

I N S I D E T H E M I N D S

The Legal Impact of Climate Change

*Leading Lawyers on Navigating New Laws,
Avoiding Liability, and Anticipating
Future Challenges for Clients*

2010 EDITION



ASPATORE

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Tailpipes and Smokestacks:
The Impact of
Climate Change Policies on
Mobile and Stationary Sources
of Greenhouse Gases

Jackie Glassman and Patrick Traylor

Partners

Hogan & Hartson LLP



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Recent Developments in Environmental Law and Climate Change

Key Climate Change Litigation

The most important recent case law development relating to climate change was the Supreme Court's 2007 decision in *Massachusetts v. EPA*, 549 U.S. 497 (2007). While that opinion was rendered in 2007, the implementation of the decision began in earnest in the last twelve months, and its full impact on the legal landscape is now being realized. That case involved a challenge to a decision by the Environmental Protection Agency (EPA) not to regulate motor vehicle greenhouse gas (GHG) emissions, in part based on the fact that the Department of Transportation (DOT) had a preexisting program regulating fuel economy. The Supreme Court held that carbon dioxide is an air pollutant under the Clean Air Act (CAA) and that the EPA is required to regulate if it finds that CO₂ emissions endanger public health and welfare. The Supreme Court also directed that the EPA and the DOT should be able to coordinate their respective programs.

With the California Air Resources Board also poised to regulate motor vehicle GHG emissions, the Supreme Court decision created the possibility of three separate programs all regulating virtually the same emissions from the same products. The full impact of *Massachusetts v. EPA* came to fruition in May 2009 when the Obama Administration used the decision as the foundation of a unified national program to create harmonized federal standards regulating GHG emissions under the CAA and fuel economy through the DOT program. The EPA has proceeded to grant California a waiver under the CAA to regulate in this area, and California agreed for an interim period of years to forestall enforcement of its program in favor of a federal program administered by the EPA. The EPA also has proceeded toward making a final finding of endangerment relating to GHG emissions that will affect not only motor vehicles, but also all major sources of GHG emissions.

Although the *Massachusetts v. EPA* decision was not issued this year, the way the Obama Administration used the Supreme Court decision during the past twelve months to fashion a regulatory structure applicable to tailpipe GHG emissions will affect a broad swath of industries. The endangerment finding underpinning the proposed GHG tailpipe standards currently under

consideration will apply equally to other sources of GHG emissions, including many stationary sources. Many of the issues requiring consideration in the mobile source rule-making are harbingers of similar issues in other contexts, including (i) how to harmonize regulatory programs that have traditionally been placed in separate government bodies; (ii) questions surrounding the traditional roles of the federal, state, and local governments; (iii) whether to include upstream emissions when calculating GHG emissions under particular programs; and (iv) the reliance on disparate government programs and distinct industries to work collectively to achieve public policy goals. These fundamental issues, while discussed theoretically for years, have taken center stage during the past twelve months, and are being tangibly implemented because of the Supreme Court's decision in *Massachusetts v. EPA*.

Also of great significance is the Second Circuit's September 2009 decision in *Connecticut v. Am. Elec. Power*, 582 F.3d 309 (2d Cir. 2009). The Second Circuit found that public nuisance claims can be brought against private emitters of GHG. Allowing a private right of action under federal common law potentially opens the door to considerable additional liability and raises the specter of legal liability for both past conduct and for forcing emissions reductions beyond future regulatory requirements. A contrary significant decision was released just a few days later in *Native Village of Kivalina v. ExxonMobil Corp.*, 2009 WL 3326113, No. C-08-1138-SBA (N.D. Cal. Sep. 30, 2009), in which the Northern District of California dismissed a public nuisance suit based on the political question doctrine. Ongoing litigation in this area will substantially affect climate change liability into the future. It could also substantially effect future climate change legislation by making preemption of such liability a significant issue to be negotiated while such legislation is constructed.

