

THE CLIMATE REPORT



■ U.S. EPA PROPOSES NATIONAL GREENHOUSE GAS EMISSION INVENTORY RULE

On March 10, U.S. EPA proposed the first nationwide mandatory reporting system for greenhouse gas emissions, addressing a range of industry sectors. U.S. EPA estimates that the proposed rule will address 80 to 95 percent of U.S. greenhouse gas emissions. Once U.S. EPA publishes the proposal in the Federal Register, companies and other members of the public will have 60 days to submit comments. The source categories subject to the proposed rule are as follows:

Upstream Fuel Sources. “Upstream” suppliers of fossil fuels, such as coal and petroleum products, as well as suppliers of industrial greenhouse gases, would be required to report the volume of fuel they introduce into commerce each year and the quantity of greenhouse gases emitted through total combustion of that volume of fuel.

Downstream Stationary Sources. For most categories of “downstream” emission sources, the proposed rule would cover facilities with 25,000 metric tons or more per year of greenhouse gas emissions. Some sources (such as food processing, industrial landfills, iron and steel production, and pulp and paper manufacturing) are

DEPARTMENTS	
U.S. Regulatory Developments	1
Climate Change Issues for Management	4
Carbon Market Transactions	6
Tools for the Carbon Market	9
Climate Change Litigation	11
Climate Change Regulation Beyond the U.S.	12

individually identified by their source types and by this emission threshold. Others fall into a general category for larger fuel-burning units, such as boilers, that meet or exceed the 25,000-ton threshold. For certain high-emitting business sectors, including cement producers, petroleum refineries, aluminum manufacturers, and power plants subject to the federal Acid Rain Program, all facilities are covered regardless of their emission levels.

Vehicle and Engine Manufacturers. Finally, manufacturers of certain types of vehicles and engines, including passenger vehicles, watercraft, heavy-duty engines and vehicles, non-road diesel engines, and aircraft engines, would be required to report the quantity of greenhouse gases emitted from the engines and vehicles they produce.

In addition to carbon dioxide emissions, annual reports would be required to track emissions of methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, perfluorocarbons, and other fluorinated gases. Reporting would occur at the facility level for downstream stationary sources and at the company level for upstream fuel suppliers and vehicle or engine manufacturers. Although the proposed rule would not require any reductions in greenhouse gas emissions, data collected would undoubtedly influence the development of future climate change policies.

Casey Fernung

1.404.581.8119
cfernung@jonesday.com

Jane Murphy

1.312.269.4239
jkmurphy@jonesday.com

■ U.S. EPA PREPARES TO RELEASE FINDING THAT GREENHOUSE GAS EMISSIONS ENDANGER THE PUBLIC, A PREREQUISITE FOR REGULATION UNDER THE CLEAN AIR ACT

U.S. EPA appears to be on the verge of proposing an “endangerment” finding for carbon dioxide (and likely other greenhouse gases) under the Clean Air Act in response to the

Supreme Court's holding in *Massachusetts v. EPA*, 549 U.S. 497 (2007), that U.S. EPA has authority under the Clean Air Act to regulate carbon dioxide emissions from new motor vehicles if U.S. EPA finds that such emissions “endanger public health or welfare.” Under the Bush Administration, U.S. EPA issued an Advanced Notice of Proposed Rulemaking (“ANPR”) that explored the issue of endangerment, as required by the Supreme Court, but also questioned whether U.S. EPA could effectively regulate such emissions under the Clean Air Act's existing programs.

New U.S. EPA Administrator Lisa Jackson sent a proposed endangerment finding to the Office of Management and Budget on March 20, 2009. The text of the proposed endangerment finding has not been made public, and U.S. EPA so far has refused to provide further details. An internal U.S. EPA document leaked in February 2009 suggests that the Agency intends to find that endangerment exists on both public health and welfare grounds. However, the finding, as described in the leaked document, would not take the next step of actually proposing to limit greenhouse gas emissions from specific sources.

As demonstrated in the pre-Obama ANPR, any regime to regulate greenhouse gases without new legislation would be fraught with legal and technical uncertainty. With respect to stationary sources of air pollution, the problems arise primarily under four programs established by the Clean Air Act: the National Ambient Air Quality Standards, the New Source Performance Standards, the Prevention of Significant Deterioration requirements, and the Title V permitting program for major stationary emission sources. These programs are ill-suited to addressing pollutants such as carbon dioxide that are emitted in significant quantities by a large number of sources and distributed equally throughout the global atmosphere.

According to the internal U.S. EPA document, once the proposed endangerment finding receives approval from the Office of Management and Budget, the U.S. EPA Administrator intends to publish a proposed rule in the Federal Register. At that point, companies and other interested parties would have 60 days to review the proposal in detail and submit comments to U.S. EPA.

