and related activities, industrial production, manufacturing, agriculture and forestry, and waste treatment and disposal. Total 1990 emissions were measured at 436.19 million metric tons. In order to achieve 1990 levels, CARB estimates that California will need to cut approximately 174 million metric tons of greenhouse gases by 2020.

By far the largest greenhouse gas emission source in 1990 was energy and fuel combustion activities, including transportation. This sector contributed 394.88 million metric tons of CO₂ equivalent. Because fuel and transportation represent such a large chunk of the emissions pie, significant efforts will be made to reduce emissions from this sector. Indeed, California has already proposed a low-carbon fuel standard and is seeking to implement strict emissions limits for new vehicles (see section VI.A. below).

For an individual business, perhaps more important than the total 1990 greenhouse gas emissions are the emissions allocated to the particular sector in which that business operates. For instance, the first draft inventory determined that, in 1990,

28.187 million tons of emissions were created by petroleum refining. This represents one of the highest numbers allocated to any specific business sector. Therefore, one can perhaps expect CARB to craft regulations aimed specifically at lowering emissions from petroleum refining, which may be more stringent than regulations that CARB might adopt for rice cultivation, for example, which represents a much smaller percentage of total greenhouse gas emissions. This is a good reason for businesses to participate and comment upon

the creation of the 1990 inventory. Based on current assessments, CARB estimates that California will need to cut approximately 174 million metric tons of greenhouse gases by 2020.

By 2009, CARB Will Create a “Scoping Plan” Explaining The Actions it Will Take and Regulations it is Pursuing in Order to Satisfy AB 32’s Emissions Reduction Requirement

By January 1, 2009, CARB must complete a “scoping plan” which will incorporate emission reduction recommendations from various government agencies (including the Public Utilities Commission and Energy Resources Conservation and Development Commission on all matters related to energy, natural gas, electricity and fuel). The scoping plan will provide a road-map for implementation of the 2012 regulations, for the purpose of “achieving the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions” from all sources. H&S Code § 38561(a).

In creating the scoping plan, CARB shall: (1) make recommendations on market-based compliance mechanisms, (2) consider programs implemented by other states, localities and nations, (3) weigh costs with expected benefits to the economy, environment and public health, (4) take into account affects on small businesses and establish a *de minimis* threshold below which regulations will not apply, and (5) identify opportunities for voluntary emissions reductions, such as by carbon sequestration.

It is likely that several drafts of the scoping plan will be circulated prior to its final adoption in 2009. CARB has already requested suggestions from all interested parties (included the regulated community) for developing the scoping plan, and CARB will host public workshops on November 30 and December 14. Businesses should carefully review and participate in the creation of the scoping plan and monitor all proposals that potentially affect their industry.

By 2011, CARB Will Establish Regulations That Will be Enforced Starting in 2012

By January 1, 2011, based on its scoping plan and the recommendations of the various committees created by Executive Order or by AB 32 (the Climate Action Team, Environmental Justice Committee and Economics and Technology Advancement Committee, etc.), CARB shall adopt greenhouse gas emissions regulations to become operative beginning on January 1, 2012. H&S Code § 38562(a). Any regulation shall ensure “that the greenhouse gas emission reductions achieved are real, permanent, quantifiable, verifiable, and enforced by the state board.” H&S Code § 38562(d)(1).

CARB must consider many factors in crafting the final regulations, including, but not limited to: (1) technological feasibility, (2) encouraging voluntary action and ensuring equity, (3) ensuring that regulations to not disproportionately impact low-income communities, and (3) consideration of cost-effectiveness and overall societal benefit. H&S Code § 38562(b)(1)-(9).

Emissions Reductions After 2020

AB 32 only explicitly covers emissions through 2020, but CARB is required to continue to make recommendations to reduce emissions after 2020. In 2005, Governor Schwarzenegger signed an Executive Order requiring that the state find ways to not only reduce greenhouse gas emissions to 1990 levels by 2020 (as stated in AB 32), but also to reduce greenhouse gas emissions to 80% below 1990 emissions in 2050. Many of the rules and regulations currently under consideration by CARB will have the effect of meeting the 2050 goals set by the Executive Order, as well as the 2020 goals set by AB 32.

AB 32 May Lead to the Creation of a "Cap and Trade" Program Whereby Greenhouse Gas Emissions Are Traded on an Open Market.

