JONES DAY

SPRING 2013 ISSUE

THE CLIMATE REPORT

U.S. REGULATORY DEVELOPMENTS

Jane K. Murphy, Editor

CALIFORNIA CONTINUES ALLOWANCE AUCTIONS AS LITIGATION EXPANDS AND CONSIDERS "CAP AND TRADE" CHANGES

The California Air Resources Board ("CARB") held its second auction of greenhouse gas allowances on February 19, 2013. Entities covered by California's greenhouse gas "cap and trade" program must acquire a sufficient number of allowances and offset credits to match their emissions of greenhouse gases. The February auction sold all of the 12,924,822 vintage 2013 allowances offered for sale at a price of $13.62 per allowance. This compares to the allowance price of $10.09 established at CARB's first allowance auction on November 14, 2012. A total of 4,440,000 vintage 2016 allowances (about half of the amount offered) were sold at the February auction at a price of $10.71 (which was also the auction reserve price). CARB's next allowance auction will be held on May 16, 2013, when 14,522,048 vintage 2013 allowances, and 9,560,000 vintage 2016 allowances, will be offered. CARB's notice of the auction does not provide the auction reserve price; CARB will provide that price prior to the auction.

In addition to allowance auctions, which are generally open to any qualified bidder, CARB's regulations provide for four percent of the available allowances to be set aside in a strategic reserve to be sold for cost-containment purposes. These reserve

DEPARTMENTS

allowances may be purchased only by emitters covered by the cap and trade program and opt-in entities with compliance accounts. As set by the regulations, the reserve price for reserve allowances ranges from $40 to $50 per allowance. CARB cancelled its first reserve sale, which had been scheduled for March 8, 2013.

While the auctions continued, a new action was filed on April 16, 2013 challenging the auctions as an unconstitutional state tax. *Morning Star Packing Co. et al. v CARB et al.*, Sacramento County Superior Court, Case No. 34-2013-80001464. The complaint alleges that the underlying statute, AB 32, does not authorize the creation of an auction process to sell emission allowances, and that the auction of allowances constitutes a tax that must, under the California Constitution and Propositions 13 and 26, be enacted by two-thirds majorities in both houses of the state legislature. As described in a Special California Update to *The Climate Report*, the allowance auctions were challenged on similar grounds in *California Chamber of Commerce et al. v. CARB et al.*, Sacramento County Superior Court, Case No. 34-202-80001313, an earlier action filed in November 2012. A hearing on the *California Chamber* action is set for August 28, 2013.

In another development, CARB approved linkage between the California and Quebec cap and trade programs on April 19, 2013, to be effective on January 1, 2014. Under the linked programs, each jurisdiction will accept the other's allowances and approved offsets for purposes of compliance with their respective cap and trade obligations.

Future amendments to California's cap and trade program are also being considered. CARB staff have released a summary of 15 aspects of the regulations that CARB will evaluate for amendment during 2013. CARB held a workshop to discuss the first group of issues, including potential amendments to the regulations related to universities, combined heat and power facilities, and the holders of "legacy contracts" related to energy production on May 1, 2013. Other areas identified by CARB and its staff for potential amendment include resource shuffling, emission leakage, offset program implementation, cost containment, allowance allocation, and establishment of benchmarks for new and existing products.

CARB is also considering approval of two new offset protocols. Greenhouse gas reduction or removal projects that meet the requirements of an approved protocol can generate "offset credits" that may be used by a covered source to meet a certain percentage of its compliance obligations. On March 28, 2013, CARB held a workshop to discuss the addition of protocols for coal mine methane and rice cultivation projects to its existing list of four approved protocols. Drafts of the two protocols are scheduled to be released this summer, followed by CARB consideration in fall 2013.

The rice protocol would apply to rice cultivation projects located in California and states in the mid-south, and it would recognize methane reduction practices related to management of straw residue, the schedule of flooding and draining rice fields, seeding techniques, and other factors. The coal mine protocol would apply to coal mine projects in the United States and would recognize the capture and destruction of methane gas that would otherwise be vented to the atmosphere. The draft protocols will draw upon rice cultivation protocols previously adopted by the American Carbon Registry and the Climate Action Reserve, as well as the coal mine protocols adopted by the Climate Action Reserve and Verified Carbon Standard.

Thomas M. Donnelly
+1. 415.875.5880
tmdonnelly@jonesday.com

Charles M. Hungerford
+1.415.875.5843
chungerford@jonesday.com

EPA PROPOSES RENEWABLE IDENTIFICATION NUMBER QUALITY ASSURANCE PROGRAM

Following several recent high-profile enforcement cases that invalidated more than 140 million biomass-based diesel renewable identification numbers ("RINs") because no renewable fuel was actually produced, the U.S. Environmental Protection Agency has proposed a new voluntary quality assurance program for use by RIN purchasers to ensure that the RINs are valid. EPA has indicated that its purpose in developing the program is to ensure that certain smaller biodiesel producers who EPA claims were shut out of the RIN market based on concerns about the validity of their RINs could continue to freely market their RINs.

