

Law Matters

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A Current Snapshot of Environmental Regulations in California: Why California's Environmental Activism May Save the World

Why is California uniquely situated to influence global environmental policy? California's fertile history – rich in water resources, agriculture, and gold – shaped the state's reputation for enacting pioneering environmental regulations.

By the mid-1800s the gold rush was on! The discovery of gold in the California hills was accompanied by a less desirable consequence: massive amounts of debris and pollutants released through hydraulic mining. Serious water quality concerns, dangers of flooding, negative impact on agriculture, and hazards to navigation prompted the state to act early to protect its resources. Adding to the severity of the situation, several major droughts and a steady population increase, forced California to focus on water conservation and environmental restoration ahead of other states.

This early environmental activism set the stage for California to take the lead in enacting environmental regulations. In several program areas, California's environmental regulations preceded similar federal laws. In the 1950s, California established the nation's first air quality program. In 1970, the state enacted the Porter-Cologne Act, the basis for the state's water quality program, which served as the model for the federal Clean Water Act. In 1988, the California Clean Air Act was passed. In 1990, the federal Clean Air Act was amended largely to align it more closely with California's version. California also pioneered advances in vehicle emission controls, control of toxic air pollutants, and control of stationary pollution sources before federal efforts were undertaken in those areas. The California Clean Air Act and vehicle emissions standards are also examples of areas where California's state environmental regulations are more stringent than the federal laws.



In other program areas, no comparable federal legislation exists. For example, the California Integrated Waste Management Act established a comprehensive, statewide system of waste handling and disposal practices designed to protect air, water, and land from pollution. California's Proposition 65 (Safe Drinking Water and Toxic Enforcement Act) requires the Governor to publish a list of chemicals that are known carcinogens, and post related warnings.

Today, the result of California's environmental trail blazing is accurately summed up from two perspectives: the Governor's and a Justice's.

On a recent business trip to China, Governor Jerry Brown commented about the state: "We've got more damn laws than you can think of." One of the reasons there are so many "damn laws" in California can be partially explained by Justice Brandeis's "state as a laboratory" theory. As the Justice eloquently stated, "[i]t is one of the happy incidents of the federal system that a single courageous state may, if its citizens so choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."¹

In the environmental arena, California has served as just such a laboratory. More recently the state has been experimenting with landmark approaches to combating green house gases; a rapidly worsening problem that the federal government was not sufficiently addressing.



Federal inaction on controlling the impact of greenhouses gases can be traced back over a decade when in 1997 the United States Senate rejected the Kyoto Protocol, which required developing countries to substantially reduce future greenhouse gas emissions. Ten years later it appeared some inroads were being made when in a 2007 Supreme Court decision,² the state of Massachusetts and several other states and cities won their case against the federal Environmental Protection Agency (EPA) for not controlling U.S. carbon emissions under the Clean Air Act. The Court required the EPA to make an impact determination regarding carbon dioxide on the United States. In 2009, the EPA complied and determined that CO₂ was a harmful pollutant and should be controlled to protect public health and the environment. However, this determination has been largely toothless given that

the EPA has not yet developed specific guidelines for controlling future U.S. carbon emissions. In 2009, similar progress was made by the House of Representatives when it passed the American Clean Energy And Security Act (HR 2454). The Act would have reduced U.S. carbon emissions by 17% in 2020 and 83% in 2050, and would have created the first ever U.S. cap-and-trade program. For a variety of reasons, among which many speculate was the pending 2010 election, the Senate did not and has not since addressed HR 2454.

Despite this federal inaction, pollution and climate change caused by green house gas emissions is not going away. It is a particularly pronounced problem in California where approximately 447 million metric tons of carbon dioxide are released every year.³

California responded to this challenge by passing the Global Warming Solutions Act of 2006, commonly referred to as AB32, which established the goal of reducing greenhouse gas (GHG) emissions statewide to 1990 levels by 2020 and, by 2050, to 80% below 1990 levels.

To help achieve this goal, California is conducting what is essentially the first domestic experiment in using markets to regulate emissions. The California Air Resources Board (CARB) adopted regulations to establish a new "cap-and-trade" program that places a "cap" on the aggregate GHG emissions from entities responsible for roughly 80 percent of the state's GHG emissions. The CARB will issue carbon allowances that these entities will, in turn, be able to "trade" (buy and sell) on the open market.