Casey Fernung

1.404.581.8119
cfernung@jonesday.com

Graham Holden

1.404.581.8220
ggholden@jonesday.com

■ CALIFORNIA PROCEEDING WITH GREENHOUSE GAS REGULATION

California’s Global Warming Solutions Act (“AB 32”)sets forth an ambitious program to combat global warming. The law requires the California Air Resources Board (“CARB”) to adopt regulations to return the state’s greenhouse gas emissions to 1990 levels by the year 2020. In addition, CARB must recommend initiatives to continue reducing the state’s greenhouse gas emissions beyond 2020.

CARB has developed, and must implement by January 1, 2010, several early action measures, including a low-carbon fuel standard, restrictions on use of high global-warming potential refrigerants, requirements for capturing landfill methane, reduced use of certain greenhouse gases with high global-warming potential in consumer products, truck efficiency requirements, a tire inflation program, and a green port program.

In addition, CARB has established greenhouse gas emission reporting requirements for a group of industries that, according to CARB, account for 94 percent of California’s greenhouse gas emissions from industrial and commercial stationary sources. Covered industries, which include petroleum refineries, hydrogen plants, power plants and cogeneration facilities, utilities, and cement plants, must report by June 1, 2009.

CARB has determined that California’s 1990 greenhouse gas emissions, its target for 2020, totaled 427 million tons. CARB estimates that achieving that limit (which would represent 10 percent lower emissions than today) will require a 30 percent reduction in projected 2020 emissions under a “business as usual” scenario. To achieve such an ambitious mark,

California must reduce its carbon emissions by four tons per person per year.

In December 2008, CARB adopted its Scoping Plan to meet the 2020 emissions limit. Key elements of the Scoping Plan include:

- A “cap and trade” program (enforceable beginning in 2012) that links to programs of partner states within the Western Climate Initiative to create a regional emission credit market for electricity sources, industrial sources, transportation fuels, and commercial and residential sources.
- Carbon fees estimated at \$10 to \$50 per ton of carbon dioxide equivalent to influence investment decisions and fuel choices made by large suppliers of goods and services. Revenue would support further reductions in greenhouse gases.
- State leadership through a green government building initiative, use of cleaner fuels in state motor vehicles, insistence on green practices by government suppliers, and commuter alternatives for state employees.
- Increased transportation efficiency, including greater use of hybrid vehicles, more aerodynamic trucks, and a high-speed rail system.
- Greater use of solar panels.
- AB 32 and its attendant regulations will likely affect, directly or indirectly, any sizable business that emits greenhouse gases and does business in California. As CARB continues the process of implementing AB 32’s extensive mandates, businesses will face the complex task of understanding their obligations and opportunities under AB 32.

Thomas Donnelly

1.415.875.5880
tmdonnelly@jonesday.com



■ INVESTOR ACTIVISTS FOCUS ON WATER SUPPLY RISKS RELATED TO CLIMATE CHANGE

In February 2009, Ceres, a coalition of activist investors and environmental groups, issued a report analyzing the impact of climate change on the quantity and quality of water available to corporations that rely, directly or indirectly, upon these resources. The report, entitled *Water Scarcity & Climate Change: Growing Risks for Business & Investors*, outlines potential water risks to a variety of business sectors, including agriculture, beverage, and high-tech manufacturing, that may result if climatic changes reduce access to adequate supplies of clean water. The report also explores the financial reporting implications of these potential risks and suggests a template for corporations and investors to use in evaluating these issues.

Calls for Greater Environmental Disclosure. Organized in response to the Exxon Valdez disaster, Ceres is the largest coalition of investors, environmental groups, and public interest organizations in North America. Ceres' mission is to integrate sustainability into capital markets for the health of the planet and its people, and it advances this agenda by bringing investors, environmental groups, and other stakeholders together to encourage companies and capital markets to incorporate environmental and social challenges into their decision making. By leveraging the collective power of investors and other stakeholders, Ceres has become a powerful voice in the market. For example, Ceres launched the Investor Network on Climate Risk, a group of institutional investors with collective assets of more than \$7 trillion.

In recent years, investor activist groups have raised concerns that under the existing reporting framework, companies were not fully disclosing the financial risks posed by climate change. This new focus is driven by both the increased likelihood of greenhouse gas regulation at the federal level and the materializing risk for some industry sectors of litigation relating to climate change, as well as by a new focus on

ancillary climate change impacts such as damage to physical assets and market shifts related to public and investor sensitivity to climate change concerns. In September 2007, a group of environmental organizations, state officials, and institutional investors formally asked the SEC to issue interpretive guidance on the scope of public companies' reporting obligations with respect to climate change risk in corporate disclosures under existing SEC regulations.

Climate Change Affects Water Supplies. Following on the 2007 SEC petition and the greater scrutiny of public company reporting of risks associated with climate change, Ceres' Water Scarcity report explores the risks that climatic changes will threaten the quantity and quality of the world's water resources and the scope of obligations, if any, on public companies to disclose the financial implications of these risks. The climate change-related water risks identified by the report include the following:

- Decreases in long-term availability of water due to reduction of natural storage capacity from glacier melt;
- Water scarcity due to altered precipitation patterns and intensity (including a drop in water table levels);
- Impacts of flooding, extreme weather, and sea level rise on the capacity and reliability of water treatment and distribution; and
- Decreased water quality due to saltwater intrusion, higher water temperatures, and increased contamination due to flooding.