Under EPA's Renewable Fuel Standard program, a specified volume of renewable fuels must be used for transportation fuel, home heating oil, and/or jet fuel in the U.S. each year. EPA establishes a yearly percentage of the total volume of all gasoline or diesel fuel produced or imported that must be renewable fuels, also referred to as "renewable volume obligations" ("RVOs"). Refiners and importers then meet that standard by acquiring RINs from biofuel producers.

The regulations prohibit invalid RINs being used to achieve compliance with RVOs, even if the RINs were purchased with a good-faith belief that they were valid. This means that purchasers of invalid RINs are obligated to incur additional costs in purchasing additional valid RINs to meet RVOs.

Pursuant to the voluntary program proposed by EPA, a purchaser's first option is to purchase RINs that have been verified as valid by third-party auditors using a fairly detailed quality assurance plan approved by EPA. The third-party auditor, rather than the purchaser, would be responsible for replacing any RINs later found to be invalid. The purchaser would have an affirmative defense to a civil enforcement action by establishing that it did not know or have reason to know that the RINs were invalid at the time they were verified.

The purchaser's second option is to purchase RINs that have been verified by a third-party auditor using a less rigorous quality assurance plan. The purchaser would have responsibility for any RINs found to be invalid, but the purchaser would have an affirmative defense to an enforcement action if the purchaser could establish that it did not know or have reason to know that the RIN was invalid at the time the RIN was used for compliance or transferred to another party.

Purchasers would also have a final option of not using any third-party auditors to verify RINs. In this case, the purchaser would remain obligated to replace any RINs later found invalid, consistent with the current regulatory scheme.

Although EPA is still reviewing public comments received on the proposal rule through April 18, 2013, EPA is implementing some portions of the proposed rule immediately. To that end, EPA issued a revised enforcement policy on January 31, 2013 stating that it does not intend to seek enforcement against purchasers who use RINs in 2013 that have been verified in accordance with the proposed rule and who meet the other requirements outlined in the enforcement policy. EPA has indicated that it intends to finalize this rule "well in advance" of the February 28, 2014 compliance date for 2013 RVOs.

Charles T. Wehland
+1.312.269.4388
ctwehland@jonesday.com

Jane K. Murphy
+1.312.269.4239
jkmurphy@jonesday.com

CLIMATE CHANGE ISSUES FOR MANAGEMENT

Christine Morgan, Editor

INVESTOR GROUP PROPOSES REQUIRING SUSTAINABILITY DATA DISCLOSURE FOR LISTING COMPANIES ON STOCK EXCHANGES

The Investor Network on Climate Risk ("INCR") has released a Consultation Paper in an effort to integrate sustainability disclosure requirements into listing standards for U.S. and global stock exchanges. INCR is led by Ceres and includes BlackRock, Boston Common Asset Management, British Columbia Investment Management Corporation, the AFL-CIO, and other investors active on corporate social issues. The group is concerned that it is difficult to factor sustainability issues into investing decisions due to perceived insufficient and inconsistent sustainability data reporting by public companies. In addition, the Consultation Paper indicates that INCR members have heard from companies that have been reluctant to report sustainability data because they are not certain what specific information investors need or how it will be utilized.

In its announcement of the release of the Consultation Paper, Ceres stated:

> The initiative is part of a growing effort by investors and stock exchanges, including NASDAQ OMX, to make environmental, social and government (ESG) disclosure a consistent requirement for corporate listings on stock exchanges. While several exchanges have adopted their own sustainability listing requirements and guidance, INCR members and NASDAQ OMX have set out to develop a uniform standard that all stock exchanges can use.

The Consultation Paper proposes three disclosure requirements as part of a listing standard:

Materiality Assessment: An assessment in annual financial filings where management will discuss its approach to determining the company's material ESG issues, including (i) how they determine their material ESG issues, (ii) who was involved in that process, (iii) which ESG issues were determined to be material and why, including a discussion of both the risks and opportunities each issue presents as well as its connection to financial performance and business strategy, and (iv) periodic review of the materiality assessment and reporting on the frequency of such reviews.

Global Reporting Initiative ("GRI") Content Index: A hyperlink in each company's annual financial filings to a GRI Content Index, which will inform investors about the availability and location of a company's ESG data.

Improved Corporate ESG Disclosure: Every company will disclose information on ESG issues, using a "comply and explain" approach, for the following categories: climate change, diversity, employee relations, environmental impact, government relations, human rights, product impact and safety, and supply chain. Companies can either provide such disclosures or explain why they are not doing so.

