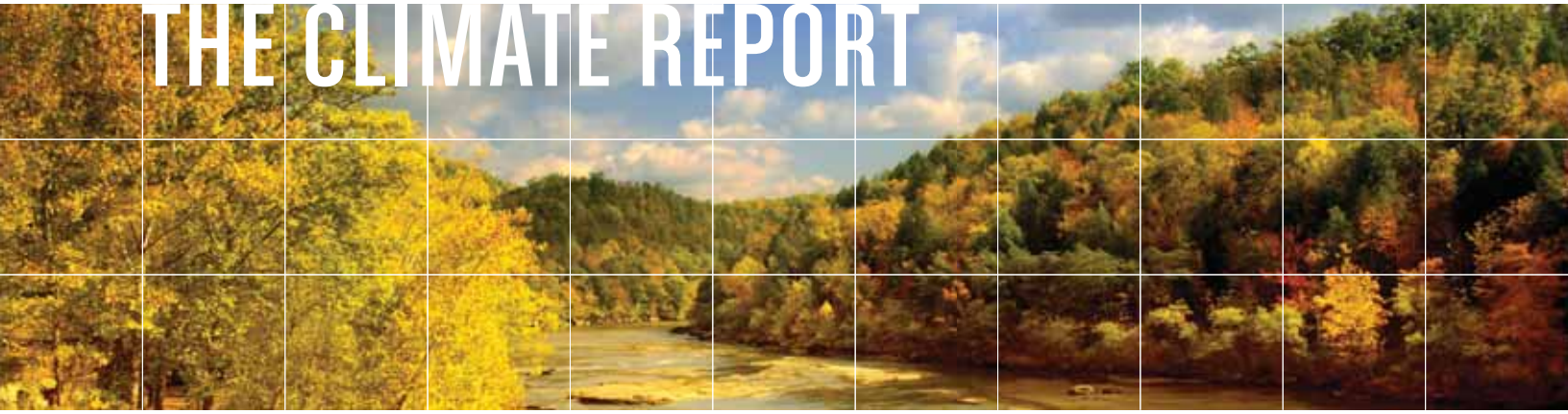
FALL 2011 ISSUE

THE CLIMATE REPORT



DEPARTMENTS

U.S. REGULATORY DEVELOPMENTS

Jane K. Murphy, Editor

CARB TO FINALIZE CALIFORNIA CAP AND TRADE REGULATIONS

While development of a greenhouse gas "cap and trade" program has stalled at the federal level, the California Air Resources Board ("CARB") is scheduled to consider final approval of a cap and trade program for California on October 20, 2011.

A cap and trade program establishes a cap on greenhouse gas emissions and requires emission sources to collectively achieve the cap by obtaining and annually submitting emission allowances, offset credits, and sector-based offset credits. The program is one of the mechanisms established by CARB's "Scoping Plan" to implement the requirement in California's Global Warming Solutions Act (AB 32) to reduce greenhouse gas emissions to 1990 levels by 2020.

A legal challenge to CARB's adoption of the Scoping Plan resulted in a state Superior Court decision forcing CARB to expand on its original California Environmental Quality Act assessment and address other deficiencies. At its public hearing on August 24, 2011, CARB approved the supplemental assessment and reapproved the Scoping Plan.

In addition, CARB is putting the finishing touches on regulations establishing the cap and trade program. Modified regulations were released for public comment on both July 25, 2011 and September 12, 2011. CARB is scheduled to consider the cap and trade regulations for final approval on October 20, 2011.

If, as expected, CARB approves the modified cap and trade regulations, the program will begin in January 2012. Emission sources covered by the program will have to register with CARB by January 31, 2012, the first auction of emission allowances will be held in August 2012, and the obligation to obtain compliance instruments for most covered sources will commence on January 1, 2013.

Thomas Donnelly
+1.415.875.5880
tmdonnelly@jonesday.com

Charles Hungerford
+1.415.875.5843
chungerford@jonesday.com

For a detailed look at California's proposed cap and trade program, see the Jones Day White Paper *entitled "California Adopts Cap and Trade Program for Greenhouse Gas Emissions," and the Jones Day* Alerts *entitled "CARB Releases Modified Cap-and-Trade Regulations for Final Approval" and "Cap-and-Trade in California Is Imminent."*

ENERGY POLICY DEVELOPMENTS FAVOR RENEWABLE ENERGY SOURCES

The Federal Energy Regulatory Commission has issued an order that bolsters policies requiring new electric transmission facilities to be planned on a regional basis and sets broad standards for cost allocation methods that take into account public policies, such as greenhouse gas reduction and the identity of beneficiaries. *See* Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities, Order No. 1000.

In explaining the FERC's decision, Order No. 1000 references, among other things, federal and state policies promoting renewable energy and other low-carbon generation resources. The FERC mentions estimates by North American Electric Reliability Corporation that roughly one third of new and upgraded electric transmission facilities will be needed to integrate variable and renewable generation. Accordingly, Order No. 1000 requires that public policies, such as promotion of renewables, be taken into account in the transmission planning process, stating that the process could better identify solutions for reliably and cost-effectively integrating the location-constrained renewable energy resources needed to fulfill public policy requirements, such as the renewable portfolio standards adopted by many states.