These environmental risks manifest as business risks by limiting the supply of pure water, increasing the cost of a reliable and sufficient water supply, affecting the cost of certain products and raw materials, and limiting locations of operation.

Other business risks include increased energy costs due to limited water supplies for energy generation, increased pretreatment costs, and restrictions on water resource uses. The Ceres report cites as examples the availability of "ultra-clean water" to the semiconductor industry in Asia, where access to such pure water may be affected by climate change. It also cites the risk that drought resulting from climatic change

could limit water supplies to U.S. beverage makers. The report also highlights “downstream” risks to industries whose suppliers face these risks.

Guidelines for Companies and Investors. Ceres recommends a set of steps for companies to identify and evaluate these business risks:

1. Measure the company’s water footprint throughout its entire value chain.
2. Assess physical, regulatory, and reputational risks associated with its water footprint.
3. Integrate water risk issues into strategic planning and corporate governance decisions.
4. Engage stakeholders, such as local communities, as part of water risk assessment and planning.
5. Disclose water performance and associated risks.

Conversely, Ceres recommends that investors demand more detailed disclosures of water-related risks by their portfolio companies and that investors encourage these companies to incorporate water issues into their climate change risk management strategies.

The Ceres Water Scarcity report is yet another reminder that publicly traded companies face increasing scrutiny of their climate change disclosures. The scope of such scrutiny, once focused narrowly on greenhouse gas emissions, has broadened to include water-related impacts. Investors (and customers) will increasingly expect companies to evaluate and appropriately manage these potential climate change risks. Even if a company does not face meaningful water-related climate change risks, it should nonetheless anticipate this sort of scrutiny and be prepared to explain its risk analysis and conclusions.

Christine Morgan

1.404.581.8215
cmmorgan@jonesday.com

Mary Beth Deemer

1.412.394.7920
mbdeemer@jonesday.com



The transition to a low-carbon economy seems likely, if not inevitable, in the years ahead. Under the existing Kyoto Protocol to the U.N. Framework Convention on Climate Change, Europe already has in place legally binding commitments to reduce greenhouse gas emissions. At the same time, the Obama Administration is actively promoting renewable energy and infrastructure, and it is prodding Congress to pass climate change legislation. Collectively, these initiatives encompass four of the main buckets of investment opportunities in a low-carbon economy:

- Low-carbon energy (*e.g.*, renewable energy and biofuels);
- Infrastructure support (*e.g.*, power transmission and manufacturing);
- Carbon trading (*e.g.*, emission “cap and trade” programs); and
- Emission offset projects (*e.g.*, the Kyoto Protocol’s Clean Development Mechanism).

The investment demand to support these initiatives will be substantial. Several studies point to an annual minimum of \$500 billion over several decades. Investors will face an array of choices in placing their bets. With the major economies of the world facing seismic changes, an interdisciplinary approach to monitoring the broad spectrum of legal and commercial developments in climate change will help investors to maximize these opportunities.

■ LOW-CARBON INVESTMENT OPPORTUNITIES AROUND UNDER THE UNITED STATES’ ECONOMIC STIMULUS BILL

Policymakers have been busy bolstering the main categories of investment opportunities through existing and proposed regulatory action. In the American Recovery and Reinvestment Act of 2009, better known as the “Stimulus Bill,” Congress and the Obama Administration appear to have laid

the groundwork for moving the U.S. away from fossil fuels via government support for renewable energy and infrastructure through loan guarantees, tax incentives, and direct government grants. This theme is almost certain to extend through the next federal budget, currently being negotiated in Congress.

The Stimulus Bill increases investment incentives by expanding the Department of Energy’s Innovative Technology Loan Guarantee Program. This program currently makes available \$38.5 billion in loan guarantees for advanced technology projects that avoid, reduce, or sequester air pollutants or greenhouse gases. The Stimulus Bill establishes a new temporary program to fund an additional \$60 billion in guarantees for projects that start construction by September 30, 2011, and widens participation by making these guarantees available to many previously ineligible projects.

The temporary program is designed to stimulate the development of (i) renewable energy projects and facilities that manufacture related components, (ii) electric power transmission systems, and (iii) leading-edge biofuel projects. Rather than limiting loan guarantees to projects supporting the use of new or improved technology, this program also finances projects that rely on existing technology (with the exception of the biofuels category). DOE awarded its first loan guarantee under the innovative technology program on March 20, 2009, when it offered a \$535 million loan guarantee for Solyndra, Inc.’s construction of a commercial-scale manufacturing plant for its proprietary cylindrical solar photovoltaic panels. More loan guarantees are expected to be awarded under the existing program over the coming weeks in the areas of innovative renewable energy and nuclear power. Meanwhile, DOE has signaled its goal to begin issuing more loan guarantees under the temporary program by summer 2009.