The initial comment period ended on May 1, 2013. INCR intends to host meetings to discuss the comments received and to attempt to develop further investor agreement. In addition, the Consultation Paper states that NASDAQ OMX has committed to engage in discussions with other stock exchanges and the International Organization of Securities Commissions to encourage the adoption of a mandatory global standard.

Thomas A. Hamilton
+1.216.586.7036
tahamilton@jonesday.com

FINANCIAL INSTITUTIONS: THE NEXT CHAPTER IN CLIMATE CHANGE SHAREHOLDER ACTIVISM

For the first time, shareholders of a major bank voted on whether greenhouse gas emissions associated with the bank's loan practices expose the bank to serious risks. Activist investors were successful in placing a shareholder resolution in the proxy materials sent to shareholders of PNC Financial Services Group ("PNC") in advance of the bank's April 23, 2013 annual meeting. As reported by the *Pittsburgh*

Post-Gazette, a majority of the shareholders voted against the resolution that was also unanimously opposed by PNC's directors.

The Resolution. Boston Common Asset Management drafted the shareholder resolution, which was cosponsored by Domini Social Investments, Friends Fiduciary Corporation, Mercy Investment Services, and Walden Asset Management. The sponsors are Quaker and Roman Catholic groups and mutual funds focused on socially responsible investments. Carbon Tracker, Ceres, and the Rainforest Action Network collaborated with the sponsors.

The failed resolution stated that PNC has acknowledged the importance of climate change management in its brand reputation. The resolution went on to say, in part:

> PNC stated that its "credit review process includes due diligence that takes into consideration the environmental impact of a prospective borrower." PNC claims to perform a "supplemental evaluation for companies in the extractive industries, including an understanding of any significant environmental impacts." PNC states it takes these actions because it recognizes the "potential risks associated with changing climate conditions that could affect business operations and performance." (PNC, 2011 Corporate Responsibility report)
>
> . . . .
>
> Banks and other financial institutions contribute to climate change through their financed emissions, which are the greenhouse gas footprint of loans, investments, and financial services. A bank's financed emissions can dwarf its other climate impacts and expose it to significant reputational, financial and operational risks.

The resolution requested that PNC's Board of Directors report to the shareholders by September 2013 concerning PNC's assessment of the greenhouse gas emissions resulting from its lending portfolio and PNC's exposure to climate change risk as a result of its lending, investing, and financing activities.

Why PNC? PNC is the only major bank located in Appalachia, a region of the United States with significant coal and gas extraction activities. PNC provides financial services to mining companies, including those engaged in mountaintop removal, a practice that has been blamed for adverse environmental impacts. At the same time, PNC also enjoys an environmentally friendly image as a result of its green building program, loans for solar projects, and environmental incentives for small businesses.

Nevertheless, the backers of the resolution maintain that PNC has not provided investors with sufficient information to allow for a meaningful assessment of the risks posed by its financing of greenhouse gas-intensive businesses. More importantly, they accuse the bank of reneging on a 2011 promise not to extend credit to individual mountaintop removal projects or to mining companies receiving the bulk of their production from this process.

Why Now? PNC asked the U.S. Securities and Exchange Commission for permission to exclude the resolution from its annual meeting ballot. This is a fairly common request. Activist investors submit hundreds of resolutions to companies every year, but companies can choose not to forward the resolutions to shareholders if the resolution addresses topics within the ordinary authority of the company's Board of Directors.

A company that has decided to exclude a resolution may ask the SEC to "concur" with its decision. PNC asked, but in a surprise move, the SEC staff did not concur. Instead, PNC was told that climate change represents a "significant policy issue" for the bank and its shareholders. Importantly, the SEC did not say that climate change is important in general, but rather that climate change is important for banks.

The SEC had in the past supported excluding similar resolutions, because the SEC agreed that such resolutions concerned the "ordinary business" of banks. In 2010, however, the SEC issued guidance stating that corporations should disclose to shareholders the potential effect of climate change on their business and their strategies for addressing the risks.

According to SEC spokesman John Nester, the PNC decision does not mean that every financial institution must consider the issue of climate change. Instead, the ruling was based on the particular facts of PNC's case, including the nature of the bank's lending criteria and its public statements, which demonstrated a "meaningful relationship" between climate change and operations.

Who Is Next? The sponsors of the PNC resolution have submitted a similar resolution to JPMorgan Chase. The sponsors have stated that they may withdraw the resolution before the bank's May 2013 annual meeting depending on the outcome of discussions with the bank.

