



# THE CLIMATE REPORT



## U.S. REGULATORY DEVELOPMENTS

Jane K. Murphy, Editor

■ **OBAMA ADMINISTRATION ANNOUNCES PLANNED RULES TO CONTROL METHANE FROM OIL AND GAS PRODUCTION SOURCES**

On January 14, 2015, the [Obama administration](#) and the [Environmental Protection Agency \(“EPA”\)](#) announced plans to propose new standards to control methane emissions from new and modified—but not existing—oil and natural gas production sources. The future regulation is projected to reduce methane emissions by up to 45 percent by 2025, as compared to 2012 levels, and is modeled on a [series of peer-reviewed white papers](#) that EPA released last year. EPA is scheduled to issue the proposed regulation in the summer of 2015, with the rule to be finalized by 2016.

After proposing the [Clean Power Plan](#) to limit carbon emissions from existing electric generating units (“EGUs”), EPA’s proposed methane standard will serve as the Agency’s next step in reducing overall greenhouse gas (“GHG”) emissions. EPA estimates that methane emissions accounted for nearly 10 percent of GHG emissions in the United States in 2012, while noting that methane possesses 25 times the heat-trapping potential of carbon dioxide over a 100-year period. Without new measures to control methane emissions, it is projected that methane emissions will increase by more than 25 percent by 2025. EPA projects this increase in methane emissions despite the fact that methane emissions within the oil and natural gas sector have

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dropped by 16 percent since 1990, during which time natural gas production has risen by 37 percent.

The proposed rule will add to the existing portfolio of regulatory measures that comprise [the administration's Climate Action Plan Strategy to Reduce Methane Emissions](#). The Climate Action Plan includes a variety of strategies that are or will be carried out by various agencies and departments, including EPA, the Departments of Energy and Transportation, and the Bureau of Land Management. Such reforms focus on implementing requirements in areas deemed to have poor air quality, as well as repairing and improving upon different facets of the oil and natural gas production, processing, and transmission infrastructure.

EPA intends to propose its future methane standards under § 111(b) of the Clean Air Act (“CAA”)—a section under which methane emissions from oil and natural gas wells have not previously been regulated. Notably, CAA § 111(d) requires states to establish standards of performance for any source for which EPA has adopted New Source Performance Standards (“NSPS”) under § 111(b). EPA relied on § 111(d) to justify its authority to regulate CO<sub>2</sub> from existing EGUs when it promulgated the Clean Power Plan. Thus, it appears that a methane regulation for new and modified sources could lead to EPA proposing a subsequent measure to address existing methane sources.

Further information regarding the proposal can be found in our *Jones Day Commentary*, [“Obama Administration Seeks to Cut Methane Emissions.”](#)

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■ **UPDATE ON CALIFORNIA'S CLIMATE CHANGE PROGRAMS AND LITIGATION**

**Compliance Offset Credits.** Under California's cap-and-trade program, the California Air Resource Board (“CARB”) awards offset credits to operators of qualifying projects that generate greenhouse gas (“GHG”) emission reductions. These credits can be sold to regulated entities to offset their GHG emissions. In *Our Children's Earth Foundation v. CARB*, the plaintiff environmental organizations allege that CARB's compliance offset protocols—which establish the eligibility criteria for offsets—fail to ensure that qualifying projects generate *additional* GHG emission reductions that otherwise would not have occurred, as required by statute. The California Court of Appeal heard arguments on December 9, 2014, and will decide whether to overturn the lower court's ruling that the protocols comply with the statute.

While this challenge is pending, CARB continues developing the offset program to meet its long-term goals. In its [First Update to the Climate Change Scoping Plan](#), CARB concluded that the compliance offset protocols will not authorize enough credits to meet maximum anticipated demand. CARB originally adopted four protocols—for forestry, urban forestry, manure digesters, and destruction of ozone depleting substances. In April of 2014, CARB adopted [a fifth protocol](#) for coal and trona mines. CARB currently is developing a protocol for [rice cultivation projects](#) but will need to further expand eligibility to meet its expected long-term demand.

**Low Carbon-Fuel Standard (“LCFS”).** *Rocky Mountain Farmers Union v. Goldstene*, the Commerce Clause challenge to California's LCFS, continues on remand following the U.S. Supreme Court's [denial of certiorari](#). The [Ninth Circuit](#) previously limited the plaintiffs' claims but permitted some to proceed. In December 2014, the plaintiffs filed an [amended complaint](#), alleging that the LCFS burdens interstate commerce and discriminates against out-of-state fuels and fuel feedstocks, in part by assigning physically identical fuels different “carbon intensity scores” based in part upon their places of origin. Because the LCFS caps the carbon intensities of fuels used in California, the plaintiffs allege that this different treatment of physically identical fuels burdens and discriminates against interstate commerce. The plaintiffs also have asserted new claims challenging the 2012 amendments to the LCFS. The 2012 amendments allow California crude oil

producers to calculate their fuels' carbon intensity scores using a "California average," which is the average of carbon emissions from California crude oils. This method could be beneficial to a fuel producer if its fuel's actual carbon intensity is higher than the statewide average. The plaintiffs allege that the LCFS amendments violate the Commerce Clause by making this averaging approach available only for California crude oil but not non-California crude oil. The Ninth Circuit did not consider the 2012 amendments, possibly opening the door to this new challenge.