The Stimulus Bill also provides \$1.52 billion to DOE for a competitive solicitation process to identify and fund industrial “carbon capture and sequestration” (or “CCS”) and energy efficiency improvement projects, including a small allocation for projects with innovative ideas for beneficial reuse of carbon dioxide. The Joint Explanatory Statement to the Stimulus Bill also specifies that DOE will have an additional \$800 million to fund coal-based CCS projects that show significant

and imminent potential for commercial use in the electric power industry.

In support of infrastructure, the Stimulus Bill allocates \$2 billion for DOE grants to manufacturers of advanced battery systems and vehicle batteries, including lithium ion batteries, hybrid electrical systems, and related components and software. The Stimulus Bill also apportions \$4.5 billion for as-yet unspecified programs to modernize the U.S. power grid, enhance energy storage, and implement “smart grid” programs, among other transmission-related improvements.

Finally, the Stimulus Bill creates various tax incentives to encourage private investment in renewable energy projects and manufacturing. Existing production tax credits are extended through 2012 for wind energy projects and through 2013 for biomass, solar, geothermal, landfill gas, trash combustion, qualified hydropower, marine, and hydrokinetic energy projects. Some projects are eligible for a 30 percent investment tax credit in lieu of production tax credits. Alternatively, owners of certain projects may exchange tax credits for government grants—in the form of reimbursements—covering 10 to 30 percent of the cost of certain depreciable property.

The Stimulus Bill also creates a new 30 percent investment tax credit, capped at \$2.3 billion, for selected projects that re-equip, expand, or construct “advanced energy” manufacturing facilities (*e.g.*, facilities that use renewable resources, manufacture fuel cells for electric or hybrid vehicles, or capture and sequester carbon dioxide). Tax benefits are available for public infrastructure as well, with new types of tax credit bonds authorized for green community projects and for government-owned renewable energy facilities and public power providers.

Dickson Chin

1.212.326.7893

dchin@jonesday.com

■ **THE EUROPEAN UNION HAS ESTABLISHED A ROBUST CARBON MARKET**

The European Union Emission Trading Scheme (“EU-ETS”) is the centerpiece of the European Union’s efforts to reduce its greenhouse gas emissions. Under the EU-ETS, large greenhouse gas emitters must monitor and annually report their emissions and retire enough European Emission Allowances (“EUAs”) to meet their emissions targets. To meet their reduction obligations, emitters covered by the EU-ETS may (i) modify their business operations to reduce their emissions, (ii) purchase excess EUAs from exchanges or in the over-the-counter markets from other emitters or brokers, and (iii) subject to certain limitations, offset their emissions by purchasing Certified Emission Reductions (“CERs”) or Emission Reduction Units (“ERUs”) generated by emission reduction projects that qualify under the flexible mechanisms of the Kyoto Protocol.

European Emission Allowances. The global carbon trading market is dominated by transactions in EUAs. It is estimated that contracts for more than 2 billion EUAs were exchanged in 2007, with an aggregate market value of €37 billion, while more than 2 billion EUAs were exchanged in the first three quarters of 2008, with an aggregate market value of €68.5 billion. The majority of these transactions were conducted bilaterally in the over-the-counter markets, with the London Energy Brokers’ Association and the European Climate Exchange brokering a significant proportion.

Exchange-traded transactions were largely handled by the European Climate Exchange, Nord Pool, BlueNext, and the European Energy Exchange. Futures contracts accounted for most of the volume and value of exchange-traded transactions, with option trades and spot trades comprising nominal amounts.

Clean Development Mechanism. The Kyoto Protocol’s Clean Development Mechanism (“CDM”) is a program that allows developed countries (called “Annex B” countries) to invest in projects to reduce emissions in developing countries, as an alternative to more expensive emission reductions in their own countries. (The Kyoto Protocol also provides for Joint Implementation projects, a mechanism analogous to CDM for

investing in emission reduction projects in other developing countries, which generate ERUs.)

To obtain approval and receive the associated CERs, a CDM project must demonstrate that the emission reductions would not have occurred without the additional incentive provided by the CERs, a concept known as “additionality.” To date, almost 1,500 CDM projects have been registered, with an expected yield of more than 1.5 billion CERs by 2012. The vast majority of CDM projects are currently undertaken in China, India, and Brazil.

There are two markets for CERs. The primary CER market involves the initial sale of CERs by the developer of a CDM project. “Carbon funds” play an important role in this market by pooling public or private capital to finance CDM projects. Analysts estimate that approximately €7 billion was invested in such funds in 2007 and that carbon funds accounted for the creation of approximately 24 percent of all CERs.

