

CLIMATE CHANGE & SUSTAINABILITY ALERT



Shook, Hardy & Bacon applies a unique multidisciplinary approach to the business challenges, risks and opportunities arising from today's international focus on climate change and sustainability.

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CALIFORNIA'S AIR RESOURCES BOARD ADOPTS THE NATION'S FIRST CAP-AND-TRADE REGULATION

California regulators have approved an extensive cap-and-trade program, the most comprehensive cap on greenhouse gases (GHGs) and the largest carbon market to date in the United States. The authorizing legislation, California's AB 32, which was passed in 2006, aims to reduce emissions to 1990 levels by 2020, resulting in a 15 percent cut from today's emission levels.

Under the cap-and-trade program, approved on December 16, 2010, emissions from the 600 largest industrial facilities, including cement manufacturers, electrical plants and oil refineries, would be capped in an initial phase beginning in 2012. A second phase, commencing in 2015 will bring distributors of transportation fuels, natural gas and other fuels into the program.

Companies will initially be granted "allowances" for each metric ton of GHG they emit, allowing for trading of any unused allowances to other emitters, which in turn reduces their own costs. Eventually, the allowances will be auctioned off to companies on a quarterly basis, although most will initially be given away for free to aid in the transition to the new regulation. Allowances, which are determined by the Joint Utilities Group, may also be saved by emitters to be used for later compliance periods.

California's cap-and-trade regime also allows companies to cover up to 8 percent of their emissions with credits from compliance-grade "offset" projects, which promote the development of beneficial environmental projects in uncapped sectors, such as forestry and agriculture.

Cap-and-trade is designed to work in concert with other existing measures in California, including stricter standards for vehicle emissions, low-carbon fuels, renewable electricity and energy efficiency, and the state's existing smog and other air pollution reduction efforts. California regulators ultimately plan to integrate this

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comprehensive system of GHG reduction measures into regional programs such as the Western Climate Initiative and any potential federal programs.

Although significant additional implementation measures are still needed over the next year, including calculating specific allowance levels for emitters, creating offsets and determining whether to include biomass caps, approval of this regulation represents a significant step toward an integrated national and international system. The state has yet to determine how to spend the auctions' proceeds, which may be given back to taxpayers who are affected by higher rates. This will likely be addressed in later independent legislation.

After much debate about its specific terms, this historic regulation is intended to provide covered entities with flexibility to seek out and implement the lowest cost options to reduce emissions.

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