Industries Affected by Recent Climate Change Issues

Since the EPA and the DOT are moving forward with regulation directly controlling GHG emissions from motor vehicles, one of the most immediate impacts of recent climate change litigation issues is felt in the automobile industry. Climate change demands, substantial shifts in the marketplace, and government ownership of two major automakers has also led to a renewal of interest in advanced powertrain

technologies—such as battery-electric and fuel cell vehicles—that can provide significant advancement toward low- and zero-emissions mobility. As a result, utilities and the government agencies that regulate them have an increasing role in the development of a new transportation infrastructure. Home construction, and permitting agencies, for example, may need to consider plug-in vehicles. The potential to recapture energy for later use will provide new opportunities for companies and government agencies to rethink how they permit, price, and regulate. Even traditional services, such as roadside assistance, need to rethink how they will operate in an environment with new and more advanced technologies. Traditional government and industry alignments will be steadily challenged, new alignments formed, and new consumer services and market demands will arise as the public adapts to a new infrastructure.

In addition to the automobile sector, fossil-fuel-fired utility companies, energy-intensive manufacturing companies, and the agriculture/silviculture sector have been deeply involved in the climate change debate. Companies that emit large quantities of GHGs directly (like utility companies) are involved because of the high potential cost of GHG regulations in a business-as-usual context. For example, for a firm with a utility boiler that emits 1 million metric tons per year of CO₂, an allowance price of just \$20 will create unsustainable costs, especially where the marginal compliance cost of CO₂ capture technologies is estimated to be in the \$70 per metric ton level. That is, unless the cost to purchase a CO₂ allowance is higher than the cost to install emission controls, a rational firm will simply purchase CO₂ allowances—in this case, upwards of \$20 million per year. Energy-intensive manufacturing companies will be exposed to increased costs from both their direct emissions of GHGs as well as their use of electricity, which will become more expensive as the result of upstream regulation at the local electric utility. Agriculture and silvicultural interests are engaged in this issue as well, both because they will experience high fuel and raw materials costs (particularly the cost of N₂O-based fertilizers), and because changes in this industry sector (e.g., no-till farming, afforestation) have the potential to generate significant profits in the developing carbon offsets market. Indeed, H.R. 2454, 111th Cong. (2009–2010) (Waxman-Markey) has specific provisions that would allow the Department of Agriculture to regulate these agricultural offsets.

The Nature of Client Liability in Climate Change and Environmental Law

One of the most significant risks multinational corporations face in the climate change area is the fact that government enforcement agencies are becoming increasingly adept at communicating with each other over concerns and/or problems, and in coordinating enforcement. With an increasing emphasis on corporate responsibility and regulatory enforcement, it is largely expected that corporate standards will be applied equally around the world, and that actions necessary to protect public health, welfare, or safety in one country are applicable in other countries as well. The rising tide of global communication between government agencies gives rise to a substantial need for more global corporate practices, policies, and actions.

An emerging trend—one that has not been dispositively managed by the Securities and Exchange Commission—is the threat of shareholder action over corporate policies that will impact profitability in a carbon-constrained economy. For example, companies that are not now focused on reducing potential financial exposure from carbon regulation policies may find that shareholders accuse management of impropriety with respect to long-term planning. So far, the Securities and Exchange Commission has been slow to implement clear guidance on the disclosure of climate-related risks, but shareholders are more likely now than ever to agitate in favor of corporate policies that take this risk into account.

New Climate Change Laws and Interpretations

Significant change is taking place these days regarding the regulation of GHGs. While starting with mobile sources, the legal construct being developed will soon also be applied to stationary sources such as utility boilers and cement manufacturing. States are taking on a substantially larger role in defining and enforcing climate change policy. This includes the state environmental agencies as well as state public utility commissions.

Another aspect of climate change affecting transportation law is the need to replace the highway funding system. For decades, the federal highway and transportation system has been based on fuel sales taxes. With public policies promoting plug-in hybrid, full electric, and fuel cell vehicles—and

with the high price of gasoline discouraging driving—a new funding construct is needed. User fees and private roadways have proven controversial, and to some extent are considered antithetical to traditional notions of infrastructure as a freely available public right. One of the serious impacts of climate change is the need to develop a new legal construct surrounding basic services, such as transportation infrastructure and the provision of electricity and energy.

As a consequence of the mobile source regulation of GHGs, the EPA has recently interpreted the CAA so as to require the assessment of GHG emissions at major stationary sources. The great difficulty is that the major source threshold for stationary sources ranges between 100 and 250 tons per year. To avoid regulating relatively small GHG sources under the Title V and “prevention of significant deterioration” (PSD) programs, the EPA has proposed redefining the major source threshold for GHGs as 25,000 tons per year. There is not great confidence that this interpretation of the statutory 100/250 tons per year definitions will withstand judicial review, however, and if the so-called PSD Tailoring Rule is vacated, the presumption will be that 100/250 tons per year GHG sources will become subject to regulation, at a tremendous cost to the economy and a great burden to air pollution control agencies.