The Energy Policy Act of 2005 directed the U.S. Department of Energy to publish a study of electric transmission congestion for public comment every three years and to designate as national interest electric transmission corridors ("NIETCs") areas that require new transmission infrastructure due to congestion. In September 2011, DOE announced that it was considering whether to delegate its transmission study and NIETC responsibilities to the FERC, based on two FERC whitepapers, a transmission siting narrative, and an outline, which provided broad policy support for delegation of NIETC-related responsibilities to the FERC. On October 11, 2011, however, DOE and the FERC issued a joint statement that DOE would not delegate its transmission study and NIETC responsibilities, but the agencies announced that they would begin working together to draft (1) transmission congestion studies mandated by Congress, (2) supplements to those studies based on FERC Order Nos. 890 and 1000, and (3) environmental analyses for proposed NIETCs.

The joint statement comes in the wake of setbacks to both agencies' authority over transmission development. In 2009, the U.S. Court of Appeals for the Fourth Circuit denied the FERC's power to authorize transmission siting specifically where a state had rejected such siting, and in 2011, the U.S. Court of Appeals for the Ninth Circuit rejected two NIETCs designated by DOE.

Kevin J. McIntyre
+1.202.879.3917
kjmcintyre@jonesday.com

Mosby Perrow
+1.202.879.3410
mgperrow@jonesday.com

FIRST GREENHOUSE GAS EMISSIONS REPORTS SUBMITTED AS EPA CONTINUES TO ISSUE RELATED RULES

Facilities and suppliers that monitored greenhouse gas emissions during 2010 under U.S. EPA's Greenhouse Gas Reporting Program were required to submit the first round of annual reports under the program to EPA by September 30, 2011. EPA received most of the emissions-related data through its new web-based system, known as the Electronic Greenhouse Gas Reporting Tool, or "e-GGRT."

Industries that were not required to begin collecting data until January 1, 2011 were not subject to the deadline. Those facilities' first annual emissions reports are currently due March 31, 2012, but EPA proposed on August 4, 2011 to extend that initial reporting deadline by six months to September 28, 2012.

Before the first reports were due, U.S. EPA issued a final rule that deferred the reporting deadline for certain business-sensitive data elements used as inputs to emission equations for some direct emitters (*i.e.*, those covered by Subparts C through JJ, RR, SS, and TT of the reporting rule. The new deadline for some of that data for calendar years 2010 and 2011 is now March 31, 2013, and for others it is now March 31, 2015. EPA says the reporting deferral is necessary to allow more time for it to consider whether the data should be made publicly available.

In addition, on September 27, 2011, EPA published two final rules modifying requirements for certain facilities. One rule allows the largest semiconductor manufacturing facilities the option of using default emission factors (instead of directly measured recipe-specific emission factors) to calculate emissions from etch processes during 2011 through 2013. The other rule amends certain provisions for oil and natural gas systems. The two rules provide additional time for the covered facilities to use "best available monitoring methods" or "BAMM" in 2011 without submitting a request to EPA, and additional time to submit a request to use BAMM to estimate emissions beyond 2011.

EPA continues to refine the program. On August 4, 2011 and September 9, 2011, EPA proposed technical corrections and clarifications to the general provisions of the mandatory greenhouse gas reporting rule, 40 C.F.R. Part 98, as well as to a number of industry-specific subparts of the rule.

Casey Fernung Bradford
+1.404.581.8119
cbradford@jonesday.com

EPA MISSES DEADLINE FOR PROPOSED POWER PLANT GREENHOUSE GAS EMISSION RULE

U.S. EPA confirmed in September that it again would miss a September 30, 2011 deadline to propose new source performance standards to regulate greenhouse gas emissions from new and existing power plants. The September 30 deadline arose from a settlement of a lawsuit brought in the U.S. Court of Appeals for the District of Columbia Circuit by 11 states, the District of Columbia, the City of New York, and three environmental groups. That suit sought to compel EPA to issue new source performance standards for greenhouse gas emissions from power plants in light of the Supreme Court's decision in *Massachusetts v. EPA*.

Under the settlement, EPA originally agreed to propose such a rule by July 28, 2011, but later negotiated an extension to September 30. EPA now says, however, that it needs more time to propose the standards. Despite missing this deadline, EPA has not proposed a new date by which it will issue the proposed rule and has not yet requested (or indicated whether it will request) an extension of the settlement's May 26, 2012 deadline for issuing the final rule.

EPA's failure to issue the proposed greenhouse gas standards comes amid a hostile political climate on such issues. Earlier this month, President Obama announced that EPA would abandon plans to reconsider the Bush administration's

National Ambient Air Quality Standards for ozone, in an effort to reduce regulatory uncertainty during the economic recovery. Industry groups and conservative members of Congress have similarly criticized recently promulgated greenhouse gas regulations and similar rules under development, such as the power plant standards, as hindering the country's job growth.

Kristin Parker
+1.312.269.4342
kristinparker@jonesday.com

CLIMATE CHANGE ISSUES FOR MANAGEMENT

Christine Morgan, Editor

CERES REPORT FINDS IRONY IN THE INADEQUACY OF INSURERS' ATTENTION TO CLIMATE RISK

In September 2011, Ceres released its report, *Climate Risk Disclosure by Insurers: Evaluating Insurer Responses to the NAIC Climate Disclosure Survey.* The Report, the first of its kind, analyzes 88 insurance companies' unique public responses to the National Association of Insurance Commissioners' climate risk disclosure survey, to evaluate how U.S. insurance companies perceive and assess climate-related risks.

