SCHNAPF ENVIRONMENTAL JOURNAL

A Newsletter Covering Recent Environmental Developments and Caselaw

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Contents

The Schnapf Environmental Journal is a bi-monthly report that provides updates on regulatory developments and highlights significant federal and state environmental law decisions affecting corporate and real estate transactions, and brownfield redevelopment. The information contained in this newsletter is not offered for the purposes of providing legal advice or establishing a client/attorney relationship. Environmental issues are highly complex and fact-specific and you should consult an environmental attorney for assistance with your environmental issues.

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Commentary & Analysis

Environmental Issues Regain Prominence In Wake of Market Turmoil

While many New Yorkers spent this past summer reminiscing about the 1977 Yankees from the comfort of a robust real estate market, transactional professionals in other parts of the country returning from August vacations to empty office desks and quiet telephones could be excused for thinking they were actually re-living the summer of 1977. The reason for the return of those lazy, hazy days of summer was the turmoil in the financial markets.

The ensuing credit crunch has created new opportunities for environmental professionals as underwriting standards are undergoing yet another paradigm shift. To help environmental professionals strategically position themselves for the new financial reality, SEJ thought it would be useful to provide an overview of the tumultuous summer.

The boom in the real estate and corporate buyout markets of the past five years was largely fueled by a combination of cheap credit, huge pools of cash (referred to in the major media outlets as excess liquity), lax (some would say reckless) underwriting standards and inattentive rating agencies that resulted in what a few experts have characterized as the "Henny Youngman Economy" ("take my money please").

In 2000, leveraged buyouts accounted for only $14 of every $100 spent on United States transactions. By the time the financial markets stalled, corporate buyouts accounted for $37 of every $100 in transactions. In past market expansions, mergers and acquisition (M&A) activity were largely stoked by corporations buying other companies. In contrast, the 2006-07 M&A binge was largely fueled by acquisitions of corporate assets by private equity and hedge funds were unlocking value through cost efficiencies or strategic asset dismemberment as well as collecting lucrative fees on the profits generated when they flipped these now more valuable corporate assets.

At the same time, the private equity firms realized that they could buy what was perceived as undervalued corporate assets with cheap debt financing and then use the sales proceeds to pay off the loans. In addition, these deals were highly leveraged with the buyers frequently only contributing 5% to 7% equity to the deal (i.e., 95% financing). Part of the financing for these highly leveraged deals often came in the form of short term bridge loans and mezzanine or subordinated debt .

Financial institutions facing brutal competition for loans from the excess global liquidity (think oil money) seeking higher returns were willing to fund these highly leveraged deals when they learned that they

could package and sell these loans to pension funds, life insurance companies, money management funds and other institutions seeking greater returns than offered by treasury notes. As lenders began tripping over themselves to do these loans and collect the large fees associated with these deals, they began lowering underwriting standards. As prospective borrowers shopped their deals, lenders also started offering “covenant-lite” loans where the loan documents did not have the customary minimal financial benchmarks that allow lenders to re-structure deals if a borrower’s business plan does not perform as expected. In addition, investment banks were able to generate large fees in so-called "staple financing" plans where the lender advising the seller packages a loan to the buyers.

The availability of highly leveraged financing meant that buyers had few assets or “skin in the game” at risk. With little to lose and the perception that asset appreciation had caused risk to decline or at least be spread by securitization, a buying frenzy occurred. To extract the greater leverage needed to support higher bids, more complex and opaque transactions were structured. Since originating lenders were selling loans instead of holding them, many banks became complacent, or felt they had become “too big to fail” so that the federal reserve would come to the rescue if the market had a hiccup like it had done in 1998 and 2002 in what had become to be referred to as the “Greenspan Put.”

Meanwhile, the real estate market was just as frothy. Real estate developers used their easy access to cheap debt financing to bid up commercial properties. Emboldened by price increases of up to 25% in the past year, buyers felt there was no penalty for overpaying 5-10% especially when the funds came from cheap debt. Many investors acquired property at prices that resulted in negative cash flow. Purchasers projected aggres- sive “hockey stick” increases in rents and property appreciation to justify the higher prices to lenders. Bank underwriters often calculated cash flow based on prevailing or future market rates even when tenants were locked into much lower rates. Assuming that rising property loans would allow the loan to be refinanced, lenders offered 100% financing, bridge loans, interest-only notes with balloon payments along with inadequate reserves for taxes, insurances and other expenses. One popular investment strategy was illustrated by the $36 billion acquisition of Equity Office Properties (EOP) by The Blackstone Group, which used highly-leveraged, short-term debt and then sold off large chunks of the portfolio at rates higher that what was paid per square foot.

Exacerbating this situation was the fact that the institutional investors generally lack the resources to perform robust diligence on the assets and relied on the rating agencies to do this analysis. Unfortunately, the rating agencies, in turn, appeared to also become intoxicated from the booming market and simply piggy-backed on the original substandard due diligence. Perhaps the high-

water mark of the over-heated market was the purchase of eight New York City EOP office buildings by Macklowe Properties. The $7.25 billion purchase price where Macklowe used only $50 million of its own funds was completed in just 10 days. While the annual rent for the buildings averaged around $57 a square foot, the deal was underwritten with projected future rents of $100 per square foot.