On January 23, 2015, the defendants filed a [motion to dismiss](#), arguing that the amended complaint does not allege new facts or raise new issues other than those already decided by the Ninth Circuit: namely, that the LCFS does not regulate extraterritorially or discriminate against interstate commerce. The defendants also argue that they are entitled to judgment on the plaintiffs' claims, based on the Ninth Circuit's decision and the lower court's obligation to execute it. The court now will need to decide the exact scope of the Ninth Circuit's decision, and whether the plaintiffs' amended complaint is consistent with that decision.

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■ **COUNCIL ON ENVIRONMENTAL QUALITY PROPOSES  
DRAFT GUIDANCE ON GHG AND CLIMATE CHANGE  
CONSIDERATION IN NEPA DISCLOSURES**

On December 18, 2014, the Council on Environmental Quality ("CEQ") released a new [draft guidance](#) on when and how federal agencies should consider the effects of GHG emissions and climate change in their reviews under the National Environmental Policy Act ("NEPA"). This likely will expand the scope and complexity of a project's NEPA analyses.

NEPA requires that federal departments and agencies consider and disclose potential environmental effects caused by major federal actions. The proposed guidance now requires

that this disclosure include analysis of both the potential effects of a proposed action on climate change—with projected GHG emissions used as a proxy for climate change impacts—and the implications of climate change on the environmental effects over the proposed action's lifespan.

For the GHG emissions analysis, the CEQ notes that many previous NEPA analyses conclude merely that the GHG emissions from the individual action are inconsequential to global climate change effects. The CEQ now explicitly states that this is not an appropriate basis to consider the climate impacts and cautions against relying on such "boilerplate texts to avoid meaningful analysis" of GHG and climate change effects. Instead, the depth of the agency's emissions analysis should be proportional to the projected level of GHG emissions and climate impacts. The proposed guidance recommends that projects with estimated GHG emissions over 25,000 annual metric tons likely warrant a quantitative assessment of emissions and sequestration.

To analyze the effect of future climate change on the project, agencies should compare the current and future state of the environment without the proposed action to the anticipated state of the environment over the lifespan of the proposed action. This analysis should focus on the aspects of the affected environment that will be affected by both climate change and the proposed action. Consequently, the CEQ recommends that the agency consider alternatives that are more resilient or adaptive to the effects of a changing climate. A cost-benefit analysis may be relevant to choosing among such alternatives.

Other notable changes in the draft guidance are its application to federal land and resource management actions—previously understood to be excluded under NEPA—and the requirement that the NEPA analysis consider activities that have a reasonably close causal relationship to the federal action, encompassing both upstream and downstream emissions.

The public comment period for the draft guidance closes on February 23, 2015.

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## CLIMATE CHANGE ISSUES FOR MANAGEMENT

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### ■ CERTAIN CLIMATE CHANGE DISCLOSURES MAY BE REQUIRED UNDER SEC REGULATIONS

In the shadow of the Environmental Protection Agency's ("EPA") proposed rule for emission reductions for existing power plants, maintaining the appropriate scope and detail of environmental disclosures as related to climate change is under a spotlight for companies subject to the Security and Exchange Commission's ("SEC") disclosure regulations. While there are currently no mandatory medium- or long-term greenhouse gas emission reduction targets and limited regulations related to greenhouse gases in the United States, public companies with an international footprint are already subject to emissions reduction targets and climate change regulations that affect capital expenditures, earnings, and the competitive position of their business. Thus, an understanding of the SEC's disclosure requirements in the context of climate change is certainly necessary for some public companies and increasingly necessary for the rest.

As Regulation S-K provides the basic instructions and minimum requirements for various SEC filings, it is the starting point for evaluating [a public company's disclosure obligations as related to climate change](#). Beginning with Item 101, Description of Business, a public company must evaluate the implications of climate change and associated regulation of greenhouse gases on disclosures. Item 101 requires a narrative description of the company's current and intended business. This description includes the "material effects" of environmental compliance on capital expenditures, earnings, and competitive position. The rule specifically states that the company must "disclose material estimated capital expenditures" for the current fiscal year and the next fiscal year. In 2010, a 3–2 split by the vote of five SEC commissioners emphasized that the requirements in Item 101 and other portions of Regulation S-K can require a company to [delineate climate change considerations](#). The capital expenditures associated with the installation of emission control equipment, such as the carbon capture and sequestration equipment contemplated under

EPA's emission reduction rule for power plants, are just one example of disclosures required under Item 101.

Under Item 103, Legal Proceedings, climate change implications and regulation of greenhouse gases may also be required to be disclosed. Item 103 requires disclosure of administrative or judicial proceedings under environmental laws if: (i) those proceedings are material, (ii) the claims exceed 10 percent of current assets, or (iii) the government is a party (unless the company has reasonable belief that monetary sanctions will be under \$100,000). Involvement in climate change litigation brought under the citizen suit provisions of environmental laws could create a disclosure obligation for a public company.