To avoid project development, registration, and delivery risks, a secondary market for CERs has recently emerged involving the trade of guaranteed-delivery CERs that may be secured by a slice of the underlying carbon portfolio and/or credit-enhanced through the balance sheet of a highly rated bank. In the first three quarters of 2008, transactions in the primary CDM market amounted to an estimated €3.8 billion, while transactions in the secondary CDM market amounted to an estimated €8 billion, with the primary CDM market decreasing in value and the secondary CDM market increasing in value, compared to the same period in 2007.

International efforts to address climate change will culminate in the December 2009 Copenhagen Conference to replace the Kyoto Protocol, which ends in 2012. The successor to the Kyoto Protocol may garner participation by the United States and will likely incorporate the lessons learned from the implementation of the EU-ETS and CDM, which may in turn present new avenues for investment.

Sophie Hagège

33.1.56.59.39.46
shagege@jonesday.com

Naïma Zitouni

33.1.56.59.39.11
nzitouni@jonesday.com



■ **CARBON EXCHANGES PROVIDE OPPORTUNITY TO REGISTER AND TRADE CARBON COMMODITIES**

As the world regulatory regime (implemented through international treaties and national laws) creeps toward the formal regulation of emissions associated with climate change, exchanges that facilitate the registration, reduction, and trading of greenhouse gas emissions continue to gain steam. The two foremost exchanges commoditizing emissions of carbon dioxide are the Chicago Climate Exchange and the European Climate Exchange. Other exchanges include the Montreal Climate Exchange, the Tianjin (China) Climate Exchange, and the Australian Climate Exchange.

While there are similarities between the Chicago and European exchanges, there are also differences, perhaps reflecting the largely voluntary nature of carbon reductions in the United States as contrasted with those required in Europe, stemming from its participation in the Kyoto Protocol. The commodity traded on the Chicago Climate Exchange is the Carbon Financial Instrument contract, which represents 100 metric tons of carbon dioxide-equivalent allowances or offsets, while the European Climate Exchange trades two types of carbon credits: European Union-issued allowances and Certified Emissions Reductions, or “CERs.”

Launched in 2003, the Chicago Climate Exchange requires direct members (entities that have direct emissions of carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, or sulfur hexafluoride) to achieve specific emission reduction targets on a set schedule (4 percent for Phase I members by 2006 and 6 percent for Phase II by 2010).

Other members include associate members (businesses with negligible direct emissions that nevertheless commit to track and report direct and indirect emissions of carbon), offset providers (owners of qualifying carbon reduction projects), aggregators of smaller offset projects, liquidity providers (market makers and traders), and exchange participants that purchase and retire carbon reduction contracts.

On the European Climate Exchange, where approximately 2.3 billion allowances have been granted yearly to the 12,000 energy-intensive installations regulated by the European Union, one allowance, known as an “EUA,” equals one ton of carbon dioxide emissions. So-called Clean Development Mechanism projects (carbon reduction projects in developing countries) generate CERs that, once validated and issued, carry the same compliance value as EUAs. Thus, with certain restrictions, CERs can be used in place of allowances to satisfy compliance obligations of regulated entities.

Why would a U.S. company consider participating in a carbon exchange when emission reduction requirements have not yet been legally imposed? There are several reasons, including mitigation of financial, operational, and reputational risks associated with direct and indirect carbon emissions. Moreover, undertaking enforceable emissions reductions and tracking obligations demonstrates corporate commitment to address the climate change concerns of shareholders, customers, and the public, giving participating companies recognition as industry leaders in achieving early reductions in corporate carbon footprints.

Such involvement may also prove invaluable in establishing internal company processes and procedures for addressing future obligations for carbon reductions that may soon crystallize into enforceable requirements for many industries in the United States. State-based and regional greenhouse gas initiatives are well along in the development stage, while the likelihood of a complementary or superseding federal program has mushroomed, in light of the Democrats’ control of both the Capitol and the White House.

Graham Holden

1.404.581.8220
ggholden@jonesday.com

■ **VOLUNTARY CARBON STANDARD ASSOCIATION LAUNCHES GLOBAL REGISTRY**

Last month, the Voluntary Carbon Standard Association launched a global registry to track carbon offset credits generated under the Voluntary Carbon Standard from issuance until retirement. The Voluntary Carbon Standard is a global

standard and program for verifying credible voluntary greenhouse gas offsets. The program accepts projects that meet the substantive standards of the U.N. Clean Development Mechanism or the California Climate Action Registry, including projects in geographic areas that would not be eligible to receive credits under those programs. The Voluntary Carbon Standard also tries to encourage the development of offsets from certain agriculture, forestry, and land use activities, including afforestation, reforestation, and revegetation, by adopting a methodology for addressing concerns related to the permanence of carbon reductions from those activities.