The summer crisis began when investors began to realize that many of "AAA" rated securitized loans they had purchased may not have been subject to rigorous underwriting and possibly contained sub-prime debt. The sub-prime mortgage crisis then metastasized into the broader market as investors became concerned that other highly rated bonds might also have bad loans packaged within them. As recently as the 1990s, most banks held their loans until they were paid off in what some have called portfolio lending or the "storage business." Except for the smaller community or regional banks, this practice of portfolio lending has been largely replaced by securitization where lenders package loans and equity stakes in companies and sell them to investors.

The downward spiral was made worse by the freeze on commercial paper. Many private equity firms and banks have structured investment vehicles (SIVs) or conduit assets that sell short-term (90 day) commercial paper and use the proceeds to buy higher-yielding securities or raise cash for leveraged deals. When the commercial paper came due, these SIVs and conduit affiliates could not sell new debt to pay for their expiring commercial paper. When banks fund conduit affiliates or SIVs, they enter into funding agreements known as liquidity backstop agreements or repurchase agreements (repo agreements) where the banks essentially agree to provide backup credit lines, which reduces the capital reserves of the lender.

A Victim of Environmental Frenzy

One of the underwriting standards that succumbed to the market frenzy was environmental due diligence. Sellers often offered properties that were packaged with "commodity-style" Phase I reports that in many cases fell short of a true ASTM E1527-05 Phase I ESA. In many cases, the bidding process was so truncated that buyers or their lenders did not have time to perform their own Phase I reports. Even if there was time and a report identified potential recognized environmental conditions, borrowers who planned to the flip the property balked at performing further investigations and threatened to take their loan to another lender. Operating under what is known as the "greater fool theory," the buyers did not want anyone to generate any information that could impact the sales price, figuring the environmental condition would become the problem of the future buyer (i.e., the "greater fool").

With the credit markets still recovering from the summer shock, financial institutions are now saddled with the prospect of sitting on as much as $400 billion in "hung loans." If the banks cannot sell this debt,

they will have to reflect this debt on their balance sheets. Since banks are required to maintain minimum capital reserves, the presence of this unsold debt has and could continue to make the lenders reluctant to finance leveraged transactions. It is unclear how these unsold deals will be priced. Just in the past week, some lenders took a hit when they sold hung loans for 95% of their face value. If the real estate market stumbles for an extended period of time, borrowers with highly leveraged loans will find themselves with negative cash flow where building rents cannot service the sizeable debt.

Large banks are not the only financial institutions impacted by market conditions. Many regional and smaller banks who finance the bulk of construction loans have seen increases in loan defaults as home builders cannot sell single family homes or complete condominium projects in formerly robust markets. In addition, a number of these smaller banks who purchased loans or participations in some of the highly leveraged deals, or themselves have conduit affiliates that are unable to sell commercial paper are having to boost their capital reserves which lowers earnings and scale back lending

So what does this mean for environmental professionals?

The first obvious answer is that deal flow will likely return to pre-2006/07 volumes. Many of the private equity firms who were the impetus for the financial feeding frenzy, are probably going to remain on the sidelines for awhile while the financial markets absorb and reprice the existing outstanding deals. Many types of loans that contributed to the long days for environmental consultants and lawyers have already seen a precipitous drop in volume. The collapse of many mortgage lenders has begun to create a glut of office space in some parts of the country, especially southern California, so expect to see less office financings. With consumer spending starting to be impacted by increases in adjustable-rate or sub-prime mortgages, second and third tier shopping centers are starting to have vacancy issues and are having trouble satisfying stricter underwriting standards. Multi-family transactions were a large source of due diligence work but until the markets settle it appears that the primary category of residential mortgages that will be attractive to the securization market in the near-term are those that will qualify for Fannie Mae or Freddie Mac financing.

On the other hand, it appears that there continues to be a strong demand for hotels in urban areas. Another source of new deals will be cash acquisitions by foreign government investment arms in Kuwait, Saudi Arabia, Dubai, Abu Dhabi and Qatar that are estimated to have $1.5 trillion in cash. Despite the real estate slowdown underway, foreign investors continue to prefer United States properties that remain attractive because of the weakening dollar and perceived transparency of the financial markets. Corporations may resume the prominence in the M&A market. If the global market

remains strong, some market experts believe that corporations will engage in strategic stock-swap deals. Of course, as highly leveraged deals unwind and borrowers default, expect to see work arising from bankruptcies, workouts and loan servicers.

With underwriting returning to more traditional standards, environmental issues have begun to regain importance not only for new transactions, but also for existing deals that with bridge loans that need to be refinanced and non-performing loans that need to be restructured. In just the past month, we have seen lenders require Phase II investigations for hotel properties with groundwater contamination that had been ignored during a prior financing. A fully rented office building constructed on a former manufactured gas plant site was deleted from a portfolio because the lender required the purchaser to enroll the property in a state voluntary cleanup program to address the contamination and the seller refused to renegotiate the price. A lender declined to fund a small portfolio of apartment buildings because of vapor intrusion originating from a petroleum spill a block away from the building. When the responsible party (a large oil company) declined to provide an acceptable indemnity to the lender, the deal collapsed. In another deal complicated by vapor intrusion, a loan servicer failed to properly monitor a post-closing obligation of the borrower (who owned a small shopping center) to complete remediation of a small discharge from a dry cleaner. When the loan came up for refinancing, the environmental due diligence discovered that the small plume had entered into a stormwater conduit and was now the size of a baseball stadium, and vapors within tenant spaces exceeded the state inhalation risk threshold, which triggered reporting obligations to tenants. What had been a $50K cleanup four years ago, now required $1 million escrow to complete the financing.