Mary Beth Deemer
+1.412.394.7920
mbdeemer@jonesday.com

RENEWABLE ENERGY AND CARBON MARKETS

Dickson Chin, Editor

IRS ISSUES GUIDANCE ON TAX CREDIT ELIGIBILITY FOR RENEWABLE ENERGY PROJECTS

On April 15, 2013, the U.S. Internal Revenue Service issued Notice 2013-29, addressing the new requirement under Section 45 of the Internal Revenue Code that certain renewable energy projects must "begin construction" in 2013 to qualify for the Section 45 production tax credit ("PTC") or for the Section 48 investment tax credit ("ITC"). The IRS guidance closely follows the standards previously developed by the U.S. Department of Treasury for determining whether an eligible renewable energy project qualified for a cash grant (in lieu of tax credits) under the Section 1603 program that was part of 2009's American Recovery and Reinvestment Act. While the similarities to the Treasury cash grant program will bring much-needed certainty for project developers and investors, there are also a number of new wrinkles in the Notice that will raise interpretive questions for credit-eligible projects.

The American Taxpayer Relief Act, enacted in late December 2012, modified the basis for qualifying for PTCs and ITCs (where the ITC is available by election of the taxpayer pursuant to Section 48(a)(5)(C)). Previously, an otherwise eligible project was required to be "placed in service" by a specified date to earn the tax credit. The Act extended the credit expiration deadline for wind energy facilities through 2013 (the deadline for other eligible technologies remains 2014), but more significantly changed the eligibility criteria so that qualifying projects need not be "placed in service" by the end of 2013, but instead need only "begin construction" this year. This change was intended to address industry concerns that the last-minute deadline extension would not allow enough time for otherwise eligible wind projects to be completed before the end of 2013, given the lengthy development and construction schedule for such projects.

Like the Section 1603 program guidance, the Notice provides two methods by which a taxpayer can establish that it "began construction" of an eligible renewable project in

2013. A taxpayer may establish the start of construction on a project by (i) performing "physical work of a significant nature" on the project in 2013, or (ii) paying or incurring at least five percent of the total costs of the project in 2013. In each case, the taxpayer must thereafter make a "continuous effort to advance towards completion" of construction of the project. Notably, the "continuous construction" condition was not present in the Section 1603 guidance for use of that program's five percent "safe harbor."

Whether a taxpayer makes continuous efforts to advance completion of a renewable energy facility will depend on the relevant facts and circumstances, and according to the Notice, the IRS will "closely scrutinize" whether such a continuous program has been maintained by the taxpayer. The Notice does provide that events outside the developer's control that impede construction, such as severe weather, permitting delays, or equipment supply shortages, will be taken into account in determining whether there was a continuous program of construction. Financing delays may also be treated as outside the developer's control, but only for delays of up to six months. Nevertheless, this new condition injects an element of subjectivity, and hence greater risk, into what was a straightforward, bright-line test for the five percent safe harbor as developed under the former cash grant program.

The Notice also includes a number of factors—most of which were part of the Section 1603 guidance—that will help clarify the kinds of off-site and on-site work that would constitute "physical work of a significant nature." For example, "preliminary activities" such as permitting, testing, clearing or grading the site, or removing existing turbines or towers do not constitute "physical work" under the Notice, but work on a step-up transformer or structures integral to the power generation activity of the renewable project would qualify.

Similar to the Section 1603 program, a taxpayer may rely on "physical work" performed by another person under a "binding written contract" entered into before such work commenced. As with the Section 1603 guidance, the Notice states that such a contract may not limit damages to a specified amount, such as by use of a liquidated damages provision, but a provision limiting damages to at least five percent of the contract price will not run afoul of this restriction.

The Notice also includes a special provision defining "facility" that may benefit wind project developers in particular. Specifically, the Notice states that where multiple "facilities" (e.g., wind turbine generators) are operated as part of a "single project" (based on various factors spelled out in the Notice), commencing construction on only a portion of such project will be sufficient to qualify for the PTC, as long as the taxpayer thereafter completes construction of the entire facility pursuant to a continuous program of construction. Consequently, it is not necessary, for example, for a wind project developer to excavate foundations for each wind turbine generator and tower that comprises a single project to have "commenced construction" on the project.

These significant changes to the tax credit eligibility criteria should provide an immediate boost to a wind power sector facing uncertain growth prospects in an environment of low power prices. Developers can take comfort that the IRS in its Notice has largely mimicked the rules that governed the highly successful Treasury cash grant program. However, by introducing a new requirement for continuous construction of projects that seek to qualify for tax credits under the five percent safe harbor, the Notice adds a dose of uncertainty to the process for securing tax credits. The potential risk of losing tax benefits could cause concerns for project developers and especially their tax equity investors. It may be possible to obtain clarification by seeking a private letter ruling or additional public guidance from the IRS. Since either type of IRS action can take three to six months on average, developers and industry groups may need to act promptly to get answers within a meaningful time frame.