To generate a Voluntary Carbon Unit, or “VCU,” in this program, a reduction in greenhouse gas emissions must be real, measurable, additional, permanent, independently verified, unique, and traceable. The purpose of the registry is to provide transparency and prevent offsets from being double-sold, with the goal of increasing market liquidity. The first registered project under the program was a 7.25 MW wind energy project in India generating more than 13,000 VCUs annually, which were worth about \$3.70 each in February. A system to allow VCUs to be traded across registries is also under development but has been delayed due to technical difficulties.

Chuck Wehland

1.312.269.4388
ctwehland@jonesday.com

RGGI initially limits aggregate carbon emissions by power generators in the region to 188 million tons per year and seeks to cut emissions 10 percent to 169 million tons per year by 2018. According to a recent report, RGGI participants emitted only 156.2 million short tons in 2008, already an 8.9 percent drop from 2007, credited in part to high oil costs and an increase in less polluting fuel sources, such as natural gas. The present oversupply of credits resulting from the drop in emissions would be expected to lead to a significant drop in the cost of carbon credits.

California is proposing to align with other western states and Canadian provinces to create a regional carbon market for electricity sources, industrial sources, transportation fuels, and commercial and residential sources. The state committed to reduce emissions to 1990 levels by 2020 in the California Global Warming Solutions Act of 2006 (AB 32). As part of its Scoping Plan to meet the 2020 emissions limit, the California Air Resources Board committed to develop a state greenhouse gas emission cap and trade program (enforceable beginning in 2012) designed to link to partner programs of other states and provinces within the regional Western Climate Initiative.

Ryan Dahl

1.412.394.9529
rddahl@jonesday.com

■ **RGGI REGIONAL CARBON MARKET GETS OFF GROUND**

In the absence of a federally regulated carbon market in the United States, regional carbon markets are beginning to take hold. The Regional Greenhouse Gas Initiative (“RGGI”), composed of 10 eastern states (CT, DE, ME, MD, MA, NH, NJ, NY, RI, and VT), which was the first mandatory, market-based effort in the United States to reduce greenhouse gas emissions, recently implemented a carbon credit auction, the first of its kind in the United States. As of March 2009, these states had raised \$263 million over the course of three auctions for emission permits.



■ U.S. AID AGENCIES SETTLE SUIT

On February 6, 2009, the United States Export-Import Bank and the Overseas Private Investment Corporation (“OPIC”) settled one of the first federal lawsuits that sought to use the courts to address impacts allegedly caused by global climate change. *Friends of the Earth, Inc. v. Spinelli* (N.D. Cal. No. 02-4106).

The suit was filed in 2002 by Friends of the Earth, Greenpeace, and the City of Boulder, Colorado. The California cities of Arcata, Santa Monica, and Oakland later joined this litigation as plaintiffs. The lawsuit alleged that fossil fuel projects financed by the two federal agency defendants produced cumulative emissions that were equivalent to nearly 8 percent of the world’s annual carbon dioxide emissions. The plaintiffs alleged that the agencies failed to assess whether the projects contributed to global warming or affected the U.S. environment, as they were required to do under the National Environmental Policy Act.

Under the settlement, the Export-Import Bank agreed to begin taking carbon dioxide emissions into account in evaluating fossil fuel projects and will create an organization-wide carbon policy. OPIC agreed to establish a goal of reducing greenhouse gas emissions associated with projects by 20 percent over the next 10 years. Both agencies committed to increasing financing for renewable energy.

This settlement is expected to substantially increase the available financial assistance for U.S.-supported projects that use, develop, or otherwise promote the use of renewable energy.

Jack Grady

1.404.581.8316
jhgrady@jonesday.com

■ STATE OF ALASKA CHALLENGES LISTING OF POLAR BEAR UNDER ENDANGERED SPECIES ACT

Last year’s much-publicized listing of the polar bear as “threatened” under the Endangered Species Act (“ESA”) has sparked a new wave of litigation over greenhouse gas emissions. Specifically, in late 2008, after the United States Fish and Wildlife Service listed the polar bear as a threatened species under the ESA due to threats to its Arctic habitat, including those from global climate change, the State of Alaska filed a lawsuit challenging the polar bear’s listing under both the ESA and the Administrative Procedures Act. *State of Alaska v. Kempthorne* (D.D.C. No. 1:08-cv-01352 EGS).

Alaska asserts that polar bear populations are stable, that melting sea ice does not pose an imminent threat to the survival of the species, and that polar bears have historically survived warming periods. Alaska further claims that listing the polar bear as a threatened species will have a “significant adverse impact” on various industries, including energy production, within the state.

Numerous industry groups, including the American Petroleum Institute, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the National Mining Association, have joined Alaska in trying to reverse the polar bear’s listing as a threatened species. While this litigation is in its initial stages, it seems certain that litigation of this kind will continue to be directed against various federal actions that are designed to address climate change, at least until a comprehensive federal, if not international, approach is adopted.