Overview of What a Cap and Trade System Would Look Like

The Governor and most private industry prefers the establishment of a market based system of emissions trading in order to reduce greenhouse gas emissions. In fact, CARB is required to consider “marketbased compliance mechanisms” in order to comply with the emissions reduction goal. H&S Code § 38570. So far, development of these “market-based mechanisms” has largely focused on creating a cap and trade program, whereby the government would set a cap on total emissions for a particular sector of the economy, but allow companies some flexibility in meeting the cap.

Roughly, the program is expected to work as follows: a company would receive an emissions allowance cap. A company could comply with its emissions cap by (1) reducing emissions to the level of its cap, (2) reducing emissions to below its cap, and then selling its excess allowances to other entities, or (3) buying allowances from other entities rather than reducing its own emissions. A well-organized cap and trade system in which caps are closely monitored and enforced could actually reward companies who reduce emissions and create innovation in emissions reduction technology.²

In June 2007, the Market Advisory Committee (created by AB 32) issued its lengthy recommendations to CARB for designing a cap and trade system for California. The key recommendations are as follows:

- Incorporate all major greenhouse gas emitting sectors of the economy into the cap-and-trade program.

²Even if a cap and trade system is adopted in California, such a system will not replace regulations mandating emissions reductions. Instead, any market-based plan would operate in conjunction with a more traditional regulatory compliance program. H&S Code section 38570.

- Take a first-seller approach to capping electricity emissions. California imports a great amount of its electricity, which is generated from coal. Under a first-seller approach, the entity that first sells the electricity in California would be responsible for compliance. Within California, the first seller would be the owner or operator of a power plant. For imported electricity, the first seller would usually be a municipal utility or wholesale power marketer.

- Use a combined approach of free allocation and auctioning of allowances. Initially, most of the allowances should be allocated, but over time allowances should primarily be auctioned off.

- Allow offsets within and outside California's borders. Emissions reductions from sources not included in a cap and trade program can be used to assist in meeting the 2020 emissions requirements, to reduce costs, and to increase flexibility.

- Link opportunities for California's cap and trade system with similar initiatives in other jurisdictions. This will actively promote a greenhouse gas trading market inside and outside of California.

Regarding "offsets" and "linking" with other states/countries on a cap and trade system, California is already making significant moves in this direction with the Western Climate Initiative and its agreement with the United Kingdom on climate change:

California is Partnering With Nearby States and Provinces to Potentially Create a Market System

California has signed on to the "Western Climate Initiative," which also includes the states of Arizona, New Mexico, Oregon, Washington and Utah, along with the Canadian provinces of British Columbia and Manitoba. The stated goal is to reduce emissions in the aggregate to 15% below 2005 levels by 2020. The goals of this Initiative appear to be twofold: (1) creating a regional cap and trade program, and (2) preventing "leakage," whereby companies would leave California to operate in a nearby state without greenhouse gas restrictions.

California Has Signed an Agreement with the UK To Create Carbon Trading Programs

In 2006, Governor Schwarzenegger signed a statement of intent with then-British prime minister Tony Blair that is intended to open the way for a transatlantic carbon trading agreement. Though there is currently no binding law or regulation in place in this regard, California's agreement to participate in a global cap and trade system may eventually prove significant for businesses in this state, who may have access to a global carbon market.

Land-Use and Development Are Impacted by Global Warming Regulation and Litigation

Real estate development and land use issues have dominated the global warming debate in California. It is easy to understand why – real estate development is a major greenhouse gas emissions contributor, but it is also a huge economic engine, representing significant revenue for cities and counties in California. Recently, the state has been concerned with promoting "sustainable development" and changing land use decisions to account for the effects of climate change.

Land Use and the California Environmental Quality Act

Environmental groups and the California Attorney General's Office have been filing lawsuits and otherwise contesting developments all over the state pursuant to the California Environmental Quality Act (CEQA). CEQA requires that public agencies prepare an Environmental Impact Report (EIR) to analyze projects that may cause "significant environmental effects," and requires implementation of feasible mitigation measures or alternatives prior to those projects being approved. Pub. Res. Code § 21000, et. seq.