Regulation S-K includes Item 503(c), Risk Factors, which requires certain SEC filings to include a discussion of the most significant factors that make an investment in the regulated company speculative or risky. The SEC requires risk factor disclosure to clearly state the risk and specify how the particular risk affects the particular registrant. In the context of climate change, risk factors vary from the impact of legislation and regulation to the actual physical impacts of climate change from catastrophic weather events and pervasive climate conditions that may affect asset value or business operations. When they are significant to a registrant, these risk factors should be disclosed to meet the disclosure requirements of Item 503(3).

In addition to the climate change-related matters identified for possible disclosure under Item 101, Item 103, and Item 503(c), Item 303, Management Discussion and Analysis ("MD&A"), requires the disclosure of other information necessary to understand the company's financial condition, including known trends or uncertainties likely to change liquidity in any material way. The extent of the disclosures required under MD&A have not been tested in the context of climate change. However, two key SEC interpretations in the context of disclosing potentially responsible party status ("PRP") in Superfund matters offer clarity. First, the Thomas A. Cole, SEC No-Action Letter (Jan, 17 1989), explains that a known uncertainty exists "where it is reasonably likely that these [clean-up] costs will be material." Second, the [MD&A Interpretive Release dated May 18, 1989](#) explains that there is a duty to disclose where uncertainty is known and reasonably likely to be material. In the example

context of PRPs, the guidance explains that MD&A disclosure is required where “management is unable to determine that a material effect . . . is not reasonably likely to occur” considering the company’s aggregate potential share of cleanup costs and the availability of insurance coverage.

This MD&A guidance language suggests that a public company grappling with making a disclosure related to climate change should default on the side of disclosure. In making its determination about the necessity of climate change disclosure, the company should consider the aggregate costs posed by the various risks associated with climate change and regulation of greenhouse gas emissions. Even as a company considers the aggregate costs, it should also consider mitigating factors such as insurance. Similarly, a public company may want to consider discussing any competitive advantage offered by climate change or regulation of greenhouse gases.

Companies that make the required disclosures are not necessarily insulated from shareholder activism. In recent years, shareholders have proposed resolutions for companies to develop reports on greenhouse gas emissions and consider establishing targets for future reductions. In some cases, companies have successfully resisted including these shareholder resolutions in proxy materials when the companies can point to [existing measures that accomplish the same functional objectives](#) as the proposed resolution would. In other cases, the [SEC has taken action](#) that leads to inclusion of the shareholder resolution in proxy materials.

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**■ SHAREHOLDER RESOLUTIONS PRESSURE  
CORPORATIONS TO DISCLOSE PLANS FOR  
CLIMATE CHANGE**

A large coalition of shareholders in several energy companies has recently published resolutions focused on provoking corporate responses to climate change. In early 2015, 150

investors in BP Plc (“BP”) and Royal Dutch Shell Plc (“Shell”) published resolutions with the two companies demanding several responses. Specifically, the resolutions call for the companies to: (i) test whether their business models are compatible with the “2C target,” the international community’s pledge to limit global warming to two degrees on the centigrade scale (3.6 degrees Fahrenheit); (ii) restructure the corporate bonus systems to no longer reward climate-harming activities; (iii) commit to reducing emissions and investing in renewable energy; and (iv) disclose how their public policy plans align with climate change mitigation and risk. These measures will be put to a vote at BP and Shell’s annual general meetings (“AGM”), in April and May 2015, respectively. In a January 29, 2015, letter to the shareholder coalition regarding the resolution, Shell stated its intention to recommend that shareholders support the resolution at its AGM.

The BP and Shell resolutions are notable for the size of the investors involved in the coalition. One of the driving forces behind the resolutions was the “Aiming for A” investor coalition, organized by CCLA Investment Management, a charity fund manager. The “Aiming for A” coalition was established with the goal of engaging with the 10 major UK-listed utilities and extractives companies to earn an “A” in the Carbon Disclosure Project’s Carbon Performance Leadership Index. The BP and Shell resolutions are the first shareholder resolutions published by the coalition.

CCLA manages, among other things, more than US\$2.35 billion of Church of England money. The full co-filing group in the BP and Shell resolutions comprises more than 50 institutional investors, including UK churches, charities, and local authority pension funds, as well as clients of Rathbone Greenbank Investments and individual supporters. Eight of the co-filing pension funds have assets higher than US\$15 billion. The co-filing group is being assisted by ClientEarth, an environmental law firm, and ShareAction, a shareholder action group

The kind of shareholder resolutions filed with BP and Shell are becoming increasingly common. According to Ceres, more than 100 similar resolutions related to climate change, carbon asset risk, and greenhouse gas emissions have already been published for 2015. The actions requested by these types of resolutions take many forms. Proposed resolutions were filed with several large banks, urging the banks to disclose

information about the loans they make to “oil, gas, coal and other companies whose practices create carbon emissions.”