For "an industry literally built on assessing, modeling and mitigating risk," the Report's assessment is unsettling. (Report at 3) The Report concludes that as more extreme and unpredictable weather contributes to increased disease, liability claims, and investment risk—threatening the insurance industry's health and consumers' ability to obtain and afford insurance—most insurers only marginally consider climate risk in their business models and risk assessments. To reach this conclusion, the Report analyzes disclosure trends in seven key areas:

Risk Perception & Management Structure. Most of the responding insurers acknowledge that climate change will affect extreme weather events, yet less than 15 percent have formal climate change polices and "[m]ore than sixty percent have no dedicated management approach to assessing climate risk." (Report at 20) Just over half maintain they are not exposed to climate change risk, but only half of those explain why. Generally, the most vulnerable insurers are those whose products are closest to consumers (*e.g.*, life/health and property/casualty).

Risk Exposure and Management. Insurers appear to focus largely on coastal regions as the geographies susceptible to climate risk, which "contradicts recent experience with inland weather-related losses and the scientific community's expectations of greater potential for catastrophic losses from

wildfires, thunderstorms and flooding in addition to other inland perils." (Report at 22) Moreover, most of the insurers' disclosures do not meaningfully identify where future exposure may be limited, explain loss expectations and corresponding effects on pricing, or cite liability exposure as part of their climate-related risk.

Financial Effects. More than 40 percent of responding insurers who recognize climate risk exposure fail to disclose its potential effects on pricing, capital adequacy, or reinsurance requirements, suggesting that most "may not be adjusting their pricing and capital allocation approaches despite growing evidence of the potential for extreme and volatile losses." (Report at 27) Similarly, more than half of respondents identify climate change as potentially contributing to financial risk, but only 18 percent "provide actionable steps being taken to manage these risks." (Report at 30) Most seem to believe, perhaps mistakenly, that their diversification, reinsurance coverage, and annual contract terms sufficiently manage their climate-related risk.

Loss Modeling. Most responding insurers rely heavily on historical statistics or third-party vendors' catastrophe models to shape their climate risk perspective and to set pricing and exposures. But, according to Ceres, most third-party vendors only marginally integrate climate-related risk into their catastrophe models, focusing on hurricanes and neglecting other loss-causing perils like tornados, wildfires, floods, and snowstorms.

Large insurers more readily recognize this inadequacy and have resources to develop their own loss models. The Report finds that others, however, rely on third-party vendors, believing—almost uniformly, but inaccurately—that the third-party models sufficiently account for climate risk, thereby creating a market where "many of the smaller companies operating within their states likely are setting pricing based on flawed beliefs of how the proprietary models work." (Report at 35)

Investments. One global investment advisor, Mercer (a wholly owned subsidiary of Marsh & McLennan Companies, Inc.), cautions that over the next 20 years, climate change could introduce 10 percent portfolio risk. Yet, less than 15 percent of responding insurers believe their investments are definitely exposed to climate-related risks, and few maintain explicit climate change investment policies. Instead, apparently believing that climate risk "will unfold slowly over decades," most cite general investment strategies, including risk management and portfolio diversification, credit quality, and duration, as satisfactory climate risk management tools. (Report at 39) Thus, the Report suggests that relatively few insurers recognize the potential for climate-based, industry-wide investment losses and opportunities.

Emissions Management. Ceres describes individual operational emissions management as the first step to address climate change risk and "indicative of an overall commitment to sustainability and environmental issues." (Report at 44) Yet, the majority of responding insurers are taking no action or only modest action to reduce their operational greenhouse gas emissions. Ceres concludes that this suggests general inattention to these issues within the insurance industry.

External Engagement. Finally, despite insurers' crucial role in shaping risk perspective and response, 70 percent of responding insurers do not report assisting their customers and society to understand and manage climate change risk. Rather, the same few insurers participate in climate change research and engage policymakers and customers on climate change issues and trends.

Ceres concludes the Report with several overall recommendations for insurance industry regulators to more effectively oversee insurers' assessment and management of climate-related risk, including: (1) institute mandatory, publicly available disclosure; (2) establish shared resources on the impacts of climate trends on enterprise risk management; and (3) clarify disclosure expectations.

Discussion of insurers' inattention to climate risk is not limited to the National Association of Insurance Commissioners and Ceres. Others have tracked and reacted to the issue. Reuters and MarketWatch publicized NAIC's survey and Ceres' Report, recapping recent and unanticipated extreme weather events, highlighting insurers' payments for losses sustained from Hurricane Irene—which occurred when 2011 insured losses had already exceeded those of 2010 by 40 percent—and expressing the public's desire to know more about climate risk. *See* Ben Berkowitz, "Few Insurers Planning for Climate Change—Report," Reuters, Sept. 1, 2011;

Al Lewis, "Global Warming No Hoax to Insurance Companies," MarketWatch, Sept. 9, 2011.

ClimateWire went further, reporting that an NAIC panel would delve into insurers' investments and their susceptibility to climate risk, which could more seriously alert the financial sector, as well as potentially lead to invigorating investments in clean energy. *See* Evan Lehmann, "Regulators to Focus on Climate Threats to Insurers' Investments," ClimateWire, Aug. 5, 2011. Increased attention to the issues raised in the Report may spark a change in insurers' business models and a renewed focus on the realities of climate change risk management.