The program is designed to occur in two phases. From 2013-15 it covers electric utilities and large industrial facilities. From 2015-20 it expands to cover distributors of transportation, natural gas and other fuels. Practically speaking, about 350 businesses (600 facilities) are currently covered.

The program is essentially made up of three essential components, including: the cap, allowances, and trade. (1) The cap is the required statewide limit on greenhouse gas emissions that is established by CARB according to carefully compiled emissions data. The limit declines about 2-3% a year to ensure the statewide level of emissions is progressively reduced over time. By 2020 the cap is projected to decline to 15% below 2012 levels (also referred to as 1990 levels). (2) An allowance permits the holder to legally emit one ton of carbon. Every regulated facility is required to report allowances proportionate to their emissions during designated periods throughout the year. The

total number of allowances in any year precisely equals the statewide cap for that year. The number of allowances declines proportionately to the cap. As allowances are less available, their value theoretically should increase thereby creating an incentive in the market for companies to reduce their emissions in the most cost-effective manner. (3) The trade is how allowances are distributed. Initially allowances are distributed free of cost to give companies a grace period to adjust. The program then is managed through auctions, the first of which took place in November of 2012.

Although California's experiment with cap-and-trade is in its fledgling stages, there are concerns about its long-term viability. These potential challenges fall into three categories: (1) volatile and uncertain markets may result in zero incentive to go green; (2) the program is bad for business in that it creates a perceived competitive disadvantage; and (3) detractors suggest the program may be unconstitutional.

With respect to markets, Europe provides a good example.⁴ In 2005, the EU launched an Emission Trading Scheme that applied to large factories and power plants in 31 countries. The goal was to create a global model for raising the costs of emitting greenhouse gases and for prodding industrial polluters to switch from burning fossil fuels to using clean-energy alternatives like wind and solar. However, this system has been plagued by three major problems:

(A) Volatility: the market has experienced several crashes. The most recent price plunge was due in large part to a huge oversupply of permits (estimated at 800 tons worth) created by Europe's economic slowdown which sharply limited industrial activity and reduced overall carbon emission. (B) Uncertainty: the market has gone through sustained periods when prices have fluctuated from \$40 to nearly zero for the right to emit one ton of carbon dioxide. (C) Abuse: as in California, the European system was designed to initially give companies large numbers of free permits. The result was these companies then raised prices, purportedly to cover cost of complying, which resulted in windfall profits at the consumer's expense. The bottom line is that due to these challenges the market is not creating the desired outcome of incentivizing polluters to reduce their carbon emissions.



Given California's still shaky economy and a declining investment in manufacturing, cap-and-trade has to overcome the perception that it is bad for business. There is a growing perception that the regulation imposes a competitive disadvantage on industries that are subject to it; a disadvantage which several commentators are concerned may result in "economic leakage," or the decision by firms to relocate outside of California to avoid the added costs. It is worth watching, and remains to be seen, what if any role insurance will play in covering real and perceived increased costs of industry compliance with the regulation.

Legal challenges may also impede any future success of cap-and-trade in California. For example, although the November 2012 allowance auction went forward despite a lawsuit filed by the California Chamber of Commerce contending the sale of permits constituted an illegal tax, this argument may gain traction in the courts. A district court found that another regulation under AB32, also designed to reduce emissions, called the Low Carbon Fuel Standard (LCFS) was unconstitutional in violation of the dormant commerce clause because it unduly burdened interstate commerce.⁵ This decision is currently on appeal in the Ninth Circuit and may set a precedent that would strengthen the voice of the regulation's opponents who argued it's an impermissible illegal tax.

In sum, while cutting California's carbon emissions alone might not make a huge impact on climate change given that the state is responsible for only 1% of global emissions, it is an experiment worth conducting and watching. The success or failure in California's laboratory may well determine whether and how national action on global warming plays out.

CITATIONS

1. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1931)
2. Massachusetts v. EPA, 549 U.S. 497 (2007), decided 5-4 in which 12 states and several cities brought suit against EPA to force the agency to regulate CO2 and other greenhouse gases as pollutants.
3. <http://www.arb.ca.gov/cc/inventory/data/graph/graph.htm>
4. <http://www.nytimes.com/2013/04/22/business/energy-environment/europes-carbon-market-is-sputtering-as-prices-dive.html>
5. Rocky Mountain Farmers Union v. Goldstene, 843 F. Supp. 2d 1071 (E.D. Cal. 2011).