Tom Havens
+1.212.326.3935
tchavens@jonesday.com

Todd Wallace
+1.214.969.3713
twallace@jonesday.com

Patrick O'Brien
+1.212.326.3678
pobrien@jonesday.com

DISTRIBUTED SOLAR GENERATION POISED TO SURGE IN 2013 AND BEYOND

In 2012, U.S. installations of photovoltaic ("PV") solar generation reached 3,313 megawatts, an industry record and an increase of 76 percent over 2011, according to a recent announcement by GTM Research and the Solar Energy Industries Association. The number of solar installations in the U.S. in 2012 exceeded 90,000, and the rent payment schedule included 83,000 installations of distributed solar generation in the residential market. GTM Research and SEIA expect that the residential market for solar generation will surge in 2013 and beyond, as third-party solar financing options become more widely available.

Third-party financing of residential PV systems is typically provided through either a power purchase agreement ("PPA") or a lease. In PPA financing, a customer pays a specified rate to a solar developer/installer for the electricity generated by a PV system installed at no up-front cost to the customer on the rooftop of the customer's home or elsewhere on property owned or leased by the customer. In lease financing, the customer pays the solar developer/installer rent for use of the PV system. The rent payment schedule may be structured so the customer pays none or a portion of system costs up front.

In either PPA or lease financing, because the developer/installer pays all or most of the up-front costs of the PV system, the developer/installer retains ownership of the system throughout the term of the PPA or the lease, subject to any early buy-out rights the customer may have. From the perspective of a traditional electric utility, the ownership of the electric generation system by a third party (i.e., neither the consumer of the system's output nor the utility itself) conflicts with the utility's monopoly on providing electric service within its specified service territory, as historically granted under state laws. According to a summary map in the Database of Incentives for Renewables and Efficiency, third-party solar PV PPAs were apparently disallowed or otherwise restricted by legal barriers in six states as of February 2013, and their status was unclear or unknown in an additional 22 states.

Notwithstanding the decreased costs of residential PV systems (average prices dropped 20 percent to $5.04 per watt in the fourth quarter of 2012 compared to the fourth quarter of 2011), where third-party financing is permitted, it is popular. For example, in California and Arizona, the two largest state solar markets in 2012, third-party financing accounted for more than 50 percent of new residential solar installations, and GTM Research projects that the size of the third-party financing market will grow from $1.3 billion in 2012 to $5.7 billion in 2016.

Three additional states may join the ranks of those that permit third-party solar financing under proposed legislation in Georgia, Minnesota, and South Carolina, albeit with certain limitations on total renewable capacity in the case of Georgia and South Carolina. Minnesota's proposed legislation (H.F. 956 and its companion Senate bill, S.F. 901), introduced in late February 2013, is currently under committee review. In addition to allowing third-party ownership to enable third-party financing options, the Minnesota bills provide a number of measures supporting renewable energy growth. They would also prohibit the Minnesota public utilities commission or any municipal utility's governing body from limiting the cumulative amount of renewable or other distributed generation eligible for net metering from a utility to less than five percent of the utility's average annual retail sales over the previous three years, and would require any limitation greater than five percent to be based on a determination that it is in the public interest.

Both the proposed Georgia legislation (H. 3425) and the proposed South Carolina legislation (H. 3425 and companion bill S. 0536) are more narrowly targeted at enabling third-party financing. The Georgia bill provides for a single, certified "community solar provider" to be the sole provider of third-party financing and limits the utility's obligation to purchase net-metered energy from renewable sources to a cumulative renewable capacity of 0.2 percent of the utility's peak demand in the previous year. The South Carolina legislation would limit the aggregate capacity of all third-party-owned renewable energy facilities in a utility's service territory to two percent of the utility's peak demand.

Michael Gibbs
+1.212.326.3792
mgibbs@jonesday.com

CLIMATE CHANGE LITIGATION

Kevin P. Holewinski, Editor

TEXAS CHALLENGES REVOCATION OF STATE PERMITTING AUTHORITY FOR FAILING TO ANTICIPATE GREENHOUSE GAS REGULATION UNDER THE CLEAN AIR ACT

Over the last several years, the State of Texas and the U.S. Environmental Protection Agency have engaged in a series of legal skirmishes relating to Clean Air Act permitting and greenhouse gas emission regulations. The latest dispute was argued on May 7, 2013 before the U.S. Court of Appeals for the District of Columbia Circuit (*State of Texas v. the United States Environmental Protection Agency,* No. 10-1425). The case arises from EPA's so-called SIP Call Rule and EPA's subsequent revocation of Texas's state implementation plan ("SIP") under its Prevention of Significant Deterioration ("PSD") permitting program and replacement with EPA's own "federal implementation plan" for Texas as it relates to permitting for greenhouse gas emissions.