Mary Beth Deemer
+1.412.394.7920
mbdeemer@jonesday.com

Megan Roby
+1.412.394.7212
mroby@jonesday.com

CARBON MARKET TRANSACTIONS

Dickson Chin, Editor

PLANTING THE SEEDS FOR DEVELOPMENT? OUTLOOK FOR FUTURE U.S. OFFSHORE WIND POWER

The energy-generating potential of U.S. offshore winds is enormous. According to a recent estimate by the National Renewable Energy Laboratory ("NREL"), it is about four times the total capacity of all other U.S. generation sources. Offshore winds are stronger and steadier than winds onshore, because of the absence of topographical interference. NREL estimates that about 66 percent of U.S. offshore winds are in wind class 6 or 7, the top two tiers of NREL's rating system of energy-producing potential.

To date, however, no offshore wind generation facilities have been deployed in U.S. coastal waters. A major factor has been the high projected capital cost of such facilities, particularly when compared to the cost of onshore facilities. NREL currently estimates that the baseline installed capital cost for offshore wind power, based on market surveys, will be $4,250 per kilowatt (kW). In comparison, the average capital cost of onshore wind power, according to a recent Department of Energy study, is $1,775 per kW, or less than 50 percent of the projected cost of offshore wind power.

The dramatically higher capital costs of offshore wind power derive from the harsher winds and waves of the offshore environment. These factors include the increased costs, using current technology, of upgraded turbines and enhanced support structures required for operation at sea, and the increased costs of installing foundations for those enhanced support structures into the seabed. There will be additional one-time costs for the infrastructure required to support installation and operation offshore, including costs to build specialized vessels for turbine support structure installation, and port and harbor upgrades to accommodate those vessels.

In February 2011, the DOE and the Department of the Interior issued a National Offshore Wind Strategy for reducing the cost and timeline for the deployment of offshore wind power

facilities in the U.S. An overarching goal of the Strategy is to coordinate DOE and DOI efforts to support the deployment of 54 gigawatts (GWs) of U.S. offshore wind generating capacity by 2030, with a cost of energy of 7 cents per kilowatt-hour (kWh). The interim target of the Strategy is 10 GWs of offshore capacity deployed by 2020, with a cost of energy of 10 cents per kWh.

In September 2011, DOE announced a potentially significant step in its implementation of the National Offshore Wind Strategy: awards of $43 million in grants to fund 41 offshore wind research and development projects, subject to Congressional appropriations. DOE's announcement divides the awards into two categories: (1) 19 offshore wind technology development projects awarded an aggregate of $26.5 million in grants, and (2) 22 market barrier removal projects awarded an aggregate of $16.5 million. DOE's announcement also notes that the technology development projects include research and development for innovations in key components, such as floating support structures and turbine rotor and control systems, that "may lead to capital cost reductions of up to 50 percent."

In concept, floating support structures for offshore wind turbines are potential game-changers for the nascent offshore wind industry. Among other potential advantages, they could enable wind turbines to be deployed in waters of depths exceeding 60 meters (which is beyond the design limits of existing rigid support structures), where the strongest and steadiest offshore winds exist, offering significantly greater power-producing potential than winds closer to shore. Floating support structures could also significantly reduce the capital costs and the timeline for deploying offshore wind-generating capacity, and the costs of maintaining offshore wind turbines, by eliminating the need for the special marine vessels used to install rigid support structures offshore, and the specialized port facilities required for those vessels.

As DOE seeks to spur research and development into technical innovations that could dramatically reduce the cost of deploying U.S. offshore wind power facilities, the DOI's complementary "Smart From the Start Initiative," announced in November 2010, has been taking steps to decrease the timeline for individual offshore projects to complete the process of siting, permitting, and leasing sites in federal waters, from what was once expected to take as long as seven years to as short as two years.

All of these developments suggest that, within the next few years, efforts by the federal and state governments to spur the deployment of economically viable, U.S. offshore wind power production may begin to bear fruit.

Michael Gibbs
+1.212.326.3792
mgibbs@jonesday.com

STORM CLOUDS WITH A SILVER LINING? OUTLOOK FOR U.S. RENEWABLE ENERGY SECTOR

Solyndra's high-profile bankruptcy on August 31, only two years after its receipt of $535 million in federal funding and loan guarantees, represents just the latest in a steady stream of negative news and unfavorable developments buffeting the U.S. renewable energy sector. These include (1) the impending expiration of valuable federal tax benefits and other incentive programs that drive private investment in renewable energy projects, and (2) the fiscal pressures leading many federal and state policymakers to eliminate or reduce renewable energy incentives. When coupled with diminished expectations for passage of a federal renewable or "clean" energy standard, these developments have created a pessimism among many for continued growth in the industry. Even so, there are other positive signs suggesting the sector could see significant increases in project installations over the next several years.

The two largest clean energy programs of the American Recovery and Reinvestment Act ("ARRA") have been (1) the ARRA Section 1603 Treasury Department cash grant initiative, under which project developers receive a cash grant in lieu of a 30 percent federal investment tax credit, and (2) the ARRA Section 1705 loan guarantee program for renewable energy projects and innovative technologies. The Section 1603 program has paid more than $8.5 billion in cash grants since 2009, far above the initial $3 billion projected. The program has been particularly important for the solar energy

sector, where installations have more than doubled in 2010 and where such growth is expected to continue into 2011. Although the grant program received a last-minute, one-year extension in December 2010, today's environment offers little hope for further extension of the program before it expires at the end of 2011. Similarly, the wind energy industry is bracing for a difficult battle to extend the federal production tax credit due to expire after 2012.