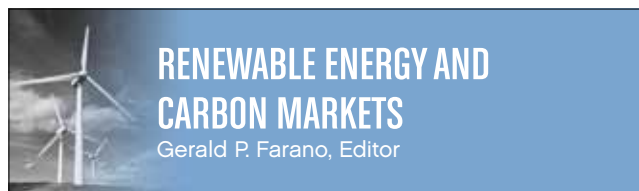
As previously reported in the [Fall 2014 Climate Report](#), multiple shareholder proposals by state pension funds in New York and Connecticut were filed in 2014 with five energy companies, requesting that they (i) report on their progress in achieving the Obama administration’s goal of an 80 percent reduction in greenhouse gas emissions by 2050, (ii) consider innovative energy generation technologies and strategies, and (iii) evaluate best practices among domestic and international peers. More recently, the Vermont Pension Investment Committee approved the co-filing of a resolution asking ExxonMobil to report to shareholders by the end of November 2015 about its plans for reducing total greenhouse gas emissions from its products and operations. And a resolution filed in November 2014 with ExxonMobil called for the company to return capital to shareholders rather than invest in high-cost, high-carbon oil projects.

As coalitions such as “Aiming for A” become increasingly active, the number of resolutions, and the amount of assets implicated, can be expected only to grow.

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## ■ TRENDS IN FINANCING RESIDENTIAL ROOFTOP SOLAR POWER

The solar industry and the use of residential solar power have grown dramatically in recent years. In fact, in the U.S. alone, a [new solar installation is completed every two and a half minutes](#). Moreover, growth in the residential solar sector is now outpacing other forms of solar installations, due in large part to an increase in the availability of third-party financing. Today, third-party-owned residential installations account for more than 50 percent of new residential solar capacity in California, Arizona, Colorado, and Massachusetts, while market share for third-party ownership in several other states (Connecticut, Delaware, Maryland, New Jersey, New York, Oregon, Texas, Vermont, and Washington) is increasing rapidly to the point that the [residential solar-financing market is forecasted to rise to \\$5.7 billion in 2016 from \\$1.3 billion in 2012](#).

So, how does this all work? Using the “third-party-owned” model, developers purchase, lease, install, and maintain rooftop systems. Customers then pay a low, fixed energy rate through a 20-year purchase agreement. Homeowners are therefore able to avoid the high cost of purchasing a system outright. While traditionally lenders would not assume the risk of making loans to solar developers based on individual long-term homeowner debt that is not secured by the underlying real estate, it became clear that homeowners meeting certain credit criteria were a good long-term risk, particularly when payments were tied to powering their homes. In order to make this arrangement financeable, solar developers retain ownership of the systems, lease the systems to homeowners, pool the leased systems, and then sell them to commercial banks in tranches ranging anywhere from \$20 million to \$700 million.

While initially the market for financing third-party-owned systems was very narrow—sourcing financing from clean-power funds such as those established by Clean Power Finance, which has placed more than \$1 billion in solar financing—the market for financing residential rooftop leases is growing at a steady clip and should continue to increase in 2015. Entrants

into the financing market include Morgan Stanley, Goldman Sachs, US Bank, JP Morgan and Google, to name a few.

Moreover, it seems that all of the residential solar players are taking advantage of the available financing opportunities. Sunrun, the largest dedicated residential solar company in the U.S., along with Investec, recently announced the close of \$195 million of senior credit facilities to support the growth of Sunrun's residential solar business. Presumably Sunrun will use this credit facility to assist in financing rooftop installations that arise out of its partnership with Sungevity. It appears that Sungevity will acquire customers and Sunrun will finance the rooftop installations and own the photovoltaic ("PV") system.

NRG Energy, Inc., through its NRG Residential Solar Systems subsidiary, recently closed an up to \$200 million financing with MySolar, funded by Morgan Stanley, where NRG will source customers, install, operate, and maintain leased residential systems, and then sell the systems to MySolar.

Finally, SolarCity, which owns one-third of the U.S. residential solar power market, recently launched its solar loan product, MyPower, which is designed to finance residential solar ownership directly with the homeowner.

Given the lowered costs of solar power, the increase in financing opportunities for residential solar power, and the continually evolving landscape of those financing options, we expect the use of residential solar power to continue to increase significantly through 2015. The real test will be how residential solar power installations (and the financing of those systems) are affected when the 30 percent investment tax credit on those systems expires at the end of 2016.

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## ■ THE SOLAR ENERGY COMPENSATION DEBATE CONTINUES IN 2015

The ongoing advance of distributed photovoltaic ("PV") solar power generation in the U.S. continues to stoke debate regarding how residential PV customers should be compensated for feeding power back into the grid.

Historically, net energy metering ("NEM") was the rate structure pursuant to which such customers have been paid. In the 43 states with NEM rate designs, the energy produced by a customer's PV system each month, measured on a kilowatt hour ("kWh") basis, is subtracted from the energy consumed by the customer for that month, and then the customer in turn pays the utility for the net amount of power. If the amount of power generated by a customer for a given month exceeds the amount of power consumed then, depending on the jurisdiction, the customer receives for such excess power either a volumetric bill credit for energy use determined at the full retail rate, a cash payment determined at the full retail rate or, less commonly, a cash payment determined upon some lower "avoided cost" rate.