EPA promulgated the SIP Call Rule on December 13, 2010 on the heels of the Agency's adoption of a series of new rules to regulate greenhouse gas emissions as pollutants under the Clean Air Act, including the so-called "Tailoring Rule," which governs permitting of major stationary sources of greenhouse gas emissions. The rule required states to update their previously approved SIPs to account for greenhouse gas emissions in their PSD permitting programs. EPA found 13 states' SIPs were inadequate at that time to regulate greenhouse gases from stationary sources and directed those states to modify them or face federalization of their permitting programs.

On December 30, 2010, after Texas notified EPA that it was not going to revise its SIP to regulate greenhouse gas emissions, EPA issued an emergency interim rule revoking its prior approval of Texas's SIP, first approved in 1992, and imposing a federal PSD permitting program in its place. Texas sought review and a stay in the D.C. Circuit Court of Appeals, arguing that the Tailoring Rule could result in a construction moratorium on new facilities and modifications of existing facilities. EPA maintained that it was acting to prevent such a construction moratorium, which would be brought on by the state's refusal to issue permits addressing greenhouse gas emissions.

On May 3, 2011, EPA issued a final rule rendering permanent its interim revocation of Texas's PSD SIP. Texas, in turn, petitioned for review of the May 3 final rule in the D.C. Circuit Court of Appeals. The cases have been consolidated by the D.C. Circuit and are currently pending.

EPA claims that its retroactive disapprovals of Texas's PSD SIP submission were necessary to correct an "error" in its 1992 SIP approval decision (i.e., failing to anticipate the future regulation of greenhouse gas emissions) and to ensure that valid PSD permits would be issued in Texas.

Texas has raised both procedural and substantive challenges to EPA's actions, arguing that EPA (i) exceeded its authority under the Clean Air Act to correct erroneous SIP approvals; (ii) relied on material from outside the administrative record and failed adequately to respond to comments; and (iii) improperly engaged in retroactive rulemaking to revise its decades-old approval of Texas's SIP. In short, Texas asserts that EPA's actions were unauthorized and unlawful because, rather than correcting a putative error, EPA imposed on Texas and its sources entirely new requirements for greenhouse gas regulation under PSD pursuant to the thresholds and other provisions of the 2010 Tailoring Rule—provisions that did not exist under the Act or EPA's PSD rules in 1992.

Jack Grady
+1.404.581.8316
jhgrady@jonesday.com

For more details on the June 2010 Tailoring Rule, see the Jones Day White Paper, *"Climate Change Regulation via the Clean Air Act: EPA's New Greenhouse Gas Rule for Facilities."*

IOWA COURT OF APPEALS DECLINES TO EXTEND PUBLIC TRUST DOCTRINE TO THE ATMOSPHERE

As previously discussed in The Climate Report, a coalition of youth-oriented climate change advocacy and other groups filed suits in 2011 against federal and state officials in federal and state courts, and filed petitions for administrative rulemaking in all 50 states, seeking to use the so-called "public trust doctrine" as a means to address climate change. The plaintiffs-petitioners argued that the atmosphere is a public trust resource and that the governments in question therefore have a fiduciary duty to current and future generations to protect the atmosphere from greenhouse gas pollution.

The latest installment in the public trust litigation story is a March 13, 2013 decision by the Court of Appeals of Iowa declining to extend the public trust doctrine to include the atmosphere. In 2011, organizations called "Kids v. Global Warming" and "Our Children's Trust," along with Glori Dei Filippone, a minor, filed a petition for rulemaking with the Iowa Department of Natural Resources ("DNR") requesting that Iowa DNR adopt new rules restricting greenhouse gas emissions. After a public hearing, Iowa DNR unanimously denied the request. On review, an Iowa district court affirmed Iowa DNR's denial. Ms. Filippone appealed the district court's decision to the state's Court of Appeals.

A three-judge panel of the Court of Appeals affirmed the district court for two reasons. First, after ruling on a number of procedural points, the court found that Iowa DNR had given the proposal fair consideration, despite certain comments by Iowa DNR's Environment Commission during the hearing, because the state agency had held a public hearing where presentations from both sides were given and had issued a written decision outlining specific reasons for the denial.

Second, as to the public trust doctrine, the Court of Appeals declined to extend the doctrine to include the atmosphere. Under Iowa law, the doctrine has always had a narrow scope. Indeed, the Iowa Supreme Court has previously declined to extend the public trust doctrine to natural resources other than water. As a result, the Court of Appeals held that Iowa DNR did not have a duty under the public trust doctrine to promulgate greenhouse gas regulations.

One of the three judges, however, concurred specially with the Court of Appeals' decision because, although he agreed that there is no Iowa case law extending the public trust doctrine to include the atmosphere, he believed that there are sound public policy reasons to do so.