Environmental consultants reviewing transactions that may have been financed during the heady days of the recent financing spree should independently verify environmental conclusions performed in environmental reports generated during the prior transaction and not simply rely on the fact that the previous consultant concluded that an environmental issue did not rise to the level of a recognized environmental condition. With many deals teetering on the brink of default, the “B-piece” investors who are first in line for any risks from defaulting loans are asking tough questions on numerous loan issues including environmental issues. In this new era of risk aversion, reputational risk has grown in importance. Some reputational risk managers are willingly taking on the mantle of “surrogate regulators” and requiring that environmental issues be resolved prior to closing or that a structure be established that imposes post-closing environmental obligations. In states without licensed environmental professional programs, opinions of Phase I consultants and especially those commonly viewed as “commodity-shops” are increasingly insufficient to

provide comfort to lenders. Expect many lenders to require regulatory closure for open spills, USTs that were formerly removed or closed without state oversight, and Phase II investigations for former dry cleaners or USTs where there is no closure documentation.

When deals turn south and collapse, lawsuits inevitably follow. Many highly leveraged real estate transactions will likely go into default if they encounter unexpected cash flow problems such as costs encountered to address previously unanticipated remediation costs. Moreover, the reliance language required in Phase I reports for securitized loans allows a whole range of parties (who a consultant never heard of, such a note holders, mezzanine lenders, B-piece buyers) to rely on the consultants reports.

As a result, environmental consultants would be well-advised to err on the side of caution when reaching opinions or providing recommendations. It would be prudent for environmental professionals to broadly interpret the ASTM definition of REC, and recommend Phase II investigations where there is evidence of a former spill. If the lender requires an estimate for investigation or remedial costs, be conservative. If a consultant experiences resistance on a $10,000 estimate, this should send off alarms. If a deal cannot afford a $10,000 cost, it is quite possible that the transaction will return to the environmental professional several years later in the form of a lawsuit.

If contaminated groundwater is discovered in a state that does not have a licensed environmental professional program but that allows for the use of risk-based cleanups, the consultant should not put itself in the position of the regulator and issue an opinion that no further work is required. If the lender or borrower wants regulatory signoff, then the party should notify the regulatory agency for a formal determination. If historical contamination is discovered, the environmental professional should not render opinions about whether the contamination is reportable but indicate that the client should consult its attorney if it wants to determine if the discovery of contamination must be reported. If staining is observed around a floor-drain near a storage tank or beneath an old elevator that was installed when hydraulic fluids may have contained PCBs, it would be reasonable to suggest further inquiry for clients with little appetite for risk. If a current dry cleaner at a property does not have a solvent-grade epoxy coating on the floor or a dry cleaner operated there in the past, it would be prudent to suggest a Phase II site investigation. Consultants should carefully review the language in the asbestos sections of the reports to make sure that they advise the client that many categories of building materials still contain asbestos and therefore that the presence of asbestos-containing materials cannot be ruled out. If the lender only requires swab samples to test for the presence of lead-based paint, the environmental professional should make sure that its report explains that swab sampling is not acceptable under the federal LBP regulations for determining that a property is “lead-free” and indicate

that different sampling (e.g., XRF) is necessary if the client wants assurance that the property is “lead-free” under the federal LBP program. Consultants should carefully consider if data gaps could be significant and further investigation required.

If a site is potentially impacted with gasoline or chlorinated solvents, the consultant should recommend vapor intrusion analysis unless it is certain that the levels detected in soil and groundwater would not exceed a regulatory threshold. Remember that state dry cleaner and UST trust funds do not take vapor intrusion into account when ranking sites so just because a property with a documented release has been assigned a low priority ranking, does not mean it does not pose a potential for vapor intrusion. If a state has a vapor intrusion threshold lower than that recommended by EPA, consultants should use the more stringent standard. Remember, vapor intrusion does not only present risk of further cleanup or re-opening of a previous NFA letter but also of lawsuits for personal injury and property damage claims. Accordingly, the most stringent standard should be evaluated to assess the potential for future claims.

CLEAN AIR/CLIMATE CHANGE

Majority of American Economy Now Subject to Greenhouse Gas (GHG) Emission Regulation

Earlier this year, we suggested that because the proliferation of state and local GHG initiatives had reached the tipping point, developers, their lenders and environmental professionals had to begin considering the impacts of them on their transactions. This observation was confirmed by a fact sheet issued by Ceres and Environmental Defense in mid-September announcing that approximately 58% of the country's gross domestic product and 54% of its population were now subject to some sort of GHG emissions restrictions. The fact sheet also alleges that half of the revenues of Standard & Poor's 500 companies occur in nations that are parties to the Kyoto Protocol.

