January 30, 2013

Court Rejects Challenge to California's Cap-and-Trade Carbon Offset Program

By William Sloan, Peter Hsiao, Michael Steel, and Sue Landsittel

On January 25, 2013, a California state court rejected a challenge to an important component of California's cap-and-trade scheme, its emission offset program. In the first legal decision regarding the program since its compliance obligations began on January 1, 2013, the San Francisco Superior Court in *Citizens Climate Lobby v. California Air Resources Board* denied a challenge to the offset standards designed by the California Air Resources Board (CARB). Two citizens groups, Citizens Climate Lobby (CCL) and Our Children's Earth Foundation, brought the action against CARB.

Under CARB's cap-and-trade program, developed pursuant to the California Global Warming Solutions Act of 2006 (AB 32),[1] certain projects that reduce greenhouse gas (GHG) emissions can apply to receive offset credits for each ton of GHG reduction. These credits can then be sold to regulated entities, who must acquire allowances or offsets for each ton of GHG emitted, and can satisfy up to eight percent of their compliance obligations through offsets. The legislature authorized CARB to credit emission reductions that were "in addition to . . . any greenhouse gas emission reduction that would otherwise occur" under a business-as-usual scenario. Cal. Health & Safety Code § 38562(d)(2). At issue in the *Citizens Climate Lobby* lawsuit was the method developed by CARB to determine whether a GHG offset project meets this "additionality" requirement.

Specifically, CARB has already adopted "offset protocols" for four different types of offset projects (Livestock, Ozone Depleting Substances, Urban Forests, and U.S. Forests). Over time, and as demand for offsets increases, CARB is likely to adopt additional protocols. An offset project must comply with one of these protocols in order to receive offset credits from CARB. Each of these protocols includes standards for determining whether a proposed project meets the additionality requirement, such that any GHG emissions reductions it generates would not have happened in the absence of the financial incentive provided by the offset crediting scheme. As the Superior Court noted, for example, in order to satisfy the U.S. Forest Protocol's additionality requirement, a reforestation project must take place on land that has had less than ten percent tree cover for at least ten years (the "10-10 standard"). A city's urban forestry program satisfies the Urban Forest Protocol's additionality requirement if annual net tree gain for the city is greater than zero. And under the Livestock Protocol, the installation of an anaerobic digester to capture and destroy methane from manure satisfies the additionality requirement.

CCL's lawsuit claimed that AB 32 did not authorize CARB to determine additionality based on the use of general project standards, which might sometimes result in the issuance of offset credits to projects that were not actually

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[1] See our prior alert "California Adopts Historic Cap-and-Trade Program for Greenhouse Gas Emissions."

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additional. CCL pointed to several examples of projects, such as the installation of anaerobic digesters, that it claimed met CARB's additionality standards even though they would have occurred anyway in the absence of an offset crediting scheme. CCL argued that rather than relying on general standards, CARB was required to undertake a project-by-project determination to ensure that each and every offset project is actually additional.

The Court rejected CCL's claim. It held that under the broad contours of AB 32 and its directive to minimize administrative burden, CARB had the authority to use a standards-based approach to determine which emissions reductions were additional. The Court held that the standards CARB adopted in its offset protocols were a defensible and reasonable means of achieving this goal. The Court generally deferred to CARB's expertise in measuring emissions. It also noted that the use of more detailed project profitability analyses under the Kyoto Protocol's Clean Development Mechanism were shown to be highly subjective and manipulable, and that CARB had relied upon data showing that each project type it identified was rarely pursued without economic incentives.

CARB's offset scheme has substantial support, as indicated by the intervention by parties ranging from the Environmental Defense Fund to regulated entities such as PG&E and Southern California Edison as respondents in the lawsuit. However, the cap-and-trade program still faces other legal hurdles, including a pending lawsuit by the California Chamber of Commerce challenging CARB's mechanism of initially distributing allowances into the market by a revenue-raising auction rather than free of charge.[2] So far, these legal challenges have not prevented CARB from continuing with its program implementation, including the scheduling of its next auctions for February, May, August, and November 2013. For now, the cap-and-trade program as designed by CARB forges ahead.

Morrison & Foerster and its Environment and Energy Group have more than four decades of experience in Clean Air Act and climate change issues, both nationally and in California. Along with our Cleantech Group, we are closely following the implementation of AB 32, including CARB's cap-and-trade program, and can provide additional detailed analysis upon request.

Contact:

Peter Hsiao
(213) 892-5731
phsiao@mofo.com

William Sloan
(415) 268-7209
wsloan@mofo.com

Michael Steel
(415) 268-7350
msteel@mofo.com

[2] See our prior alert, "California Drops the Hammer on First Carbon Auction Despite New Lawsuit."

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