CEQA does not specifically mention greenhouse gas emissions or climate change as a "significant environmental effect" that must be considered in an EIR. However, CEQA is broadly written, requiring consideration of a project's direct

or indirect effects on humans and consideration of cumulative impacts (i.e., taking into account not just the particular project standing alone, but also the project's impact in relation to past, current and future projects). Pub. Res. Code § 21083(b). The Attorney General's Office and several environmental groups have asserted that CEQA's broad language requires consideration of climate change, not just from the project itself, but also from the potential increase in vehicle traffic and emissions from other sources related to the project.

The Attorney General has sent CEQA compliance letters to several counties, most prominently the County of San Bernardino, challenging each counties' master development plan for failing to comply with CEQA regarding climate change. The Attorney General recently settled its dispute with the County of San Bernardino in which the County agreed to study various steps to reduce emissions, including creating plans to reduce traffic, creating a greenhouse gas inventory, requiring energy efficient designed buildings, and using solar panels and other alternative energy sources. This settlement may provide a model for future CEQA settlements. The Attorney General also recently settled a dispute with a leading oil company, Conoco-Phillips, in which Conoco agreed to pay \$10 million to offset greenhouse gas emissions caused by its expansion of a major refinery near San Francisco. Conoco agreed to audit its emissions and undertake efforts to reduce future emissions.

CEQA and climate change is a divisive issue in the Legislature, and the outcome is uncertain. Recently, in passing a state budget, California lawmakers passed a minor amendment to CEQA that requires the State Office of Planning and Research to develop and prepare guidelines addressing the analysis and feasible mitigation of greenhouse gas emissions under CEQA, which will go into place in 2010. The amendment also allows a temporary exemption for transportation and flood protection projects until 2010. Based on

the amendment, transportation and flood protection projects cannot be sued under CEQA for failing to adequately take into account climate change. Other than this relatively minor amendment, CEQA law as it relates to climate change remains unresolved.

Land Use Policies and Smart Growth as Affecting Business

In August 2007, the California Energy Commission released its final report entitled *The Role of Land Use in Meeting California's Energy and Climate Change Goals*. The Report focuses on "smart growth development plans" to increase population density in order to reduce vehicle traffic traveling to and from urban centers. The Report recognizes that land use decisions are almost exclusively local, so that the state should take a more active role in developing statewide growth management, providing financial assistance to localities that promote energy-efficiency, and restricting infrastructure financing to localities whose plans do not fit within the state's greenhouse gas emissions reduction goals.

One bill that has been making its way through the legislature (but which was recently put on hold by Assembly Speaker Fabian Nunez pending further study) is Senate Bill 375, which would require local land use decisions to meet regional greenhouse gas reduction goals. This bill, or one

similar to it, may become law soon. Businesses, especially those involved in real estate development, must keep abreast of legislative changes that could effect their business operations.

Climate Change and Fuel Standards and Electricity

California is Seeking to Change Fuel Standards In Order to Reduce Emissions

Given that vehicle emissions are a major source of the greenhouse gas emissions in California, the Governor recently signed Executive Order S-01-07, which sets a goal to reduce the carbon intensity of fuel by 10% by 2020. California is also seeking to enforce strict vehicle emission standards which are expected to cut greenhouse gas emissions from vehicles by 22% in 2012, and 30% in 2016. Implementation has been blocked by a lawsuit filed by the auto industry. California long ago requested a waiver of preemption from the United States Environmental Protection Agency (EPA) in order to enforce its standards, but the EPA has not yet agreed to grant the waiver. Governor Schwarzenegger and Attorney General Jerry Brown have threatened to sue the EPA if the EPA does not grant a waiver.

Reducing Emissions From Electricity Production

Electricity production is a major green-

house gas source. At the same as it passed AB 32, the legislature passed Senate Bill 1368, which imposes a greenhouse gas emission standard on baseload generation of electricity. The law will be implemented and enforced by the California Public Utilities Commission and the California Energy Commission in conjunction with CARB. The law requires that regulations be adopted to establishing an emission performance standard for local electrical utilities which will go into effect in 2012. Businesses involved in electricity generation, import or purchase should be aware of changes to the electricity sector from global warming laws.

Conclusion: AB 32 and Related Climate Change Issue Will Impact the Business Community.

California is in the midst of establishing a new playing field for business in this state. The laws and regulations that have passed or will pass impact all aspects of the economy, from energy to travel and real estate and beyond. In this "climate" of relative uncertainty regarding future regulations and legal developments, it is important for businesses to ready themselves for a new environmental regulatory model.