The fact sheet was issued in connection with a petition filed with the federal Securities and Exchange Commission (SEC) by Ceres, Environmental Defense and institutional investors managing $1.5 trillion in assets asking the agency to require public-traded companies to disclose how climate change will impact their financial performance. The petition asks SEC to require firms to not only calculate their own direct emissions but also to analyze the economic disruptions to their companies that could result from changes to the physical environment resulting from climate change such as rising sea levels, droughts, floods and extreme temperatures. The petition stated that the companies with significant carbon dioxide (CO_2) emissions such as the oil and electric power industries had the most comprehensive disclosures. However, the petition alleges that service companies such as lenders, insurers, health-care companies, and telecommunications firms that do not view themselves as major GHG emitters often ignore climate change in their filings. In March, the Investor Network on Climate Risk representing more than $4 trillion in assets managed by 65 institutional investors asked the SEC to clarify disclosure requirements.

The action followed an announcement by New York Attorney General Andrew M. Cuomo that his office was launching an investigation into five energy companies under a state securities law to determine if they had adequately disclosed financial liabilities associated with carbon dioxide (CO_2) emissions from coal-fired power plants that the companies either own or operate. The subpoenas were issued to AES Corporation, Dominion Resources, Xcel Energy, Dynegy, and Peabody Energy and seek information about the companies' analyses of the risks posed by their CO_2 emissions and the extent of the disclosure of such risks to their shareholders. The investigation was commenced under

the NY State Martin Act, a 1921 law that predates the creation of the SEC. The Attorney General suggested that Dominion, Dynergy, Peabody and Xcel have not adequately disclosed the increased financial, regulatory and litigation risks associated with the planned coal-fired power plants, and that AES did not disclose projected emissions or evaluate the impact of upcoming local or regional GHG regulations on the company's operations. The investigation is part of a national effort by a coalition of environmental groups, shareholder activists and state officials in the Northeast and on the West Coast to prevent approval of approximately 100 coal-fired power plants.

According to Ceres, a record 43 climate-related shareholder resolutions representing $200 billion in assets were filed during the 2007 proxy season. In addition to the usual list of GHG suspects, several resolutions were filed against homebuilders. None of the shareholder resolutions passed, but 15 were withdrawn after the companies agreed to implement climate-related commitments. The resolutions that went to a vote averaged 21.6% support.

In August, six Western states and two Canadian provinces entered into a far-reaching Western Climate Initiative (WCI) to reduce aggregate GHG emissions by 15% below 2005 levels by 2020. The WCI members are Arizona, California, New Mexico, Oregon, Utah, Washington, British Columbia and Manitoba.

WCI is broader than the Regional Greenhouse Gas Initiative (RGGI) established by ten Northeast and Mid-Atlantic states. Unlike RGGI, which was limited to CO_2 emissions from power plants, the WCI pact applies to all sectors of the state economies. In addition, the agreement applies to all of the Kyoto Protocol GHGs not just CO_2. The emissions subject to WCI are CO_2, methane, nitrous oxide, hydrofluoucarbons, perfluorocarbons and sulfur hexafluoride.

The WCI establishes individual member reductions ranging from 11% for Washington to 32% for Oregon by 2020. These aggregate regional reduction goals do not replace individual GHG emissions reduction targets established by WCI signatories. It is anticipated that WCI members will establish a cap-and-trade program for the covered GHG emissions. In contrast, RGGI only contemplates a cap-and-trade program for CO_2 emissions from power plants. When it becomes effective in 2009, RGGI will become the first mandatory GHG trading program in the United States. RGGI imposes power plant reductions by 10 percent by 2019.

Meanwhile, Oregon became the 17th state to adopt GHG emission reduction targets when Oregon Governor Ted Kulongoski signed the Climate Change Integration Act, (CCI) into law in August. CCI has three major components. First, the law calls for a halt in the increase of GHG emissions by 2010 and then phases in emissions reductions of 10% below 1990 levels by 2020 and 75% reduction by 2050. The law also authorizes creating the Oregon Global Warming Commission (Commission) to recommend policies to state and local governments to

reduce GHG emissions, including examining the feasibility of a state-wide and/or multi-state cap-and-trade program or other market base mechanisms. The Commission will also be responsible for tracking and evaluating GHG emission trends; monitoring progress toward meeting the reduction targets; impacts of climate change on Oregon; identification of new zero or low-GHG emitting technologies and reporting on in carbon sequestration. Finally, CCI allocates $180,000 toward the creation of the Oregon Climate Research Institute administered by Oregon State University to serve as a clearinghouse for climate change information. The legislative action follows passage of a bill in June where Oregon became the 23rd state to require large electric utilities to produce or obtain a portion of their energy from renewable sources. Under that legislation, Oregon utilities must obtain 25% of their electricity load from renewable energy sources by 2025.

Environmental Organizations Turning to Environmental Quality Laws to Address GHG Emissions

The National Environmental Review Act (NEPA) in 1969 was the first national environmental legislation. NEPA requires federal agencies to evaluate and mitigate the environmental impacts of major federal projects. The project proponent is required to consider a "range of alternatives" when issuing any permits, and select the approach that offers "maximum protection" to the environment.