Daniella Einik
+1.202.879.3775
deinik@jonesday.com

D.C. CIRCUIT AFFIRMS LISTING OF POLAR BEAR AS "THREATENED" UNDER ENDANGERED SPECIES ACT

After losing at the district court level, various industry groups, environmental groups, and states appealed the U.S. Fish and Wildlife Service's designation of the polar bear as "threatened" under the Endangered Species Act. Some of the petitioners challenged the designation as overly protective and others as insufficiently protective. On March 1, 2013, the United States Court of Appeals for the District of Columbia Circuit affirmed the district court ruling, finding the designation appropriate. *In re: Polar Bear Endangered Species Act Listing and Section 4(d) Rule Litigation – MDL No. 1993*, 2013 BL 56260, No. 11-5219.

The Fish and Wildlife Services listed polar bears as "threatened" based on three principal considerations: (i) "the polar bear depends on sea ice for its survival"; (ii) "sea ice is declining"; and (iii) "climatic changes have and will continue to reduce the extent and quality of Arctic sea ice."

Appellants challenged the listing on seven different grounds, asserting that the Fish and Wildlife Service: (i) inadequately explained all steps in its decision-making process; (ii) should have divided polar bears into distinct population segments and erred in making a range-wide determination, because certain ecoregions were not as affected; (iii) relied on defective population models; (iv) used the wrong likelihood standard in determining that polar bears are likely to become endangered; (v) used the wrong period of time in considering the "foreseeable future"; (vi) did not consider Canada's polar bear conservation efforts; and (vii) failed to provide Alaska with an adequate response to the state's comments.

The Court of Appeals reviewed the Fish and Wildlife Service's actions to determine if they were arbitrary and capricious, and held that they were not. In addressing the appellants' arguments on the whole, the court noted that the appellants did not point to mistakes in the Service's reasoning, cite data or studies that the Service overlooked, challenge the climate science relied upon by the Service, or challenge the Service's findings on polar bear biology.

More specifically, the court rejected all of the appellants arguments on the following grounds: (i) Fish and Wildlife Service clearly explained how the polar bear's habitat loss leaves the polar bear likely to become endangered, articulating a rational connection between the facts and the listing; (ii) there were insignificant differences in the polar bears to warrant separating them into distinct population segments, and sea ice is declining throughout the Arctic such that all polar bear populations will be affected; (iii) the Service explained the limitations of the population models it used and relied upon them only for a limited purpose; (iv) the Service used the dictionary definition of "likely" in determining that polar bears are likely to become endangered, which is the appropriate way to interpret an undefined statutory term; (v) the Service sufficiently justified its use of 45 years as the "foreseeable future" by relying on accepted climate models up to the point where the models diverge; (vi) the Service addressed the Canadian harvest and export program and determined that it did not address the primary threat to polar bears—the loss of sea ice; and (vii) the Service's 45-page reply letter to Alaska showed sufficient thought about Alaska's objections and provided reasoned responses.

Jane Story
+1.412.394.7294
jbstory@jonesday.com

CLIMATE CHANGE REGULATION BEYOND THE U.S.

Chris Papanicolaou, Editor

SHAPING THE 2015 CLIMATE CHANGE AGREEMENT: STAKEHOLDER CONSULTATION

On March 26, 2013, the European Commission adopted a consultative paper inviting stakeholder input on how to design a 2015 international agreement laying down global rules for combating climate change after 2020. In doing so, the Commission intends to learn from the shortcomings that have hampered the functioning of the United Nations Framework Convention on Climate Change ("UNFCCC") and the Kyoto Protocol, and to move beyond the limited national commitments secured at UN conferences in Copenhagen (2009) and Cancun (2010). Underscoring the need for a successful agreement, some anticipate that even if fully implemented, current pledges from the EU and others will deliver only about one-third of the greenhouse gas emission reductions needed to stay below a 2° C temperature increase compared to pre-industrial levels.

One of the main challenges will be to bring together the currently intertwined set of binding and non-binding agreements entered into under the UNFCCC to produce a single, comprehensive post-2020 global regime. While the EU, some individual European countries, and Australia have agreed to join a legally binding agreement for the 2012–2020 period, much remains to be done to include other major greenhouse gas emitters, including the United States, China, India, Brazil, and South Africa. As a prerequisite, the 2015 agreement will have to be inclusive and contain commitments actually applicable to all countries—whether developed or developing—while factoring in geographical, cultural, social, and economic differences and countries' varying capacities to adapt. The Commission's aim is a 2015 global agreement that is ambitious and contains commitments pursuing the foregoing temperature increase limitation target of 2° C.