In those states that have adopted an NEM rate structure and that otherwise have a strong solar resource, it is indisputable that the NEM rate design has spurred the adoption of residential distributed PV solar systems. It is likewise the case, particularly in those jurisdictions that either credit or pay the customer the full retail rate for excess electricity generated, that investor-owned electric utilities and solar developers have disputed whether the NEM rate structure is appropriate.

Specifically, utility companies argue that while they typically recover most of their costs through volumetric charges per kWh of energy delivered across their networks, most distribution network costs arise from fixed investments in wires, transformers, and other equipment sized to meet peak demands. Utilities maintain that because of the mismatch between the mostly variable energy charges and mostly fixed transmission and distribution costs, an NEM rate structure that provides full retail-rate payments to PV customers threatens the utility's ability to [recover rates for such transmission and distribution costs](#). To counter that threat, utilities contend that they must seek to raise the retail rate for all customers which in turn effectively [shifts grid system costs](#) from customers who can afford solar PV systems to those who cannot.

[Advocates of NEM rate structures](#) that compensate solar customers at the full retail rate contend that systemic retail-rate compensation already covers fixed grid reliability costs and, additionally, that the growing number of PV solar systems in any given service territory permit the utility to avoid environmental, generation, and transmission and distribution loss

costs. These NEM design supporters, led by many of the large independent residential solar installers across the country, believe that the NEM structure is essential to the third-party-ownership business model they have successfully developed and implemented. In their view, the effective combination of federal tax credits, plummeting solar installation costs, third-party financing, and NEM rate design have supported unprecedented U.S. solar growth over the last few years.

As state legislatures, public utility commissions, and municipalities attempt to address this tension, a number of potential—albeit hotly contested—alternatives to full retail-rate NEM structures have begun to emerge.

In April 2014, Minnesota approved a [value of solar tariff \(“VOST” compensation methodology\)](#). The VOST, which the Minnesota Legislature had directed the state’s department of commerce to develop, is based in large part on an NEM rate design alternative pioneered in 2006 by Austin Energy and Clean Power Research, a Texas municipal utility. Pursuant to the VOST methodology, solar PV customers in Minnesota are billed for their energy use at the incumbent utility’s full retail rate, but given a credit against that bill for energy produced by their PV systems. The credit is calculated at the fixed VOST rate.

In theory, the Minnesota VOST more accurately values how much solar power is worth to the utility, its ratepayers, society, and the environment, by taking into account certain avoided system costs (e.g., fuel, fixed and variable operations and maintenance, generation, reserve, transmission and distribution capacity, environmental, etc.) afforded to the grid by a customer’s installation of a residential solar PV system. To date, the VOST—which is being challenged in respect to its income tax implications for PV system owners, its effect on one’s eligibility for the federal investment tax credit, and its potential chilling effect on third-party ownership financing alternatives—has yet to be adopted by any utility which can choose between the VOST and NEM for its solar PV customers.

More recently, in November 2014, the [Wisconsin Public Service Commission \(“PSC”\)](#) voted 2 to 1 to permit We Energy to charge all residential customers in its service territory a \$16.00 monthly fixed fee (up from \$9.00) plus a volumetric fee of \$0.1349 per kWh (down from only \$0.139). Solar customers will also have to pay \$3.80 per kilowatt per month and will only

get \$0.03 per kWh for excess energy provided to the grid each month (down from \$0.14). Additionally, the PSC’s approved change in NEM design shifts the program from annual netting to monthly netting.

The decision in Wisconsin, if unchanged, will likely eliminate any possibility of residential solar power ever becoming economical in the state. In light of there being only about 600 residential PV customers in Wisconsin today, its impact on the current market is negligible. That said, for the residential solar industry generally, the Wisconsin decision provides utilities with an alternative tool for fighting allocating costs in other states.

In addition to the solar compensation models in Minnesota, Wisconsin, and Arizona, the NEM rate structure is being revisited in California, Massachusetts, Colorado, Hawaii, and a host of other states. Suffice it to say that the debate about compensation for distributed generation PV solar systems will continue in 2015.

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## ■ NEBRASKA SUPREME COURT CLEARS ROADBLOCK FOR KEYSTONE XL PIPELINE PROJECT

On January 9, 2015, the [Nebraska Supreme Court upheld](#) former Nebraska Governor Dave Heineman's approval of TransCanada Corp.'s Keystone XL pipeline route, removing a roadblock frequently cited by President Obama as part of his hesitation to sign a bill approving the project. The proposed pipeline—which would move up to 830,000 barrels of oil a day from Canada's oil sands to Gulf Coast refineries—has become a hot political issue over climate change and economic growth.

The Nebraska lawsuit challenging the state's approval, *Thompson et al. v. Heineman et al.*, No. S-14-158, was premised on plaintiffs' contention that a statute allowing the governor to set the route violated the Nebraska Constitution. The suit was filed in March 2013 by three landowners seeking a declaratory judgment that the law violated the equal-protection, due-process, and separation-of-powers provisions of the Nebraska Constitution, along with its prohibition of special legislation. The suit alleged that the bill unconstitutionally delegated to the governor powers over a common carrier that exclusively belonged to the Nebraska Public Service Commission, and unconstitutionally delegated plenary authority over the exercise of eminent domain power that belonged exclusively to the state legislature. The challenged law, L.B. 1161, allows "major oil pipeline" carriers to bypass the regulatory procedures of the state's public service commission and, as an alternative, permits pipeline carriers to obtain approval from the governor to exercise the power of eminent domain for building a pipeline in Nebraska.