Federal courts have required agencies to consider GHG emissions under NEPA but usually have deferred to the agencies' climate change assessments. For example, in *Border Power Working Group v. Department of Energy,* 260 F.Supp.2d 997 (S.D. Cal. 2003), the Southern District of California initially invalidated an EIS by the Department of Energy ("DOE") involving a proposal to connect the southern California power grid with two coal-fired plants in Mexico. Subsequently approved a modified EIS that calculated the project would increase global GHG emissions by 0.088%, and the United States' GHG emissions by 0.023% but concluded that the expected impacts to global climate change would be "negligible."

Mid-States Coalition for Progress v. Surface Transp. Bd., Appeal No. 06-2031 (8th Cir. Dec. 28, 2006) involved approval of new railroad lines for transporting low-sulfur coal from the Powder River Basin in Wyoming to power plants in the Midwest. The Eighth Circuit initially ruled that increased coal consumption, and associated GHG emissions were a reasonably foreseeable consequence of the project, and Surface Transportation Board (the Board) should have considered air quality issues in its EIS. However, the court upheld a supplemental EIS in December 2006 concluding that the project would not have significant environmental impacts.

In Friends of the Earth v. Mosbacher, 2007 WL 962949 (N.D. Cal. 2007), the plaintiff alleged that the Overseas Private Investment Corporation and Export-Import Bank

failed to comply with NEPA when the federal agencies provided funding and loan guarantees to overseas projects without assessing the impact of GHG emissions from the energy-intensive projects. The court initially denied the government's motion to dismiss but then held that the agencies were not required to prepare an EIS because the foreign energy projects were not federal actions. However, in a nod to the plaintiffs, the court said it would be difficult to conclude that there was a genuine dispute that GHGs do not contribute to global warming, and suggested that future NEPA climate change litigation could be focused on whether a particular agency's action was the "but-for" cause of effects on the domestic environment. While this language is technically referred to by lawyers as "dicta" because it was not related to the holding of the issue before the court, it is not unreasonable to expect future litigation involving federally-financed projects such as airports, highways, rail projects ports or marine terminals that fail to analyze the climate impacts of those projects.

A number of GHG-related NEPA suits have been filed. In *Environmental Montana Environmental Center v. Johanns*, No. 06-1059 (D.D.C), a group of environmental organizations have asked the United States District Court for the District of Columbia to enjoin the Rural Utilities Service (RUS), a branch of the U.S. Department of Agriculture (USDA) from lending billions of dollars to private developers and utilities across the country to build new coal-fired power plants until climate-related impacts of these projects are evaluated under NEPA. The RUS facilitates the electrification of rural areas by making direct loans and issuing loan guarantees to electric utilities to finance the construction of electric distribution, transmission, and generation facilities. The complaint charged that the RUS has already elected to participate in the funding of a 250 MW coal plant near Great Falls, MT and was considering funding an additional seven coal plants located across the country that will accelerate climate change and eliminate the market for clean power. The plaintiffs estimated that the RUS funded projects will account for a "significant share of U.S. greenhouse gas emissions yet never took a 'hard look' at the consequences of proposed major federal actions." Specifically, the plaintiffs alleged that the RUS failed to consider the cumulative or incremental impacts of GHG emissions from the seven other coal plants that it was considering funding, that the actual energy needs were significantly less than what was claimed in the EIS, that RUS failed to consider a reasonable range of alternatives, and that RUS should have prepared a supplemental EIS based upon new information that was received after the issuance of the FEIS. The case was settled when EPA agreed to withdraw a letter issued to an industry consultant that owners of new power plants did not have to consider use of best available technology (BACT).

State Actions Proliferate on GHG Policy

Most states have adopted their own versions of NEPA that they have used to evaluate potential environmental impacts such as air and water pollution, congestion and noise. In the wake of the United States Supreme Court decision in *Massachusetts v. EPA,* environmental organizations and states are beginning to turn to NEPA or state environmental quality laws to force developers to reduce the GHG impacts of their projects as well as to ensure that the developments meet sustainability requirements.

For example, this past April, the Massachusetts Executive Office of Energy and Environmental Affairs (EOEEA) issued a Greenhouse Gas Emissions Policy to be implemented under the Massachusetts Environmental Policy Act (MEPA). Under MEPA, projects conducted by either a state agency or a private developer utilizing state funds or requiring state approvals must undergo environmental review if they exceed certain thresholds (e.g., alteration of more than 25 acres of land or the creation of more than 300 new parking spaces). The first step in the process is the filing of an Environmental Notification Form (ENF) that describes the project, its potential impacts, and any required state approvals. If potential environmental impacts are identified, the project proponent must then submit an Environmental Impact Report (EIR), which is similar to the NEPA Environmental Impact Statement (EIS).

Under the new GHG Policy, an EIR must quantify the GHG emissions generated by the project and identify measures to avoid, minimize or mitigate the emissions. A project will be subject to the GHG Policy when an EIR is required and the project falls into one of the following categories:

- the Commonwealth or state agency is a project proponent;
- the Commonwealth or state agency is providing financial assistance to a private project proponent;
- the project is privately funded, but requires an air permit from the Massachusetts Department of Environmental Protection; or
- The project is privately funded but will generate (i) 3,000 or more new vehicle trips per day for office projects, (ii) 6,000 or more vehicle trips per day for mixed use projects that are 25% office space, or (iii) 10,000 vehicle trips per day for other projects.

