

Climate Change and Sustainability Law Report

February 2009

NEW YORK REGULATES GREENHOUSE GAS EMISSIONS THROUGH NEW CAP-AND-TRADE PROGRAM

New York's CO₂ Allowances Auctioned on December 17, 2008

Background

Motivated in part by the lack of regulation at the federal level, since 2003, New York has been a leader of the Regional Greenhouse Gas Initiative (RGGI). Ten Northeast and Mid-Atlantic states are participating in the RGGI cap-and-trade program in an effort to reduce greenhouse gas emissions. The program currently applies to the power generation sector.

What Is A Cap-And-Trade Program?

The RGGI program is market-based and involves:

- (a) a multi-state CO₂ emissions budget (cap) for the power sector that will be gradually reduced by 10% by 2019. New York's CO₂ base budget is 64.3 million tons;
- (b) allowances to be held by power generators for every ton of CO₂ they emit;
- (c) a market-based auction and trading system so generators can buy, sell and trade CO₂ emissions allowances;
- (d) the use of the auction proceeds to support further development of energy efficiency strategies and renewable power; and
- (e) the use of offsets that can assist generators to meet their allowance requirements.

The power sector accounts for about one-quarter of CO₂ emissions in New York State.

RGGI States:

Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont

What Do New York's Regulations Require?

A regulation to implement the CO₂ budget trading program (6 NYCRR Part 242) issued by the New York State Department of Environmental Conservation (NYSDEC) requires, as of January 1, 2009, that fossil-fueled power plants having 25 or more megawatts of electric output (MW) purchase an allowance for every ton of CO₂ they emit during various control periods. Allowances will be available for purchase at periodic auctions and on the secondary market.

The requirement for the purchase of 100% of all needed allowances was not required under the RGGI Model Rule that participating states drafted to be used as a guide in crafting state-specific regulations. States could have required power generators to purchase a portion of the needed allowances, and allocated the rest to the generators at no cost. But gradually, the RGGI states agreed that the better approach, and a good source of funding for energy efficiency technology and renewable energy development, was to have generators pay for all of the allowances needed.

This is the first edition of Bond, Schoeneck & King's Climate Change and Sustainability Law Report. On a regular basis, this Report will focus on legal developments concerning climate change at the local, state and federal levels; sustainability initiatives undertaken by government and the private sector; and legal strategies to help you attain your own sustainability objectives.

With certain limited exceptions, New York requires electric generators to purchase 100% of the needed allowances. Of the contaminants emitted by power plants, CO₂ is typically emitted at the highest rates; it was previously unregulated, and there is no commercially available control technology to control CO₂ emissions. For example, an efficient 275 MW gas-fired plant may emit as much as one million tons a year of CO₂. Thus, a regulation that requires an allowance to be purchased for every ton of CO₂ emitted represents a significant departure from business as usual for power generators (and also an increased cost).

Who Oversees Allowance Auctions?

CO₂ allowances will be available for purchase through auctions overseen by the New York State Energy Research and Development Authority. Purchasers at the auctions are not limited to power generators, and thus, a secondary market for CO₂ allowances has been created.

The first RGGI auction, offering over 12.5 million CO₂ allowances, occurred on September 25, 2008, but New York's allowances were not offered for sale at that auction. Nonetheless, any allowances purchased at the September auction can be used by a regulated facility for compliance in any RGGI state. The price of an allowance in the September auction was \$3.07. This price was \$1.07 higher than NYSDEC had predicted for 2009 allowances.

New York allowances were available for purchase at the December 17, 2008 auction and sold for \$3.38 each.

Who Pays For Allowance Costs?

Although RGGI can be thought of as embodying a "polluter pays" approach, it might be more accurately characterized as a "consumer pays" regulation. The cost of allowances, like other costs to operate a power facility, such as fuel, will typically be built into the generator's electric prices. Utilities will request increases in their rates to cover RGGI costs. NYSDEC's modeling predicts an increase in electric costs by 2015 for a residential consumer of 78 cents per month; and an increase by 2021 of \$1.13 per month.

Electric price bids to the New York Independent System Operator are typically based on the price of gas. Coal-fired units are disfavored under the RGGI program because they emit significantly more CO₂ than gas-fired units, but will be able to pass on to the power purchaser, and ultimately to the consumer, only a portion of their RGGI costs.

What Types Of Offsets Are Available For RGGI Compliance?

