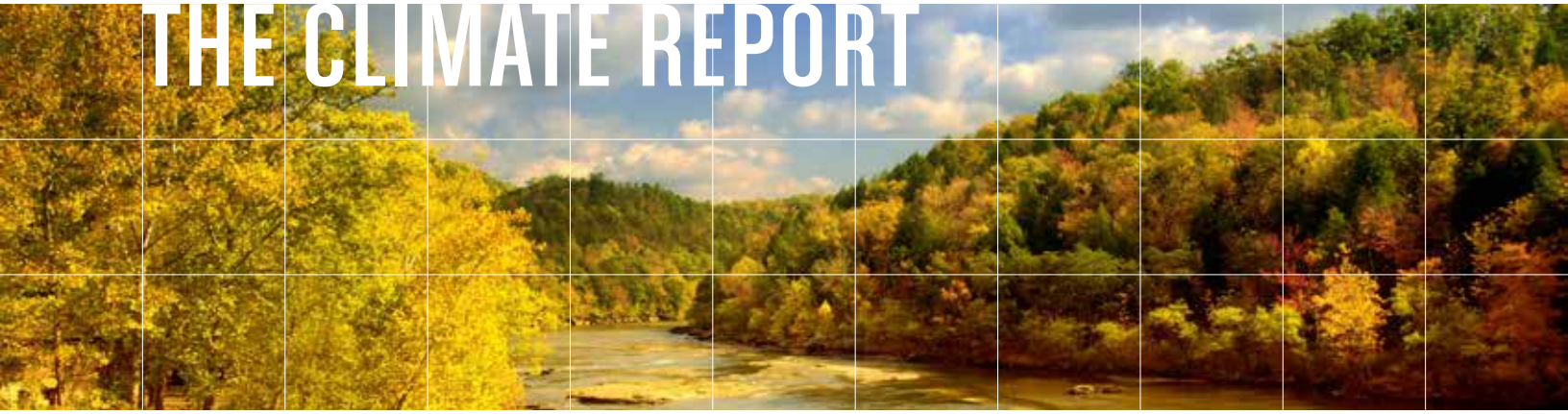
FALL 2015 ISSUE

THE CLIMATE REPORT



DEPARTMENTS

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EPA'S CLEAN POWER PLAN TAKES EFFECT . . . MUCH HIJINKS ENSUE

On October 23, 2015, the Clean Power Plan, EPA's regulatory effort to reduce greenhouse gas emissions from the U.S. power industry by 32 percent from 2005 levels, was officially published in the *Federal Register*. As expected, this triggered a deluge of judicial challenges from business and governmental foes, along with pledges of support for the plan from environmental groups, alternative energy providers, and like-minded state governments. Four of the challenges included requests that the U.S. Court of Appeals for the D.C. Circuit stay implementation of the new rule until judicial review is complete. In Congress, resolutions seeking to invalidate the plan under the Congressional Review Act were introduced in both the Senate and the House.

On the first day of the 60-day period in which petitions for judicial review of the Clean Power Plan were permitted, 19 separate petitions—encompassing 26 states and dozens of business groups—were filed with the D.C. Circuit. The State of West Virginia, whose coal industry would be negatively affected by the plan, filed a petition on behalf of itself and 23 other states, while Oklahoma and North Dakota filed their own petitions. Mississippi became the 27th state to challenge the rule on November 5, 2015. Trade associations for power utilities and fossil fuel producers, along with an individual coal company, also filed petitions on the day the plan was published.

Other business petitioners ranged from broad-based organizations, including the U.S. Chamber of Commerce, National Federation of Independent Business, and National

Association of Manufacturers, to more specialized groups, such as the American Iron and Steel Institute, the Brick Industry Association, and even the National Oilseed Processors Association. The D.C. Circuit has consolidated all petitions for review of the Clean Power Plan with West Virginia's challenge, and a single three-judge panel will decide them together.

On the other side of the dispute, motions to intervene in support of the Clean Power Plan were promptly filed by a group of nine environmental organizations, ranging from the Sierra Club to the American Lung Association, as well as by two clean energy trade associations. Eighteen states, along with a handful of municipalities, have moved to intervene in the D.C. Circuit litigation in support of EPA, meaning that 45 of 50 states are now actively choosing sides in the dispute.

In the near term, the D.C. Circuit must address multiple motions seeking an emergency stay of the Clean Power Plan's requirements until judicial review—a process that will likely extend to mid-2018 if the U.S. Supreme Court hears the case—is complete. Although the new rule's emission reduction obligations do not apply until 2022, states are required to submit initial plans for implementing the rule in early September 2016. States that fail to either submit a plan or demonstrate enough progress to EPA to warrant an extension of the deadline face the imposition of EPA's own federal implementation plan. Further complicating states' evaluations is the fact that EPA has issued only a proposed federal plan thus far.

On October 29, 2015, the D.C. Circuit adopted a schedule for the consolidated challenges that requires any further motions for stay to be filed by November 5, 2015, with all briefing on the motions to be completed by December 23, 2015. However, since the Clean Air Act allows additional petitions for review of the Clean Power Plan (and therefore additional motions for stay) to be filed until December 22, 2015, one challenger has already asked the court to defer any action regarding motions for stay until the deadline for filing challenges has passed.