The Policy will be implemented in phases. Effective immediately, scoping documents for EIRs must identify and describe sources of project-related GHG emissions, and propose measures to avoid, minimize, or mitigate such emissions. Project proponents will not be expected to quantify GHG emissions until the state has developed a GHG protocol.

The Policy applies to the six GHGs covered by the Kyoto Protocol (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and, sulphur hexafluoride). Applicants must also consider both "direct emissions," such as

emissions from boilers and "indirect" emissions, such as emissions from vehicles driven by employees and plants supplying electricity to the proposed project.

Although the Policy does not mandate the type of measures that must be used to avoid, minimize, or mitigate GHG emissions, EOEEA has developed a guidance document that provides examples of the type of emission reduction techniques that project proponents will be required to implement. These include:

- energy efficiency improvements;
- site orientation and building layout to maximize use of natural light, heating, cooling;
- use of low-impact development techniques such as reducing the use of asphalt and increasing the amount of shade provided by building elements or landscaping (e.g., green roofs or rain gardens);
- transportation demand management (e.g., locating near mass transit, access to shuttle or bus services, ridesharing programs, bicycle and pedestrian accommodations; zip car spaces, etc.);
- on-site renewable energy and combined heat and power generation;
- use of clean and alternative fuels; and
- on-site reuse and recycling of construction and demolition materials and occupant waste materials.

Local Actions on GHG Issue

Likewise, the California Environmental Quality Act (CEQA) requires state and local agencies to determine if a project that requires discretionary approval may have significant environmental effects and to impose feasible mitigation measures. In general, the project proponent must prepare an environmental impact report (EIR) and may prepare a Mitigated Negative Declaration to reduce or mitigate a project's potentially significant effects.

Following passage of the California Global Warming Solutions Act of 2006, public agencies have begun receiving comments on draft EIRs demanding that the project's contribution to climate change be assessed by estimating the project's GHG emissions. Earlier this year, the state Attorney General filed a lawsuit against the County of San Bernardino's General Plan alleging that county's general plan failed to analyze climate change issues.

Last month, San Bernardino settled the lawsuit and agreed to amend its General Plan. Under the terms of the settlement, the General Plan must establish a policy to reduce GHG emissions "reasonably attributable to discretionary land use decisions" and internal operations, and require adoption of a "Greenhouse Gas Emissions Reductions Plan." The Plan must set a baseline inventory of current sources of GHGs within San Bernardino, establish an inventory of the 1990 GHG emissions from those same sources and project new GHG emissions in San Bernardino in 2020

from its discretionary land use decisions and governmental operations. The Plan must then target reductions of those projected emissions.

A key to the San Bernardino settlement will be the identification of feasible mitigation measures that can be used to minimize GHG emissions. At this point in time, feasible measures appear to include high-density development to reduce vehicle trips, promoting carpooling, alternative fuel vehicles, public transportation, transportation impact fees; energy efficient design for buildings and appliances; use of solar panels; water reuse systems and on-site renewable energy production. As a result of the settlement, it appears that developers and project proponents will have to address GHG emissions in their CEQA documents. Indeed, air districts and other public agencies are now considering requiring project proponents to estimate their project GHG emissions and discuss their contribution to potential global warming effects. It would appear the future projects will have to be designed to reduce direct and indirect GHG emissions. In addition, to pass CEQA muster, project proponents will have to provide a clear analysis in the CEQA documents showing how those designs or measures will reduce GHG emissions so that public agencies can determine that climate change impacts have been properly evaluated.

A number of lawsuits have been filed under CEQA challenging the adequacy of climate change analysis prepared for private developments. The plaintiffs have challenged an EIR for a 2,700 unit residential/commercial development in *Center for Biological Diversity vs. City of Desert Hot Springs,* an EIR for a 1500 residential development in Banning (*Center for Biological Diversity vs. City of Banning),* have challenged a permit for commercial composting facility in *Center for Biological Diversity vs. San Bernardino County* and a permit for a 520,000-square-foot, big-box retail development with a 24-hour Wal-Mart Super center that will generate close to 40,000 daily vehicle trips in *Center for Biological Diversity v. City of Perris*.

Earlier this month, the California Public Utilities Commission proposed that all new housing developments and commercial buildings would have to produce all of their power needs in a manner that achieves “zero net energy” by 2020. The energy would be produced from solar panels, windmills or small generators. The commission also proposed that California electric utilities create a statewide energy efficiency plan rather than pursuing their own separate programs.

The California Energy Commission is recommending legislation that would mandate regional growth plans for areas with more than 100,000 residents to identify housing needs, development patterns and areas that should remain off-limits. Some utilities and municipal utility districts are working with local governments to site power stations more efficiently and communicate with developers early on in the planning stage to

implement non-transportation efficency measures.

The Urban Land Institute recently released a report showing that shifting 60% of new growth to dense developments would save 85 million metric tons of CO_2 annually by 2030. The report urges Congress to require regional transportation plans to take CO_2 impacts into account or for EPA to regulate GHG emissions under the CAA.

Boston has become the first major city to incorporate LEED Standards into its zoning code. Article 37 of Boston's zoning code requires projects over 50,000 square feet achieve the base LEED "Certified" level. In addition to the 36 LEED points necessary for "Certified", the zoning code requires four additional points reflecting city priorities. These four points are for modern mobility (transportation), modern grid (energy), historic preservation and groundwater.