Indeed, one of the most serious legal issues going forward is that of the applicability of the CAA to relatively small sources of GHG emissions. Environmental lawyers are even now beginning to devise strategies to minimize the risk of onerous regulation, as well as developing strategies to challenge and/or overturn EPA efforts to regulate GHGs through the CAA.

Once the EPA’s Tailpipe Rule becomes effective, there will be a dramatic reallocation of resources necessary to cover PSD and Title V permitting for newly covered sources. These newly regulated sources are generally minor sources for criteria pollutants, and will likely not be particularly sophisticated in terms of air quality permitting. Both the regulated community and the federal and state air permitting agencies will face significant resource-related challenges in actually implementing GHG regulation under the CAA. The EPA, for example, has estimated that some 14,000 individual stationary sources may need permits under the CAA new source review program.

Climate Change Science and Environmental Law

New Scientific Features of Climate Change and Environmental Law

An increasingly prevalent feature of climate change law is a focus on the rate of change and whether laws and regulations should be designed to prevent further change or to reverse impacts that have already occurred. The goals of laws and regulations on climate change affect how costs and benefits of new requirements will be assessed when regulations are made. These approaches may also lead to different approaches by enforcement agencies in deciding when and how to enforce existing environmental laws. A significant scientific feature to both policy development and enforcement is the availability of more advanced technologies. Not only will new programs be premised on the most advanced technology reasonably available, but also compliance agencies may view a failure to invest in and deploy reasonably available technology as evidence of a failure to make reasonable efforts should compliance fall short. Such an approach could raise the stakes when negotiating consent decrees and/or civil penalties.

In a negative sense, the public perception that climate change is an imminent threat appears to be receding, largely in the United States, because of a decade-long cooling trend. Compounding this public perception shift is the recent release of awkward communications between climate change scientists. Combined with reluctance to support large government programs, the failure of science to dispositively dispel contrary science by climate change skeptics contributes to a loss of momentum in climate change strategy.

The Science of Climate Change and Its Impact on Compliance Requirements

Various scientific analyses of climate change impacts have been giving rise not only to new regulatory requirements, but also to allegations that a company or industry that has not acted in accordance with current expectations regarding climate change may have contributed to the development of a public nuisance, and is liable to compensate the citizens of a state for its contribution. As climate change science develops, expectations with regard to reasonable efforts to comply may change and become more aggressive.

An additional area of significance is the focus on environmental assessments on project financing and grant/loan applications. While always

included in such analyses, the focus on climate change has led to an increasing emphasis on ensuring not just environmental protection, but also environmental benefits and advancement. Clients seeking government support for their projects place a growing emphasis on the ability to evidence significant technological and environmental advances across their corporate enterprise.

The Supreme Court's decision in *Massachusetts v. EPA* dramatically lowered the bar for the use of climate change science by states to enforce environmental laws. For non-state plaintiffs, the highly diffuse relationship between a particular source of GHG emissions and the global impact of cumulative GHG emissions on the climate makes it very difficult to establish standing to sue or a causal link between emissions and harm. Courts in the United States have split on these standing issues, and the matter will inevitably need to be resolved by the Supreme Court.

Using New Technology to Respond to the Legal Requirements of Climate Change Compliance

Technologies are rapidly developing around climate change concerns. Clients may choose to broadly deploy readily available technologies to meet legal requirements, or invest in a smaller deployment of very advanced technology. In the motor vehicle industry, for example, an automaker may choose to comply with new GHG requirements through the deployment of substantial amounts of implemental improvements in internal combustion engines and hybrids, or may alternatively invest in a smaller volume deployment of more advanced, zero-emission vehicles such as fuel cell or electric cars. Another type of technology that is being developed to help respond to climate change legal requirements is tracking technology that allows corporations to track the type of energy being generated (nuclear, coal, wind, etc.) and to be able to distinguish and claim benefits for lower life-cycle emissions.

In the utility sector, carbon capture and sequestration technology is receiving extraordinary attention as a possible method by which the combustion of fossil fuels can continue without adversely affecting the climate. But the costs of these technologies remain prohibitive, and without significant government funding for the deployment of these technologies in the near term, the risk is that they will not be proven quickly at the commercial scale.