An "offset" is a reduction in greenhouse gas emissions occurring at a source not subject to the RGGI program that may be used by a power plant to comply with Part 242 requirements. Offsets can be used to account for 3.3% of overall emissions, with an increase to 5% or 10%, depending upon the price of an allowance.

New York allows offsets from:

- landfill methane gas recovery
- reduction in emissions of sulfur hexafluoride
- reduction or avoidance of CO₂ emissions from natural gas, oil, or propane end-use combustion due to end-use energy efficiency
- sequestration of carbon due to forest creation
- avoided methane emissions from agricultural manure management operations

What Issues Remain?

A major concern is whether the RGGI rule will sunset when Congress regulates CO₂ emissions, which is expected to occur during the first years of the Obama Administration. The RGGI rule does not contain a "sunset" provision. Federal legislation may or may not preempt New York's RGGI rule. Under the Clean Air Act, states can always choose to impose more stringent regulations than the federal government. New York's energy costs are currently among the highest in the country. At a time of economic crisis, there will be some pain associated with increased costs due to this new regulatory scheme. Dual state and federal regulation may result in even higher energy costs.

Another concern is that Part 242 does not contain a "circuit breaker," that is, a maximum price for allowances. The rule does provide for an increased percentage in the use of offsets when the price of an allowance reaches certain thresholds (\$7 and \$10/ton).

Lastly, no air quality regulation to date has required a permittee to buy at auction 100% of the number of allowances needed to operate. There is significant concern that the uncertainties associated with price volatility for allowances may adversely impact a facility's ability to plan and manage budgets and borrowing in a way that assures proper plant maintenance and reliable electricity production.

INCREASED LITIGATION AND ENFORCEMENT FOR “GREENWASHING”

The desire to promote environmentally-friendly products and services, whether chemicals, housing materials, or consumer products (to name only a few), has led to a dramatic proliferation of “green” marketing claims. While many of these claims are valid and can be legally substantiated, there is increasing – and legitimate – concern that some of these claims may be misleading. Such claims are generally referred to as “greenwashing.”

Section 5 of the Federal Trade Commission (FTC) Act prohibits deceptive acts and practices in or affecting commerce. To address the implementation of Section 5 to environmental advertising and marketing, the FTC issued Guides for the Use of Environmental Marketing Claims, more commonly known as the “Green Guides,” in 1992. The Green Guides are administrative interpretations of laws enforced by the FTC, and they apply to environmental claims in any form of labeling, advertising, or marketing, whether express or implied.

The Green Guides provide guidance, including specific examples, regarding when terms such as “eco-friendly,” “biodegradable,” “ozone friendly,” and “recyclable” may be misleading or deceptive. Due to the increased use of these and similar terms in the marketing of products and services, the FTC is currently reviewing the Green Guides so they are responsive to changes in the marketplace and to consumers’ perception of environmental claims. A revision of the Green Guides is expected in 2009.

What does this mean for manufacturers and service providers? In short, increased administrative enforcement where no reasonable basis exists to substantiate a claim of environmental attributes (i.e., 30% recycled content) or environmental benefits (i.e., “environmentally safe”). In recent years, the FTC has infrequently invoked its enforcement authority to contest allegedly deceptive or unsubstantiated environmental claims, but the revision of the Green Guides signals a change in approach. In addition, where a product or service that is claimed to be “green” does not meet environmental performance expectations, litigation may be the result. Before manufacturers, service providers and their marketing professionals “go public” with their environmental claims, it will be increasingly important to ensure that a documentary record exists to ensure that representations regarding the environmental attributes or benefits can be legally substantiated.

BS&K GOES GREEN THROUGH ABA-SEER LAW OFFICE CLIMATE CHALLENGE PARTICIPATION AND EPA WASTEWISE MEMBERSHIP

BS&K is taking steps in environmental stewardship to promote waste reduction and other energy reduction practices throughout the Firm’s twelve offices.

Recently, BS&K became an active participant in the Law Office Climate Challenge, which is organized through the American Bar Association’s Section of Environment, Energy, and Resources (SEER). The Firm is participating in the Best Paper Practices and WasteWise Components, which designate it as a Law Office Climate Challenge Partner.

WasteWise focuses on three key elements of waste reduction – waste prevention, recycling, and buying or manufacturing recycled content products.

Research by EPA and others has shown that conserving materials through waste prevention and recycling saves energy and reduces pollution, including emissions of greenhouse gases that contribute to global warming. In addition to the numerous environmental benefits waste prevention and recycling offer, waste reduction can improve operational efficiency and reduce waste management and purchasing costs.