Harvard University entered into the nation's first legally-enforceable GHG restrictions for a major real estate project in connection with the university's 20-year master plan for a new campus in Boston's Allston neighborhood. The project will increase the size of the Allston campus from 140 acres to approximately 215 acres.

Under a Draft Record of Decision issued under the state MEPA, the state DEP granted a waiver of a full environmental impact review for construction of a Science Complex consisting of a four-building, 589,000-square-foot project. The proposed waiver was based on the project's minimal environmental impact, ample available infrastructure, commitments for future environmental reviews of other aspects of the project, and other specified conditions. One of the conditions is that the Science Complex will have to achieve 50% reduction in GHG emissions compared with national standards set by the American Society of Heating, Refrigerating and Air-Conditioning Engineers, Inc. (ASHRAE).

Under a second MEPA document, Harvard agreed to establish a Special Review Procedure that would be used in lieu of the traditional two-step environmental review process. A Special Review Procedure is frequently used to provide environmental review for complex development that will be implemented over several years. The Special Review Procedure for this project requires Harvard to provide Interim Updates every three years and mandates project-specific filings to go through an extensive public comment process. Harvard also agreed to provide resources to facilitate technical review of documents by a citizens advisory group.

A third scoping document also delineates "sustainable development principles" that Harvard must implement. These practices include stormwater and wastewater standards, and high-level transportation requirements as Harvard develops its Allston Campus Master Plan.

County Resurrects Old Provision of CAA to Address Climate Change

In the early years of the CAA, EPA contemplated imposing standards on developments that attracted high numbers of vehicles under its “indirect source review” authority. Because this effort was perceived as potentially stifling growth during an economically challenged era, Congress prevented EPA from devoting resources to this effort.

Now, though, some states with a large component of transportation-related GHG emissions are dusting off this strategy. A recent example is the Indirect Source Review rule promulgated by the San Joaquin Valley Air Pollution Control District in 2005. The agency’s jurisdiction encompasses the southern half of California's Central Valley, which suffers some of the highest concentrations of ground-level ozone and particulate matter in the nation. The goal of the rule is to achieve “emissions reductions from the construction and use of development projects through design features and on-site measures." It requires developers who build 50 houses or more to offset air emissions. Developers can either pay a mitigation fee to the district for the purchase of off-site emission reductions, or can incorporate into their projects elements that will minimize traffic-related emissions such as incorporating traffic controls to reduce congestion, siting new homes and businesses near public transit, adding bicycle lanes, or building walkable shopping. The National Association of Homebuilders (NAHB) filed suit challenging the regulation arguing that local air districts do not have authority under the CAA to regulate "indirect sources" of air pollution such as tailpipe emissions from construction equipment and motor vehicles related to home construction. The NAHB also argues that instead of reducing emissions, the rule will actually exacerbate air quality in the San Joaquin Valley's because residents will not be able to afford homes close to their jobs and have to commute longer distances. Environmental groups that have sought to intervene in the lawsuit contend that the measure is consistent with a 2003 California law mandating that districts regulate indirect emission sources.

The Lawyers Are Coming, The Lawyers Are Coming

In the face of federal inaction on climate change and emboldened by the United States Supreme Court decision in *Massachusetts v. EPA*, environmental organizations and state governments are increasingly turning to the courts to combat GHG emissions.

In one of the more innovative actions, the Center for Biological Diversity filed petitions with seven states asking them to declare their coastal waters "impaired" by carbon dioxide emissions under section 303(d) of the Clean Water Act (CWA). The petitions were filed in Alaska, Florida, Hawaii, New Jersey, New York, Oregon and Washington and seek to force the states to adopt total maximum daily loads (TMDL) for CO_2 that would effectively require

the states to limit CO_2 emissions. Earlier this year, a similar petition was filed in California.

Under section 303 of the CWA, states are required to identify segments of surface waters that do not attain water quality standards and then propose measures to achieve water quality standards. The petitioner alleges that coastal ocean waters absorbed half of the CO_2 emissions emitted into the atmosphere and that as a result of the CO_2 emissions, the pH of coastal ocean water has fallen from 8.2 to 8.1. Because the pH scale is exponential, what appears to be an insignificant drop actually translates into 25% increase in water acidity. The petitioner alleges that the oceanic acidification will have disastrous effects on the food chain because the acidic water will inhibit plankton and coral from absorbing the calcium carbonate they need to build their skeletons and shells, thereby reducing an important food source for marine animals higher in the food chain and also jeopardizing the existence of phytoplankton that are a critical source of atmospheric oxygen. Moreover, the petitioners assert that reduced pH will reduce the ability of marine animals to absorb oxygen.