The Nebraska Supreme Court actually voted 4 to 3 to uphold a lower court judge's opinion that a law allowing the governor to set the route violated the Nebraska Constitution and that the landowner appellees had standing to raise the issue. However, under the Nebraska Constitution, a five-vote supermajority is required for the court to rule that a law is unconstitutional. Although the majority bloc was in favor of overturning

the pipeline-siting route, it lacked the necessary five-vote supermajority. Accordingly, L.B. 1161 remains intact and the former governor's approval of the permit stands.

Although the Nebraska Supreme Court ruling focused on the permitting process and state constitutional issues, President Obama, and other opponents of the pipeline, have repeatedly alleged concerns about the pipeline's impact on climate change. The President has asserted that a pending review process within the State Department should be completed before he makes a final decision. The State Department review, known as a national-interest determination, considers several factors, including the pipeline's impact on energy security, the environment and climate change, geopolitics, and the economy. Notably, in January 2014, the State Department issued a Final Supplemental Environmental Impact Statement report in which it concluded that the construction of the pipeline is unlikely to have significant effects on climate-change-causing greenhouse gas emissions. The State Department previously extended the time to complete its review process based, in part, "on the uncertainty created by the on-going litigation in the Nebraska Supreme Court..." On February 2, 2015, the EPA submitted comments to the Final SEIS. In its letter, the EPA stated that it was providing comments now, rather than when the Final SEIS was published, because of the possibility that the Nebraska Supreme Court decision could have led to changes to the Final SEIS. In its letter, the EPA disagreed with the State Department's conclusions the construction of the pipeline is unlikely to have significant effects on climate-change-causing greenhouse gas emissions because of the recent large declines in oil prices.

On the same day as the Nebraska Supreme Court ruling, the U.S. House of Representatives passed a bill approving the route and, on Monday January 12, the whole U.S. Senate cleared a procedural hurdle allowing the Senate's version of the Keystone bill, which had cleared the Senate Energy and Natural Resources Committee on the previous Thursday, to be brought to the Senate floor for debate. President Obama has formally threatened to veto the measure.

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■ **D.C. CIRCUIT CONSIDERS MOTIONS TO GOVERN FUTURE PROCEEDINGS IN LIGHT OF SUPREME COURT'S DECISION IN *UTILITY AIR REGULATORY GROUP V. EPA***

As previously reported in the [Summer 2014 issue of \*The Climate Report\*](#), on June 23, 2014, the United States Supreme Court held that (i) the Clean Air Act (“CAA”) does not compel the EPA to regulate greenhouse gas (“GHG”) emissions under either the Prevention of Significant Deterioration (“PSD”) or Title V programs and that the EPA’s current interpretation was impermissible and beyond the statutory purpose of the PSD and Title V programs; and (ii) the EPA’s decision to require Best Available Control Technology (“BACT”) for GHGs emitted by sources otherwise subject to PSD requirements is permissible under the CAA, though the Court did not rule on the EPA’s current approach to requiring BACT for such sources. *See Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427 (2014) (“*UARG*”).

In the aftermath of the Supreme Court’s decision, the United States Court of Appeals for the District of Columbia Circuit must now decide how to proceed with underlying consolidated cases that were the subject of or otherwise directly implicated by the *UARG* decision. *See, e.g., Coalition for Responsible Regulation, Inc. v. EPA*, 09-1322 (D.C. Cir.). To that end, the D.C. Circuit directed the parties in *Coalition for Responsible Regulation* to file motions to govern future proceedings. The motions were filed in October 2014, and responses were filed in November 2014.

In their motions and responses, the EPA, certain states, and certain environmental groups acknowledge that EPA regulations requiring stationary sources to obtain PSD or Title V permits, if GHGs are the only pollutant that the source emits above applicable major source thresholds, should be vacated under *UARG*. However, they argue that *UARG* permits the EPA to continue requiring BACT for GHG emissions from sources that are already subject to PSD permit requirements based on emissions of other pollutants (referred to as “anyway sources”) without the need for new rulemaking. They contend that the BACT requirement is set forth in § 165(a) of the CAA itself, and that requiring new rulemaking would create confusion because it would upend PSD permitting processes already effectively administered.

In contrast, certain other states and industry groups argue in their motions and responses that *UARG* does not support

continued application of BACT for GHG emissions to “anyway sources.” These states and industry groups assert that *UARG* requires vacation of the Tailoring Rule and any portion of the Timing Rule or other challenged rules that the EPA relied upon to support PSD and Title V regulation of GHG emissions. They contend that no PSD regulation of GHGs survives the *UARG* decision, such that the EPA would have to enact new rules that properly define and justify application of BACT to GHG emissions of “anyway sources.” They argue that allowing the EPA to enforce a BACT program on “anyway sources” without new rulemaking would result in an interim program administered on a permit-by-permit basis that would cause disruption and uncertainty for regulated sources.