UPCOMING HIGHER EDUCATION BRIEFING SERIES WEBINAR

November 2009

Sustainability on Campus – Legal Trends

This program is for college and university senior administrators, general counsel, HR personnel, risk managers and other decision-makers. It will focus on current legal developments affecting sustainability initiatives, including emerging regulation at the State and Federal levels.

Issues covered will include “green” construction (and associated litigation risk), climate change legislation and regulation, factors to consider when trading or purchasing greenhouse gas credits, and sustainable purchasing decisions (including “greenwashing” claims of vendors).

Visit www.bsk.com for more information.

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THE “GREENING” OF CONSTRUCTION LAW

The following is an excerpt of an article that appeared in the October/November 2008 *CNY Business Exchange* and is reprinted with permission.

In some ways, the “Green Revolution” has necessitated a “Green Evolution” for lawyers and their clients.

In the past, when a construction client – whether a developer, building owner or general contractor – sought legal services in connection with a proposed project, the contract documents often focused on the design specifications of the project. These specifications were components of the contract between the parties, and in many instances, whether the specifications were achieved could be known at the completion of construction.

Green construction means that projects are no longer constructed to meet only design specifications. Instead, the consumer, whether the owner of a residential home or a commercial building, has an expectation that the building must behave a certain way, and not merely possess certain physical and operational characteristics. An owner may desire a percentage reduction in energy usage, or may insist that the landscaping be wholly maintained through the use of storm water, or that the building inhabitants will have a workplace free from toxic materials.

Green technologies and construction techniques are constantly evolving, and they present potential legal risks which should be addressed in the parties’ contract documents.

- One obvious risk is the “green” pedigree of the architect or contractors. Do they have experience on similar green construction projects? Relevant experience, demonstrated through a careful check of references, is a primary tool to reduce risk. Experience should also be the basis of representations and warranties in the contract documents.
- Another potential risk is the inherent ambiguity in calling something “green” in the first instance. Some people may interpret “green” to mean that a building will last longer, require less maintenance, or result in a healthier environment for its occupants than a “non-green” building. Simply stated, however, there is no single definition of “green,” and green construction is not subject to a universally recognized standard of care. Where the project has been designed and will be constructed to achieve the Leadership in Energy and Environment Design (LEED) Certification, applicable LEED requirements should be specified in the contract. However, for a variety of reasons, many owners want their building to be environmentally friendly and energy-efficient, but they do not seek to achieve LEED certification. In this case, in the absence of a uniform standard of care, it is important for the parties to agree on their precise expectations and to incorporate them into the contract using objective language.
- It is important to understand that the parties’ interests in a contract negotiation may be very different. The consumer (i.e., owner) will want the architect and owner to provide extensive, performance-based representations and warranties. For example, the owner may have an expectation that the building will result in a 40% reduction in electrical usage, and will want the contract to reflect that reduction. The architect and contractor, on the other hand, will be averse to a numerical performance specification, as failure to achieve the specification can give rise to a legal claim.
- Another risk to consider is whether the green technology performance specification is likely to be effective in the geographic location where it is proposed to be used. For example, the performance of a solar heating system that performs well in the Southwestern United States may not work well in Central New York.
- In the event the parties agree on some form of objective performance specification, they should consider the time period in which the specification must be achieved. For example, if the contract requires a 15% reduction in electrical usage, how will success (or failure) be determined? Must the building achieve that reduction at the end of the first year? Every year for the next 20 years? If the specification is not achieved in year 10, who should be responsible and how should the damages be allocated? Representations and warranties and indemnification provisions will frequently extend well into the future.

The advent of green construction projects has placed a renewed emphasis on risk mitigation and risk allocation by lawyers on behalf of clients. All parties involved in the green construction project, including the owner, architect, contractors and subcontractors, and even downstream suppliers, should attempt to work collaboratively and cooperatively to achieve a mutually desirable result. The contract should, to the extent practicable, define the parties’ green expectations, anticipate potential risks that could occur, and fairly allocate responsibility for those risks if realized. Parties’ insurance professionals should also be consulted during the negotiation process, as insurance may offer solutions.

The “Green Revolution,” and also the “Green Evolution,” is underway and is unstoppable. While legal risks remain, the contract documents, rather than the court room, offer a better opportunity to mitigate these risks.