The ARRA Section 1705 loan guarantee program, administered by the Department of Energy, came to an end at the end of September 2011. The program received significant negative publicity following the Solyndra bankruptcy and the prior bankruptcy filings by Evergreen Solar and SpectraWatt. Notwithstanding these high-profile failures, the program provided conditional commitments for loans and loan guarantees totaling more than $40 billion, including the $1.237 billion project loan guarantee provided to SunPower Corporation in connection with its sale to NRG of the 250-megawatt California Valley Solar Ranch on September 30. Nevertheless, Washington's current deficit reduction focus, and the unlikelihood that anything characterized as "stimulus" will survive the current fiscal climate, means there is very little chance that the Section 1705 program will be renewed or replaced in the near term.

The states also find themselves struggling with renewable energy initiatives in the current fiscal climate. For example, Ohio is expected to revisit the state's Alternative Portfolio Standard, which currently mandates 12.5 percent of Ohio's power from renewable sources by 2025. Similarly, New Jersey, a leader in solar energy development for the past three years, has proposed an Energy Master Plan calling for 22.5 percent renewable by 2020, a retreat from a more ambitious 30 percent target sought previously.

Amid these headwinds, several positive signs exist, particularly in places like California where a new aggressive renewable energy portfolio standard requires the state's utilities to procure 33 percent of their electricity from renewable resources by 2020. Also in California, on the last day of the legislative session, the governor, members of both parties, and the Chamber of Commerce collaborated on legislation still pending on the governor's desk designed to streamline the permitting, siting, and development process for renewable energy projects in order to reduce the costs of permitting, which have grown from an estimated 17 percent to 33 percent of installation cost over the past six years. Finally, in August, the California Public Utilities Commission adopted final rules to implement a Renewable Auction Mechanism program designed to jump start the construction of smaller renewable energy projects (up to 20 MW) in the state.

In addition, the Department of Defense continues its vigorous promotion of renewable energy use as the largest institutional energy user in the U.S., managing more than 500,000 buildings and structures at more than 500 major bases in the U.S. and overseas. For example, the U.S. Army recently established an Energy Initiative Office Task Force to work with the private sector to develop large-scale renewable energy projects, with a goal of obtaining 25 percent of the Army's energy needs from renewable sources by 2025. The Army anticipates the initiative could attract nearly $7 billion in private investment over the next decade and significantly reduce its dependence on oil.

Although this momentum may not overcome the challenges to financing renewable energy projects caused by the loss of the ARRA programs and other subsidies, California's continued growth of the sector and the military's strong support suggest reason for some optimism.

Tom Havens
+1.212.326.3935
tchavens@jonesday.com

CLIMATE CHANGE LITIGATION

Kevin P. Holewinski, Editor

COURTS FIND LACK OF STANDING TO CHALLENGE AGENCIES FOR FAILURE TO CONSIDER CLIMATE CHANGE

Two different federal district courts recently ruled that certain environmental groups lacked standing to sue federal agencies for failing to consider the impact their actions might have on climate change.

In *Sierra Club v. U.S. Defense Energy Support Center*, No. 01:11-cv-41 (E.D. VA), plaintiffs alleged that the Defense Logistics Agency's component DLA Energy violated the Energy Independence and Security Act of 2007 ("EISA"), the Administrative Procedures Act, and the National Environmental Policy Act when it entered into purchase contracts for fuel derived from Canadian oil sands recovered crude oil ("COSRC") because it failed to specify that the lifecycle greenhouse gas emissions associated with COSRC fuels would not exceed those of conventional fuels, as required by Section 526 of EISA.

On July 29, 2011, the U.S. District Court for the Eastern District of Virginia granted defendants' motion to dismiss, because the plaintiffs had failed to prove that their individual members would have standing to sue. According to the court, the plaintiffs did not plead a particularized injury-in-fact from refining of COSRC or DLA Energy's purchasing contracts, but instead relied on the generalized environmental impacts of climate change. The court also found that plaintiffs' injuries were not fairly traceable to defendants' actions and not redressible by the court because the unique global nature of greenhouse gases makes it impossible to prove that plaintiffs were injured by emissions arising from DLA Energy's contracts and not from the emissions of an independent third party.

Similarly, in *Amigos Bravos v. United States Bureau of Land Management*, No. 6:09-cv-00037-RB-LFG (D. NM), the plaintiffs alleged that the Bureau of Land Management ("BLM") failed to "meaningfully address the issue of climate change" when it approved 92 oil and gas leases on public land in New Mexico. On August 3, 2011, the U.S. District Court for the District of New Mexico granted defendants' motion to dismiss for lack of standing, holding that plaintiffs failed to prove they had a particularized injury-in-fact and that their injuries were fairly traceable to defendants' actions. Specifically, the court held there was insufficient evidence of imminent threatened or actual harm, because plaintiffs did not present "scientific evidence or formal, recorded observations to support" their allegations but instead relied on unsubstantiated conjecture regarding the impact of climate change on New Mexico.

Also, plaintiffs' allegation that their members generally used public lands in New Mexico failed to prove a geographic nexus between their injuries and the land in question. The court then held that the plaintiffs' injuries were not fairly traceable to defendants' actions because "it stretches credibility to believe that the injuries Plaintiffs' members complain of … can be said to be fairly traceable to this relatively small amount of [greenhouse gas] emissions" from the oil and gas leases.