Kristin Parker

1.312.269.4342
kristinparker@jonesday.com

■ UTILITY COMPANY SEEKS INSURANCE COVERAGE FOR CLIMATE CHANGE LITIGATION

Does a company’s liability insurance provide defense and indemnity coverage if the company is sued for contributing to climate change? This question is currently being litigated in *Steadfast Ins. Co. v. AES Corp.* (Cir. Ct. of Arlington Cty. Va. No. 2008-858). Energy producer AES was one of multiple

energy companies sued for public nuisance by the Native Village of Kivalina. Kivalina alleged that the energy companies emitted greenhouse gases that caused global warming, resulting in massive erosion that is destroying Kivalina's land. AES sought defense and indemnity coverage under its liability policy with Steadfast Insurance. Steadfast thereafter filed suit for a declaratory judgment that Kivalina's climate change lawsuit is outside the scope of the applicable insurance policies.

Steadfast has asserted three reasons why there is no coverage for climate change litigation. First, the insurer argues that release of greenhouse gases does not constitute a covered "occurrence," because the release is not accidental but rather is part of the business of producing energy and foreseeably leads to global warming. Second, Steadfast argues that release of greenhouse gases falls under its policy's "Known Loss and Loss in Progress" exclusion, because such emissions began before the effective date of the policies. Finally, the insurer argues that release of greenhouse gases falls under its policy's pollution exclusion clause, because greenhouse gases were deemed "pollutants" by the U.S. Supreme Court in *Massachusetts v. EPA*, 549 U.S. 497 (2007).

Whether these arguments will succeed remains to be seen—Steadfast's motion for summary judgment is currently pending. Whatever the outcome, it is likely to shape other courts' interpretations of language in similar policies, as well as how insurers will draft policies in the future.

Jane Story

1.412.394.7294

jbstory@jonesday.com



■ **UNITED KINGDOM IMPLEMENTING CAP AND TRADE PROGRAM FOR ELECTRICITY USERS**

Pursuant to the U.K. Climate Change Act 2008, the new Carbon Reduction Commitment ("CRC") will establish carbon dioxide emissions trading obligations for large non-energy-intensive organizations. On March 12, 2009, the U.K. Department of Energy and Climate Change launched a consultation on the Draft Order to Implement the CRC; consultation on the Draft Order is due to close June 4, 2009.

The new program will affect an estimated 20,000 private and public organizations whose annual electricity bills exceed £1 million a year. The CRC will apply if (a) the organization has at least one meter settled on the half-hourly market; and (b) the total of its half-hourly metered electricity consumption is greater than 6,000 megawatt hours per year during 2008. The CRC will not extend to emissions covered by U.K. Climate Change Agreements or those dealt with under the EU Emission Trading Scheme ("EU-ETS"). Emissions associated with transportation are also excluded from the CRC. Special rules will require parent and subsidiary organizations to amalgamate their electricity consumption in assessing whether the CRC applies to them. If they qualify, they will have to participate on a combined basis through the highest parent organization. The CRC will therefore affect non-U.K. companies with U.K. subsidiaries.

The CRC scheme will start in April 2010 with a three-year introductory period. In April 2011, affected organizations will have to buy allowances to cover their actual energy use during Phase 1, from April 2010 to March 2011, and their expected energy use for Phase 2, from April 2011 to March 2012. Reported emissions for Phase 1 will set the baseline against which participants' future performance will be measured. Allowances during the introductory period will be sold at a fixed price of £12 per ton of carbon dioxide.

Following the introductory period, the government will establish a cap on total carbon dioxide emissions in any year, and the government will then auction an equivalent number of allowances. Participants will have to annually surrender sufficient allowances to cover the amount of carbon dioxide they emitted. Additional allowances to make good any shortfalls will have to be purchased from other participants or through the EU-ETS.

The government will publish an annual “league table” ranking CRC participants according to their performance for the year. Revenue from auctioning allowances will then be recycled back to the participants (after deducting the government’s administration costs), incorporating a bonus/penalty adjustment of between +10 and -10 percent in Phase 1, widening annually to reach +50 to -50 percent by the fifth year of the CRC, depending on their position in the CRC league table.

Chris Papanicolaou

44.20.7039.5321

cpapanicolaou@jonesday.com

■ MOST COMMERCIAL AVIATION EMISSIONS TO BE COVERED BY THE EU TRADING PROGRAM

On November 19, 2008, the EU-ETS was amended to include greenhouse gas emissions from certain aviation activities. Member states will have until February 2, 2010, to incorporate this change into their national legislation.

Beginning in 2012, “Operators” of passenger and cargo aircraft with a potential maximum takeoff weight of at least 5,700 kg flying to, from, and within the EU will be subject to the EU-ETS, whether or not the Operator is EU-based. Each such Operator will be administered by a single member state regarding emissions from all flights to, from, and within the EU. Exemptions are military, police, customs, and rescue flights; flights on state and government business; and training or testing flights. There is also an exemption for commercial Operators with very low traffic levels (emitting less than 10,000 tons of carbon dioxide per year).