Scientific Knowledge Needed by Environmental Lawyers

In general, lawyers do not need to become experts on the science of climate change in order to advise their clients on regulatory developments or responses to regulations. However, there is a subset of lawyers who are actively engaged in challenging EPA rule-makings on climate change that may develop a more specialized scientific base of knowledge.

Moreover, climate science is so multi-disciplinary that a single expert is often inadequate to explain climate change science. The International Panel on Climate Change recognizes this when it relies on a large number of scientists in multiple fields of study to inform its observations and recommendations.

The Changing Role of Enforcement Agencies and Stakeholders

Primary Issues and Responsibilities for Environmental Enforcement Agencies

As traditional regulatory programs increasingly focus on climate change concerns, agencies must adapt enforcement to meet new regulatory demands or structures. The application of the EPA's traditional tailpipe emissions programs focusing on individual vehicles to a program focused on fleet-wide compliance created the need for an enforcement procedure consistent with past practices, but that recognized a new compliance structure. The EPA proposed a program to grant conditional certifications based on preliminary reports, with final compliance to be determined later. Similarly, new constructs surrounding the in-use program were necessary, as well as different approaches to ensuring adequate compliance margins and accounting for testing variability.

The sharing of responsibilities among regulatory agencies is an evolving process. Each agency must promote the goals established for it by its statute. The DOT, for example, has a statutory responsibility to advance fuel economy and protect safety, while the EPA has a statutory responsibility to protect public health and welfare. Both will address their responsibilities through regulating the emission of GHGs from motor vehicles. The legal authorities and constraints imposed on these agencies differ, and the agencies have struggled to design harmonious programs that allow the regulated industry to have one compliance path toward meeting both sets of regulatory requirements. Effectiveness has traditionally been measured by each agency

only with regard to the benefits claimed from its particular regulatory structure. However, in a shared regulatory environment, the agencies should measure effectiveness not only with regard to promoting the particular benefits associated with its statutory program, but also the benefits associated with helping to advance the public policy goals of sibling agencies.

The legal impact to clients from a change in agency focus is directly related to the extent to which agencies are able to align this change with other regulatory requirements so that a regulated industry can pursue one compliance path. Inconsistent incentives and obligations create additional, sometimes unnecessary, costs and detract from synergies that may be available from more aggressive deployment of technology servicing one program but not the other.

Stakeholders Shaping Climate Change Enforcement Efforts

The media has a substantial impact on climate change legal issues because it helps to frame the way the public views how a company responds to its civic responsibilities. Media surrounding compliance with environmental and safety requirements has a profound impact on how enforcement agencies proceed and how companies respond. An enforcement agency may use access to media to bring public attention to an environmental or safety problem and to place the company in a more defensive posture. Increasingly, relying on legal defenses and the legal process alone is inadequate to respond to significant enforcement concerns.

Best Practices for Defensive Strategies

Components of a Defensive Strategy for Environmental Clients

In the past couple of months, clients have begun to need to respond to GHG-related issues in state and federal environmental reviews under statutes such as the California Environmental Quality Act and the National Environmental Policy Act. These statutes require an analysis of the GHG-related impacts from agency actions, and may require expensive GHG avoidance, minimization, and mitigation techniques like source-level GHG reductions, and the purchase of GHG offsets to reduce the significance of a proposed project's GHG footprint. The costs of such effort vary depending on the unavoidable GHG footprint of the facility, and the market for GHG offsets.

Related Resources:

- Federal Register, EPA Endangerment Finding:
<http://edocket.access.gpo.gov/2009/pdf/E9-29537.pdf>

***Jackie Glassman** is a partner with Hogan & Hartson LLP. He is a former acting administrator and chief counsel of the National Highway Traffic Safety Administration, the agency within the Department of Transportation responsible for fuel economy regulation. Since joining Hogan & Hartson in 2006, Mr. Glassman's practice has focused on mobile source climate change and safety regulatory policy and compliance.*

***Patrick Traylor** is a partner with Hogan & Hartson LLP. His practice area is environmental law, with a particular focus on energy infrastructure, Clean Air Act compliance, litigation, and climate change. Mr. Traylor is a regular lecturer and teacher with regard to climate change and the nexus between energy infrastructure and environmental law.*



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