The D.C. Circuit must now determine the extent to which *UARG* compels EPA regulations of GHG emissions to be vacated based on these competing arguments.

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■ **CALIFORNIA COURTS SHELVE SAN DIEGO'S TRANSPORTATION PLAN FOR FAILING TO ADDRESS CLIMATE CHANGE IMPACTS**

On November 24, 2014, the California Court of Appeal held that the San Diego Association of Governments’ (“SANDAG”) environmental impact report (“EIR”) for its 2050 Regional Transportation Plan/Sustainable Communities Strategy failed to comply with the California Environmental Quality Act (“CEQA”) by not adequately considering the climate change impacts of the plan. *Cleveland National Forest Foundation v. San Diego Association of Governments*, Nos. 37-2011-00101593, 37-2011-00101660 (Cal. Ct. App. Nov. 24, 2014).

The court affirmed the superior court’s finding that the EIR violated CEQA because it failed to analyze the inconsistency between the state’s policy goals reflected in Executive Order S-3-05 and the plan’s greenhouse gas emissions impact. Executive Order S-3-05 sets greenhouse gas emissions reduction targets in California through 2050. California’s legislature enacted equivalent emissions targets through 2020 into law with the intention that the progress and reductions extend beyond 2020 and directed the California Air Resource Board

("CARB") to develop regional greenhouse gas emissions targets for automobiles and light trucks for 2020 and 2035. The San Diego plan acknowledged an increase in greenhouse gas emissions but SANDAG argued that it did not need to compare the plan's greenhouse gas impacts with the state climate policy as articulated in Executive Order S-3-05 because (i) there is no statute or regulation translating the Executive Order into reduction targets specific to the region through 2050 and (ii) the plan complied with the CEQA Guidelines located in title 14 of the California Code of Regulations.

The California Court of Appeal disagreed holding that, even though SANDAG may not know the specific reduction targets it needs to meet, SANDAG could have compared its plan with the state policy of continual greenhouse gas emissions reductions. The court of appeal also held that the use of the CEQA Guidelines did not automatically mean compliance with CEQA when failure to consider other evidence frustrates the state's climate policy and renders the EIR misleading.

Despite the fact that the court's decision that the plan violated CEQA rendered the petitioners' other challenges to the EIR partially moot, the court addressed the other challenges in turn and found that the EIR also violated CEQA for the following reasons: (i) it failed to adequately address mitigation measures for the post-2020 greenhouse gas emissions; (ii) it failed to address any project alternative that would significantly reduce total vehicle miles traveled and instead focused on congestion relief; (iii) it failed to adequately present a baseline of existing air-quality conditions and analyze the health effects of the air-quality impacts and; (iv) it failed to analyze and mitigate the plan's impact on agricultural land.

Judge Patricia D. Benke filed a dissenting opinion arguing that the superior court's decision should be reversed because SANDAG adequately analyzed the EIR's greenhouse gas impacts in relation to the regional reduction targets promulgated by CARB.

On January 6, 2015, SANDAG filed a petition for review with the California Supreme Court arguing primarily that consistency with Executive Order S-03-05 is not an appropriate standard by which to evaluate the significance of the transportation plan's greenhouse gas impacts. An Executive Order is not binding state policy with which local governments must

comply, and it cannot repudiate Guidelines § 15064.4, which was specifically adopted at the direction of the Legislature to guide analysis of greenhouse gas impacts.

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■ **LIMA CLIMATE CONFERENCE PAVES THE WAY TOWARD A CLIMATE AGREEMENT IN PARIS**

The 20th session of the Conference of the Parties (“COP”) of the United Nations Framework Convention on Climate Change (“UNFCCC”) and the 10th session of the COP serving as the meeting of the Parties to the Kyoto Protocol (“CMP”) took place in Lima, Peru, in December 2014. Signed in 1992, the UNFCCC sets the goal of preventing dangerous man-made interference with the global climate system. In 1997, to better fight the effects of climate change, the Kyoto Protocol was adopted to legally bind developed countries to emission reduction targets. The last commitment period of the Protocol will expire in 2020, thus creating the need for a new agreement.

The 194 countries attending the Lima COP/CMP have reached decisions that provide for the foundation of a new climate change framework. They have agreed on two initiatives: the [Lima Call for Climate Action](#) and the draft elements for the new agreement to be adopted.

The Lima Call for Climate Action requires all countries to describe their proposed emissions reduction targets in a clear, transparent, and understandable way, in order to assess whether these contributions are fair and ambitious. The UNFCCC secretariat will publish the contributions and prepare a synthesis report. The European Union declared its willingness to assist in this process and engage in constructive discussions with other countries about their proposed targets.

In Lima, parties have also begun compiling the draft elements of the new agreement, intended to be adopted during the 21st COP/CMP, which will take place in Paris in winter 2015. This agreement aims to merge all binding and nonbinding arrangements under the UNFCCC and to build a single comprehensive regime in the form of a new protocol, thus replacing the Kyoto Protocol. This regime will be binding on all parties to the UNFCCC, including certain developing countries.