Operators will be required to surrender one allowance for every ton of carbon dioxide emitted on flights to, within, and

from the EU. Like others covered by the EU-ETS, Operators will be able to sell surplus allowances if they reduce their emissions, but they will need to buy additional allowances if their emissions grow. Allowances can be purchased from other parties subject to the EU-ETS (such as utility or industrial companies) or on the open market. Operators may use emission credits from emissions reductions projects under the Kyoto Protocol’s Clean Development Mechanisms or Joint Implementation projects to meet up to 15 percent of their obligation.

Initially, a quantity of emission allowances equal to 97 percent of recent historical aviation emissions (the average of emissions from 2004 to 2006) will be available. This cap will be lowered to 95 percent from 2013 to 2020, although this percentage may be reviewed as part of the general review of the EU-ETS. Operators will receive 85 percent of their allowances for free in 2012 (this percentage will be reduced starting in 2013) and must purchase the remaining 15 percent. The allocation will be determined by the Operator’s total amount of ton-km in the base year 2010 (*i.e.*, product of payload and distance) and a benchmark factor. Operators will be limited to 1 million allowances per year. A number of free allowances (representing 3 percent of overall allowances) is reserved for new entrants and very fast-growing airlines.

Noncompliant Operators face penalties of €100 per ton of excess carbon dioxide emissions. Payment of a fine will not release an Operator from its obligations, and the excess emissions will be added to the Operator’s obligation for the next year. Member states will publish the names of Operators that fail to surrender sufficient allowances, and at the request of a member state, the European Commission may impose an operating ban on such Operators if other enforcement measures are ineffective.

Françoise Labrousse

33.1.56.59.39.48

flabrousse@jonesday.com

Chris Papanicolaou

44.20.7039.5321

cpapanicolaou@jonesday.com

THE CLIMATE REPORT EDITORIAL BOARD

EDITORIAL BOARD

Dickson Chin

New York Office
Energy
+1.212.326.7893
dchin@jonesday.com

Stephanie S. Couhig

Cleveland Office
Environmental, Health & Safety
+1.216.586.7337
sscouhig@jonesday.com

Kevin P. Holewinski

Washington Office
Environmental, Health & Safety
+1.202.879.3797
kpholewinski@jonesday.com

Christine M. Morgan

Atlanta Office
Environmental, Health & Safety
+1.404.581.8215
cmmorgan@jonesday.com

Jane K. Murphy

Chicago Office
Environmental, Health & Safety
+1.312.269.4239
jkmurphy@jonesday.com

Chris Papanicolaou

London Office
Environmental, Health & Safety
+44.20.7039.5321
cpapanicolaou@jonesday.com

EXECUTIVE EDITOR

John A. Rego

Cleveland Office
Environmental, Health & Safety
+1.216.586.7542
jrego@jonesday.com

CONTACTS

CALIFORNIA

Thomas M. Donnelly

San Francisco Office
Environmental, Health & Safety
+1.415.875.5880
tmdonnelly@jonesday.com

GEORGIA

G. Graham Holden

Atlanta Office
Environmental, Health & Safety
+1.404.581.8220
ggholden@jonesday.com

ILLINOIS

Charles T. Wehland

Chicago Office
Energy
+1.312.269.4388
ctwehland@jonesday.com

NEW YORK

Thomas C. Havens

New York Office
Energy
+1.212.326.3935
tchavens@jonesday.com

OHIO

John A. Rego

Cleveland Office
Environmental, Health & Safety
+1.216.586.7542
jrego@jonesday.com

PENNSYLVANIA

Mary Beth Deemer

Pittsburgh Office
Environmental, Health & Safety
+1.412.394.7920
mbdeemer@jonesday.com

TEXAS

Jason F. Leif

Houston Office
Energy
+1.832.239.3727
jfleif@jonesday.com

WASHINGTON, D.C.

Kevin P. Holewinski

Washington, D.C. Office
Environmental, Health & Safety
+1.202.879.3797
kpholewinski@jonesday.com

EUROPE

Sophie Hagège

Paris Office
Mergers & Acquisitions
+33.1.56.59.39.46
shagege@jonesday.com

ASIA/AUSTRALIA

Kaoru Umino

Tokyo Office
Banking & Finance
+81.3.6744.1616
kumino@jonesday.com

LATIN AMERICA

José Estandia

Mexico City Office
Energy
+52.55.3000.4081
jestandia@jonesday.com

JONES DAY LOCATIONS

ATLANTA

BEIJING

BRUSSELS

CHICAGO

CLEVELAND

COLUMBUS

DALLAS

DUBAI

FRANKFURT

HONG KONG

HOUSTON

IRVINE

LONDON

LOS ANGELES

MADRID

MEXICO CITY

MILAN

MOSCOW

MUNICH

NEW DELHI

NEW YORK

PARIS

PITTSBURGH

SAN DIEGO

SAN FRANCISCO

SHANGHAI

SILICON VALLEY

SINGAPORE

SYDNEY

TAIPEI

TOKYO

WASHINGTON