Unlike the court in *Sierra Club*, the *Amigos Bravos* court did note that plaintiffs would likely meet the redressibility prong of the standing analysis, because requiring BLM to reevaluate the leases based on their greenhouse gas emissions is likely to at least "slow or reduce the pace at which global emissions are increasing." However, plaintiffs still lacked standing to sue, because meeting redressibility did not negate the lack of injury-in-fact.

Daniella Einik
+1.202.879.3775
deinik@jonesday.com

VIRGINIA SUPREME COURT REJECTS INSURER "DUTY TO DEFEND" IN CLIMATE CHANGE SUIT

In a decision that could have significant consequences in ongoing and future climate change litigation, the Supreme Court of Virginia unanimously held on September 16, 2011 that an insurer did not have a duty to defend a commercial general liability policyholder accused of contributing to the effects of climate change. *The AES Corporation v. Steadfast Insurance Co.*, No. 100764.

This dispute between AES and Steadfast stemmed from AES being named as a defendant in *Native Village of Kivalina v. Exxon Mobil Corp*. In February 2008, Kivalina sued AES and 23 other oil, gas, and utility companies for allegedly rendering the village uninhabitable as a result of their emissions of greenhouse gases. *See* 663 F. Supp. 2d 863 (N.D. Cal. 2009). After being sued, AES tendered a claim to its insurer, Steadfast, under its commercial general liability policies. Steadfast agreed to defend AES under a reservation of rights and later filed an action seeking a declaratory judgment that AES was not entitled to coverage or defense.

Steadfast advanced three theories in support of its position: (1) the underlying complaint in *Kivalina* did not allege "property damage" caused by an "occurrence" sufficient to trigger a duty to defend; (2) the injury or damages claimed in *Kivalina* incepted prior to the effective date of the policies; and (3) a pollution exclusion under the policies barred coverage. The Supreme Court of Virginia accepted Steadfast's first contention, holding that the allegations in *Kivalina* did not give rise to a duty to defend under AES's policies.

The case hinged on provisions in AES's policies that extended coverage to suits claiming "property damages" caused by an "occurrence." "Occurrence" was defined in the policies as "an accident, including continuous or repeated exposure to substantially the same general harmful condition." Thus, the question before the court was whether the *Kivalina* complaint alleged property damages caused by an "accident" as defined under Virginia law.

AES asserted that the *Kivalina* complaint alleged that AES had engaged in both the intentional and negligent release of greenhouse gases. Further, according to AES, the term "accident" in the insurance policy comprehended negligent conduct as well as intentional acts with unintended (even if foreseeable) consequences. At bottom, AES argued that only intentional acts with subjectively intended or known consequences were excluded by the policies. Steadfast countered that even if the complaint alleged that AES had engaged in negligent conduct, under Virginia law the crucial inquiry is whether the complaint alleges that the consequences were reasonably anticipated. Steadfast argued that if the alleged harm is reasonably anticipated, the event is not an accident, and it noted that the *Kivalina* complaint repeatedly alleged that AES knew or should have known that its greenhouse gas emissions would result in harm.

The court initially noted that "accident" is "commonly understood to mean 'an event which creates an effect which is not the natural or probable consequence of the means employed and is not intended, designed, or reasonably anticipated.'" The court agreed with Steadfast that "the dispositive issue" is whether "the Complaint can be construed as alleging that Kivalina's injuries … resulted from unforeseen consequences that a reasonable person would not have expected to result from AES's deliberate act of emitting carbon dioxide and greenhouse gases." The court then held that the allegations of the *Kivalina* complaint did not meet the definition of an "accident" under AES's policies.

The court stressed that the heart of Kivalina's claim was that the "damages it sustained were the natural and probable consequences of AES's intentional emissions," and rejected AES's contention that allegations of negligence were synonymous with averments of an accident. The court also rejected AES's position that an insured's subjective perception is relevant; the court indicated it would find no coverage "[e]ven if AES were actually ignorant of the effect of its action."

On its face, the decision could ostensibly bar coverage of nearly all claims, even those alleging negligence, where the precipitating conduct was intentional and the result was the natural and probable consequence of that conduct, leaving insurers to defend only cases arising from the most attenuated consequences of allegedly negligent behavior. In a concurring opinion, two Senior Justices sought to quash that fear by distinguishing between cases in which the relevant act is clearly intended (*e.g.*, release of greenhouse gases in energy production) and those in which the ultimate issue is whether the relevant act was performed negligently or intentionally. They then asserted that the *Kivalina* complaint alleged that the release of greenhouse gases was not only intentional, but that the consequences of the emissions were inevitable. According to the concurrence, therefore, the term "negligent" was used in the complaint in the narrow sense that AES knew or should have known "that its actions would cause injury no matter how they were performed." Under such circumstances,

the intentional performance of the relevant act, with "eminently foreseeable" harmful consequences, did not constitute an "accident."

Shimshon Balanson
+1.216.586.7151
sbalanson@jonesday.com

ENVIRONMENTAL GROUPS CHALLENGE DEFERRAL OF GREENHOUSE GAS PERMITTING REQUIREMENTS FOR BIOENERGY AND BIOGENIC SOURCES

Environmental groups have challenged in the U.S. Court of Appeals for the District of Columbia Circuit a July 2011 U.S. EPA rule deferring air permitting requirements for three years for biogenic carbon dioxide emissions from bioenergy and biogenic stationary sources. *Center for Biological Diversity v. EPA*, No. 11-1285 (8/15/11); *Natural Resources Defense Council v. EPA*, No. 11-1328 (9/19/11).