The expectations surrounding the 21st COP/CMP are, therefore, very high, since the new agreement will provide for the climate action legal framework from 2020 onward.

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■ **CHINA AIMS FOR NATIONAL CARBON MARKET BY 2016**

In November 2014, the United States and China issued a joint announcement recognizing that each nation had a “critical role to play” in combating global climate change—and announcing measures to be taken by each nation in that regard.

Following recommendations made in August 2014 by the Energy Research Institute (a think tank led by the National Development Resource Council (“NDRC”)), China committed to “peaking” its carbon emissions by 2030 and to use its best efforts to peak before this date. China also pledged to increase the share of non-fossil fuels to 20 percent of primary energy consumption by 2030. These goals will be incorporated into China’s next three “five year plans,” with the current plan due to expire in 2015.

A core component of China’s climate change strategy involves the establishment of a national carbon market by 2016, which will also be incorporated into the next “five year plan” and is expected to cover 40 percent of the nation’s economy. Further emitting sectors will be brought within the scheme after 2020, and links to international markets may be sought within the decade.

Seven regional pilot schemes are now up and running, covering the cities of Beijing, Tianjin, Shanghai, and Shenzhen, as well as Chongqing, Guangdong, and Hubei provinces. Twenty-four million tons of carbon dioxide equivalent were traded under these schemes in 2014, and this number is predicted to rise to 40 million tons in the coming year.

The NDRC estimates that the national scheme will regulate between three billion and four billion tons of carbon dioxide and will be worth between 60 billion and 400 billion yuan (or between US\$10 billion and US\$64 billion) by 2020. This would create a market roughly twice the size of that in place in the European Union, currently the largest in the world.

Under outline rules released in December 2014, the State Council will establish a total emissions cap to be divided between the provinces and regions. Carbon permits will be allocated free of charge at first, with the scheme transitioning to paid allocations when appropriate. While certain provinces will be ready to join the scheme in 2016, others will be given more time to prepare.

The pilot schemes have seen a relatively high level of compliance by emitters. However, concerns have been raised in the past about a lack of transparency as to emissions levels on the part of companies and local governments. A further challenge is the existence of significant variations between the schemes, including as to allocation methods, monitoring, reporting, and verification, and whether banking or borrowing is allowed.

With the advent of a national market, China will become the focal point of carbon trading in the Asia-Pacific, overtaking South Korea, which launched its mandatory carbon trading scheme in January 2015 (currently, the second largest in the world). New Zealand and Kazakhstan also have emissions trading schemes in place, while similar schemes are being developed in Thailand, Vietnam, and Indonesia.

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#### ■ THE UK ENERGY SAVINGS OPPORTUNITY SCHEME 2014

The Energy Savings Opportunity Scheme (“ESOS”) Regulations (SI 2014/1634), which came into force on July 17, 2014, requires large undertakings in the UK to carry out an energy audit and notify the Environment Agency (“EA”) of compliance by

December 5, 2015. Participants must carry out an assessment in each subsequent four-year compliance period ending on December 5, 2019, 2023, etc. While there is no obligation to follow any recommendations, the assumption is that having carried out such an assessment, participants are then likely to take action to reduce their energy use. ESOS is the UK’s method of transposing its obligations under Article 8(4) of Energy Efficiency Directive 2012 to promote energy efficiency.

In the first four-year period, an undertaking must participate if, as of December 31, 2014, it either: (i) employed at least 250 people; or (ii) employed less than 250 people but had an annual turnover in excess of €50 million and an annual balance sheet in excess of €43 million; or (iii) was part of a corporate group that included an undertaking that meets the criteria at (i) or (ii) above.

In group situations, compliance responsibility rests with the highest UK parent unless all group companies agree otherwise in writing. Global parents and overseas undertakings not carrying on a UK business are not subject to ESOS. An “undertaking” is determined by reference to section 1161(1) of the Companies Act 2006, i.e.: limited or public companies, trusts or partnerships, unincorporated associations, not-for-profit bodies engaged in a trade or business (which could include some charities), and some universities.

Public bodies and companies in insolvency are excluded. For these purposes, a “public body” (in England, Wales, and Northern Ireland) is a contracting authority as defined in Regulation 3 of the Public Contracts Regulations 2006 (SI 2006/5). This includes government departments, local authorities, police, and fire authorities. Global parents and overseas group undertakings are not required to participate.

In carrying out the assessment, participants must ensure that at least 90 percent of their total energy consumed in the UK in buildings, transport, and industrial processes is covered over a 12-month reference period. The compliance package in respect of the audit has to be signed off by a qualified lead assessor that meets special competency requirements.

The EA has indicated it will take a light-touch approach to ensuring compliance, although failure to comply can lead to civil fines. Financial penalties vary according to breach but

range from a fine of up to £5,000 for failure to maintain records to up to £50,000 for failing to carry out an audit. Penalties may also include additional fines of £500 per day for noncompliance, together with the costs of the compliance body in carrying out additional auditing activity to check ESOS compliance. The EA can also publish a penalty notice setting out the breach on its website.

Undertakings should therefore assess whether they are caught by the qualification criteria as of December 31, 2014 and take steps to ensure compliance by December 5, 2015.

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