A federal district court in Vermont ruled that states were not pre-empted by federal fuel efficiency laws from adopting clean car emissions standards enacted by California. In *Green Mountain Chrysler v. Crombie, CV-F-04-6663 (D.Vt. 9/12/07)* automobile manufacturers argued that the Vermont automobile GHG emission standards constituted fuel efficiency standards that are exclusively regulated by the federal government under the 1975 Environmental Policy and Conservation Act (EPCA) that established national corporate average fuel economy (CAFÉ) standards for passenger automobiles and light duty trucks. Section 509(a) of EPCA contained an express preemption clause prohibiting any state or local entity from adopting or enforcing any law or regulation relating to fuel economy standards. Meanwhile, section 209(a) of the CAA prohibits individual states from adopting emission standards for new motor vehicles. However, 209(b) authorizes California to adopt more stringent tailpipe emissions standards if it obtains a waiver from EPA. In September of 2004, the California Air Resources Board adopted standards that apply to such vehicles beginning with model year 2009. Automobile manufacturers challenged those regulations and while that case was pending, other states began adopting California's standards. The automobile manufacturers contended that GHG tailpipe emissions were essentially attempts to increase fuel economy. The court found that EPCA does not preempt California's GHG-related tailpipe emissions because California can obtain a waiver from EPA. Since EPA has not yet approved the California standards, the court felt it was presumptuous to assume that EPA would approve the standards. If EPA does not approve the California standards, the court said, Vermont's regulation would be preempted by section 209(a). The court found that Congress intended California to be a proving ground for innovation in

emission control regulations and that other states were free to adopt California's standards under Section 177 of the CAA so long as the standards were adopted at least two years before the model year that they regulate.

Meanwhile, a federal district court dismissed a lawsuit filed by the California attorney general asserting that the six biggest automakers have created a nuisance because the GHG emissions from the vehicles they have manufactured. In *California v. General Motors*, No. 3:06-cv-05755 (N.D. Ca. 9/17/07), the plaintiff charged that the cars manufactured by the defendants accounted for 30% of GHG emissions generated in California and alleged a variety of damages arising from those emissions. The court agreed with the defendants that climate change involved complex policy questions that were not to be decided by the judicial branch of the government.

Friends of the Chattahoochee, Inc. and Sierra Club v. Couch involved an administrative challenge to a Prevention of Significant Deterioration (PSD) permit issued to a new 1,200-megawatt pulverized coal-fired power plant. The plaintiffs argued that CO_2 was a regulated air pollutant in the wake of the United States Supreme Court's ruling in *Massachusetts v. EPA* and therefore, Georgia Environmental Protection Division should have required the plant to install best available control technology (BACT) to limit CO_2 emissions. The administrative law judge upheld the permit, finding that that CO_2 was not yet a regulated pollutant.

A day before the second anniversary of hurricane Katrina, federal district court in Mississippi dismissed a class action lawsuit filed against major coal, oil, electric utility and chemical companies in *Comer v. Murphy Oil* ,No. 1:05-cv-00436 (S.D. MS. 8/30/07). The plaintiffs argued that the defendants knowingly contributed to climate change by emitting large quantities of GHGs and that these emissions produced the conditions that led to the severity of the storm. However, the court ruled that the 14 property owners did not have standing and said that their claims raised political questions best left to Congress and the Executive Branch.

Green Building Certifications Pose Trap for Unwary Professionals

Green buildings often come with high expectations and lots of publicity. Thus, it should not be surprising that while the green building movement is still in its infancy, we are already seeing litigation filed against service professionals. A presentation at a recent conference of the American Institute of Architects reviewed actual "green claims" brought against engineers and architects. The claims range in size and scope from a project failing to achieve the promoted level of LEED certification, to a school district asserting that its design team failed to reduce operating costs by fifty percent over comparably-sized schools, to damages for project delays caused by unavailability of green building products selected by the architect, and even to claims filed by tenant

who experienced greater incidences of sick days and lower productivity. SEJ will continue to track developments in this area in future issues.

Commentary: *Because building owners frequently have unreasonable expectations of the benefits and costs of green buildings, it is important for professional service providers to manage these expectations through careful and clear communication so the client understands the scope, goals and limitations of the design process.*

Perhaps the most important lesson for environmental professionals to glean from the growing green building lawsuits is the need to carefully prepare and/or review construction/design contracts for unreasonable risks and contractual obligations. In particular, design professionals should make sure the documents do not guarantee a specific outcome such as a certain LEED level or percent reduction in energy use. Words that raise such concerns are certify, warrant, guarantee, ensure, assure, affirm, or declare. The reason is that the standard exclusion for professional liability policies covering design professionals states that coverage is not available for any claims based on express warranties or guarantees.

Like any other construction project, green building design involves a number of tradeoffs and clients may impose time or budgetary constraints on design professionals that could inhibit the ability of the building to achieve the certification that the owner desires. Design professionals should carefully review requirements for the various certification requirements with clients and memorialize the client decisions.

Design professionals should not simply rely on promotional materials but vet the sustainability claims of manufacturers by reviewing technical data. For example, a recent study of the EPA Energy Star program by the EPA Inspector General concluded that the agency has failed to adequately verify manufacturer certifications or adequately monitor use of the Energy Star label in stores. The report also found fault with EPA's process for revising specifications that products must meet to achieve an Energy Star rating. The report said that EPA tests some products while relying on third-party testing for other products but lacks sufficient quality assurance or review of these results. The study also found that EPA lacks a clear methodology governing products selected for verification tests and does not strive for statistically valid results. According to the report, the agency also does not have clear guidelines on changing specifications. While EPA established standards to ensure label misuse, the Inspector General found that Energy Star staff could not provide documentation on follow-up actions, final results for all retail store assessments, or status of label inconsistencies.