The petitioners contend that the rule will encourage the burning of biomass, which could result in harm to forests as additional trees are cut down for fuel. The petitioners also contend that a failure to address carbon dioxide emissions from biomass sources undermines the goal of reducing greenhouse gases and exacerbates the problems caused by climate change. Multiple trade associations and industry groups representing manufacturers and users of biofuels have moved to intervene in support of the three-year deferral. The cases are expected to be consolidated with an earlier-filed case, *Center for Biological Diversity v. EPA*, No. 11-1101 (D.C. Cir.), challenging U.S. EPA's grant of the National Alliance of Forest Owners' petition for reconsideration, which ultimately led to the three-year deferral.

Additional information on the EPA rule being challenged can be found in "U.S. EPA Defers Greenhouse Gas Permitting Requirements for Some Biogenic Emissions," in the Summer 2011 edition of *The Climate Report*.

Jane B. Story
+1.412.391.7294
jbstory@jonesday.com

CLIMATE CHANGE REGULATION BEYOND THE U.S.

Chris Papanicolaou, Editor

RENEWABLE ENERGY OFFERS NEW HOPE FOR POST-3/11 JAPAN

Japan enacted a new law to introduce full-scale feed-in tariffs ("FIT Law") on August 26, 2011. The FIT Law, which takes effect July 1, 2012, mandates power utilities to purchase electricity from renewable energy sources, such as solar, wind, hydro, geothermal, and biomass, at a fixed price for a given period. How far the FIT Law can promote renewable energy in Japan is still uncertain because some of the details, such as the purchase price and duration, still need to be determined. Nevertheless, the enactment of the FIT Law was much awaited by businesses and has raised expectations for renewable energy as a solution for global warming as well as a booster for the Japanese economy following the March 11, 2011 earthquake.

Background. Feed-in tariffs were originally proposed in the context of fulfilling Japan's commitment to reduce greenhouse gas emissions in line with the Kyoto Protocol. However, in promoting carbon-free energy, Japan's energy policy had placed priority on nuclear energy rather than renewable energy. Of Japan's total electricity supply in 2009, nuclear energy accounted for approximately 30 percent, while renewable energy (excluding large-scale hydroelectric plants) accounted for less than 1 percent. This energy policy, combined with resistance from the power utilities to a feed-in tariff system, had delayed the enactment of the FIT Law.

The Great East Japan Earthquake on March 11, 2011 and the subsequent Fukushima Daiichi nuclear disaster have completely changed the energy situation in Japan. The ongoing nuclear disaster has led to deep public concern over Japan's heavy reliance on nuclear energy. Since "3/11," 44 out of the 54 nuclear reactors in Japan have suspended operation indefinitely in the aftermath of the earthquake or due to scheduled maintenance, with the remainder scheduled to follow in due course. This suspension of nuclear power operation has led

to a serious power shortage in post-3/11 Japan. Increasing Japan's already heavy reliance on imported fossil fuels was not an attractive solution, given the added cost as well as the negative impact of such reliance on Japan's commitments under the Kyoto Protocol. As a result, it became imperative for Japan actively to pursue renewable energy as an alternative to nuclear power. Former Prime Minister Kan, facing a political crisis leading to demands for his resignation, made enactment of the FIT Law a precondition for his resignation.

Overview of the FIT Law. Ten Japanese power utilities dominate both power generation and transmission in respective geographic areas allocated to each of them. The FIT Law requires these power utilities to purchase, at a fixed price for a given period, electricity (1) generated from solar, wind, hydro, geothermal, biomass, and other renewable sources to be specified by government ordinance, and (2) that is supplied by power-generating facilities certified by the Ministry of Economy, Trade and Industry ("METI"). Under this system, power utilities must enter into purchase agreements with, and allow grid connection to, renewable energy producers, but they may add a surcharge to their electricity bills to cover the cost of the mandatory purchase.

The fixed purchase price and the length of the required purchase period for each renewable energy source will be determined annually by METI through consultation with a third-party committee of five experts to be appointed by METI and approved by Japan's Diet. The FIT Law also requires the bases of METI's purchase price calculation to be reported to the Diet. However, whether METI could set appropriate pricing, with sufficient incentives for investments in renewable energy, has been questioned by some observers due to concerns that the power utilities reportedly have close relationships with METI.

The initial purchase price is expected to be determined by the spring of 2012. Annual setting of the purchase price creates uncertainty for potential investors making long-term investment plans for renewable energy projects in Japan.

The FIT Law allows power utilities to be exempted from the mandatory purchase requirement in two exceptional cases. First, a power utility may refuse to enter into a purchase agreement with a renewable energy generator if the utility's profits may be harmed by such agreement or if other justifiable reasons (to be specified by METI) exist. Second, a power utility may refuse to connect a renewable energy generator if such connection may interfere with the utility's stable electricity supply or if other justifiable reasons (to be specified by METI) exist.

Since potential interference with the stable electricity supply was the main reason given by power utilities to refuse connections to renewable energy generators in the past, and considering that the output of most renewable energy sources is inherently unstable and thus requires an enhanced grid to maintain a specified voltage and frequency, there is concern that the exemptions may be used as an excuse to unduly reject the mandatory purchase requirement. To prevent this, the implementing ordinances should provide clear requirements to qualify for the exemptions, as well as a third-party referee.