Above and beyond affirmations of principles, the 2015 agreement will also have to be effective in combining mitigation efforts, incentives for sustainable technologies dissemination, market-based mechanisms, and adequate financing, all in a transparent and accountable framework. As the Commission's consultative document states, it is essential that "[c]limate considerations both for mitigation and adaptation ... be fully integrated into all public and private investments in the coming decades." The document further insists that the 2015 agreement must be perceived as "fair and equitable in the way in which it shares the effort to reduce [greenhouse gas] emissions and the cost of adapting to unavoidable climate change." It will have to be adaptable and flexible. In this respect, it will notably have to accommodate, if not promote, measures designed locally to meet local situations while ensuring global coordination.

Finally, the 2015 agreement will have to be a legally binding treaty, as the Commission now considers this as inevitable to secure the global transition toward a low-carbon economy and the new model of development. Broad-based support from a "critical mass" of political leaders is called for by the Commission, while stressing the virtues of the EU's "leadership by example." The EU managed to decouple its greenhouse gas emissions from economic growth, with such emissions having decreased 18 percent since 1990 while the economy grew by 48 percent in the same period.

The consultation is available online to receive public comments until June 26, 2013.

David Desforges
+33.1.56.59.46.58
ddesforges@jonesday.com

EUROPEAN COMMISSION'S GREEN PAPER ON A 2030 FRAMEWORK FOR CLIMATE AND ENERGY POLICIES

On March 27, 2013, the European Commission published a Green Paper (COM(2013) 169 final) that launches a public consultation on the content of the EU's 2030 framework for climate change and energy policies. The EU acknowledges it is making good progress toward achieving its 2020 targets but considers it essential to envisage a new 2030 framework for climate change and energy policies, to provide investors and stakeholders alike with sufficient visibility.

This next step is all the more necessary, says the Commission, because significant changes have taken place since the EU's original 2008–2009 framework was established. Such changes over the last five years include the consequences of the global economic crisis, the budget constraints of Member States, developments on EU and global energy markets (i.e., the rise of unconventional gas and oil exploitation), the issue of the affordability of energy for households, and the growing competitiveness concerns of business. Bearing in mind these issues, in particular the ongoing economic downturn, the Commission's purpose remains an ambitious one: meeting the long-terms goal of cutting greenhouse gas emissions by 80–95 percent from 1990 levels by 2050.

In order to set the stage for the next 15 years or so, the Green Paper reviews past achievements with the 20 percent emission reduction target for 2020, the development of renewable energy technologies, energy savings, and the security of supply and affordability of energy. Then, the Commission identifies four broad issues that structure the questions stakeholders are asked to consider.

First, how should the type, nature, and level of climate and energy targets be set? Indeed, the dominance of the 20 percent greenhouse gas reduction target at the EU level is not necessarily the most relevant one. A wider variety of targets and objectives at the EU level, as well as national or even local levels, may be more appropriate.

Second, coherence among policy instruments is also regarded as a key issue. Emphasis in this respect is placed on the need to strike a balance between the implementation of measures at the EU level and Member States' flexibility to pursue targets at a pace and according to measures most adapted to domestic circumstances, while not fragmenting the internal market.

Third and unsurprisingly, the competitiveness of the EU economy is also factored into the Commission's approach as a major policy driver in a 2030 perspective. In that regard, the Commission remains notably confident that energy and climate policies can foster growth in the low-carbon economy through the potential of energy-efficient and eco-friendly technologies to create five million jobs alone by 2020.

Fourth, drawing from recent Member States' experiences with their respective capacities to act in adverse situations, the Commission believes that their diversity and response abilities must be taken into account when devising a climate and energy policy framework for 2030. A fair and equitable sharing of the effort will be pursued by the Commission, while at the same time seeking measures likely to facilitate public acceptance.

The consultation based on the Green Paper will be open for comment until July 2, 2013. Based on the views expressed by Member States, EU institutions, and stakeholders, the Commission contemplates finalizing the EU's 2030 framework for climate and energy policies by the end of 2013.

David Desforges
+33.1.56.59.46.58
ddesforges@jonesday.com

CONTACTS

CALIFORNIA

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

NEW YORK

Thomas C. Havens
New York Office
Energy
+1.212.326.3935
tchavens@jonesday.com

TEXAS

Jason F. Leif
Houston Office
Energy
+1.832.239.3727
jfleif@jonesday.com

ASIA

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

GEORGIA

G. Graham Holden
Atlanta Office
Energy
+1.404.581.8220
ggholden@jonesday.com

OHIO

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

WASHINGTON, D.C.

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

AUSTRALIA

Tony J. Wassaf
Sydney Office
Energy
+61.2.8272.0527
twassaf@jonesday.com

ILLINOIS

Charles T. Wehland
Chicago Office
Energy
+1.312.269.4388
ctwehland@jonesday.com

PENNSYLVANIA

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

EUROPE

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

LATIN AMERICA

José EstandÍa
Mexico City Office
Energy
+52.55.3000.4081
jestandia@jonesday.com

JONES DAY GLOBAL LOCATIONS

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