Challenges Facing Expansion of Renewable Energy in Japan. Currently, regulation of land usage, construction, and other issues restrict the establishment and operation of renewable energy facilities in Japan. To successfully expand renewable energy in Japan, deregulation in these areas will be necessary. Although the FIT Law requires the Japanese government to evaluate and take necessary measures in this respect, the speed and extent of these efforts remain unknown. Also, introduction of an enhanced grid and national grid to cope with unstable and geographically uneven renewable energy output is critical for the expansion, but there have been no such governmental initiatives thus far. A further issue to be overcome is Japan's use of two different frequencies of electricity; power utilities in eastern Japan supply 50Hz electricity, while power utilities in western Japan supply 60Hz electricity, resulting in difficulty sharing electricity between utilities supplying different frequencies.

An Energized Movement to Renewables. Despite the various uncertainties that remain, enactment of the FIT Law has energized the movement toward renewable energy in Japan. Various leading companies in and out of the power sector have announced the expansions or launches of renewable energy businesses. Local governments also have been active in promoting renewable energy business. For instance, renewable energy is expected to play a key role in the ongoing

restoration plans for the Tohoku region devastated by the 3/11 earthquake. In close cooperation with leading businesses and academia, the city of Sendai plans to promote installation of renewable energy generating facilities and to build "eco towns" and launch new agriculture businesses, both utilizing renewable energy in the city's devastated areas. Thus, the expansion of renewable energy in Japan means not just reduced carbon dioxide emissions, but also new business opportunities through technology innovation and job creation to revitalize the country's long-sluggish economy.

Kaoru Umino
+81.3.6744.1616
kumino@jonesday.com

Junko Dochi
+81.3.6800.1876
jdochi@jonesday.com

FRANCE ADOPTS REGULATORY FRAMEWORK FOR ON-SHORE WIND GENERATORS

Beginning July 13, 2011, on-shore wind generator installations are subject to French legislation, known as ICPE, on installations registered for purposes of environmental protection. In August 2011, France adopted a long-awaited regulatory framework clarifying the regime governing on-shore wind generators. This new framework implements provisions of the Law no. 2010-788 of July 12, 2000, the so-called "Grenelle II Law." Decree no. 2011-984 of August 23, 2011 establishes an on-shore wind generator installations category (no. 2980) within the categorical classifications of ICPE based on the height of their masts and their power output.

Wind farms comprising at least one generator with a mast exceeding 50 meters high are subject to authorization (regardless of electrical output) (no. 2980.1). Wind farms comprising generators with masts less than 50 meters high, but including at least one generator with a mast 12 meters high or higher, are also subject to authorization if the combined electrical output of all generators present is equal to or exceeds 20 MW (no. 2980.2 a), or are subject to declaration if such combined output does not exceed 20 MW (no. 2980.2 b). Two ministerial orders of August 26, 2011 complement this regime and govern, respectively, wind farms subject to authorization and those subject to declaration.

In terms of location, the new framework establishes minimum setback obligations. Installations subject to authorization may not be located within 500 meters of dwellings or of areas zoned for housing or within 300 meters of Seveso sites or nuclear installations. For installations subject to declaration, the minimum setback distance from dwellings is computed in accordance with the height of masts present in the installation.

To address potential aesthetic and noise disturbances associated with operation of larger wind farms, a public inquiry within an extended radius must be conducted for those installations subject to authorization. The new regime requires that the operator of an air-traffic, defense, or weather radar affected by a proposed wind farm expressly agree to the establishment of the wind farm before the wind farm applicant files the application or declaration for operation of the installation.

Wind farm operators—or their parent company, in the case of bankruptcy—are responsible for the cost of equipment dismantling and site remediation upon closure of the installation. A major change in this respect is the addition of an obligation for operators or owners of wind farms subject to authorization to post financial warranties covering these closure obligations (*see* Env. code, art. L. 553-3 § 1 and R. 553-1 to R. 553-1 to R. 553-8; *see also* ministerial order of August 26, 2011). Existing installations must comply with this obligation by August 26, 2015.

The Grenelle II Law also provides for transitional conditions applicable to existing installations and to pending wind farms applications.

David Desforges
+33.1.56.59.46.58
ddesforges@jonesday.com

Anne-Caroline Urbain
+33.1.56.59.39.93
aurbain@jonesday.com

THE CLIMATE REPORT EDITORIAL BOARD

CONTACTS

CALIFORNIA

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

GEORGIA

G. Graham Holden
Atlanta Office
Energy
+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 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 Estandía
Mexico City Office
Energy
+52.55.3000.4081
jestandia@jonesday.com

JONES DAY GLOBAL LOCATIONS

ATLANTA	DALLAS	LOS ANGELES	NEW YORK	SHANGHAI
BEIJING	DUBAI	MADRID	PARIS	SILICON VALLEY
BOSTON	FRANKFURT	MEXICO CITY	PITTSBURGH	SINGAPORE
BRUSSELS	HONG KONG	MILAN	RIYADH	SYDNEY
CHICAGO	HOUSTON	MOSCOW	SAN DIEGO	TAIPEI
CLEVELAND	IRVINE	MUNICH	SAN FRANCISCO	TOKYO
COLUMBUS	LONDON	NEW DELHI	SÃO PAULO	WASHINGTON