In any event, it's clear that no judicial stay will be imposed before early 2016, if ever. This timing is important to the Obama administration because it means that the Clean Power Plan will be in full force when the President travels to Paris in early December 2015 for a United Nations conference seeking to finalize a global climate change agreement to replace the Kyoto Protocol. Combined with prior EPA regulations regulating greenhouse gas emissions from vehicles and from certain major industrial projects, the Clean Power Plan represents the core of the United States' pledge to the U.N. to cut such emissions 26 to 28 percent below 2005 levels by 2025.

While judicial action is not expected before the Paris conference, it is possible that Congress will take action in November demonstrates the absence of broad-based political support for the President's climate change agenda. Both the Senate and House of Representatives are considering "resolutions of disapproval" under the Congressional Review Act, a statute that authorizes Congress to invalidate a regulation like the Clean Power Plan based on simple majority votes in each chamber. The Act contains provisions to ensure that such resolutions are actually brought to the floor for a vote, including a provision that prevents filibustering in the Senate. In light of these provisions, it is likely that both the Senate and the House will hold disapproval votes before the end of November 2015.

Majority support for a resolution of disapproval appears certain in the House and, at most, a vote or two away in the Senate. Even if successful, however, the effect of disapproval under the Congressional Review Act would likely be limited to political messaging, since President Obama could exercise his constitutional right to veto any such resolution, with very little chance that two-thirds of each chamber would vote to override his veto. However, knowing that President Obama will no longer be in office after 2016 to ensure implementation of either the Clean Power Plan or the United States' broader emission pledges in Paris, other major greenhouse gas emitters might view a resolution of disapproval that received majority support from both chambers of the U.S. Congress as a signal to temper their own pledges of future reductions.

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U.S. REGULATORY DEVELOPMENTS

Jane K. Murphy, Editor

CALIFORNIA GOVERNOR SIGNS S.B. 350 INTO LAW, INCREASING RPS TO 50 PERCENT BY 2030

On October 7, 2015, California Governor Jerry Brown signed S.B. 350, the Clean Energy and Pollution Reduction Act of 2015, into law. The bill increases California's Renewable Portfolio Standard ("RPS") from 33 percent by 2020 to 50 percent by 2030 and doubles energy efficiency standards by 2030. S.B. 350 follows Governor Brown's January 5, 2015 inaugural address, wherein he announced the renewable energy and efficiency targets that S.B. 350 embodies.

Like California's original RPS, established in 2002, S.B. 350 will be implemented jointly by the California Public Utilities Commission ("CPUC") and the California Energy Commission ("CEC"). S.B. 350 requires each investor-owned utility to submit renewable energy resource procurement plans setting forth strategies for procuring and integrating reliable, renewable energy into the grid, and requires the use of zero carbon-emitting resources to the "maximum extent reasonable." The procurement plans will be reviewed and adopted by the CPUC as part of, and pursuant to, the general procurement plan process. The law also establishes interim renewable energy targets of 40 percent by the end of 2024 and 45 percent by the end of 2027. S.B. 350 does not alter the categories of resources that count toward compliance with the RPS.

S.B. 350 also requires a 50 percent increase in energy efficiency for existing residential and nonresidential buildings by 2030. The law directs the CEC to establish energy efficiency targets and specify programs that will be utilized to meet the 2030 energy efficiency goal. The bill also directs publicly owned utilities to meet energy efficiency targets specified by the CEC.

As initially introduced, S.B. 350 called for a 50 percent reduction in petroleum use from cars and trucks. The 50 percent petroleum reduction standard, however, was not included in the version of the bill ultimately approved by Governor Brown.

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FEDERAL COURT LARGELY DISMISSES CLAIMS CHALLENGING CONSTITUTIONALITY OF LOW CARBON FUEL STANDARD

On August 13, 2015, the Eastern District of California issued an order largely dismissing claims challenging the constitutionality of California's Low Carbon Fuel Standard ("LCFS"). *Am. Fuels & Petrochemical Mfrs. Ass'n v. Corey*, 2015 U.S. Dist. LEXIS 106901 (E.D. Cal. Aug. 13, 2015). The order follows a Ninth Circuit decision affirming the district court's earlier conclusion that the crude oil provisions of the LCFS do not facially discriminate against out-of-state commerce but reversing its conclusion that the LCFS was enacted for an improper purpose (i.e., economic protectionism) and had a discriminatory effect on out-of-state crude oil. The Ninth Circuit also reversed the district court's determination that the LCFS constituted an extraterritorial regulation and remanded to the district court to determine whether the ethanol provisions of the LCFS have the purpose or effect of discriminating against interstate commerce.

On remand, as ordered by the Ninth Circuit, the Eastern District granted defendants' motion for partial summary judgment on plaintiffs' claim that the LCFS is an impermissible extraterritorial regulation. Additionally, the court granted summary judgment for defendants regarding the crude oil provisions of the LCFS, holding that the Ninth Circuit already decided that the provisions are not discriminatory facially, purposefully, or in effect. The Eastern District also granted summary judgment for defendants on plaintiffs' claim that the ethanol provisions of the LCFS are facially discriminatory.

With regard to whether the ethanol provisions of the LCFS discriminate in purpose or effect, the court rejected defendants' argument that plaintiffs had "disavowed" their claims when they moved for summary judgment on only some of their discrimination claims. The court found that there was no indication that plaintiffs abandoned or disavowed their ethanol provision claims and, therefore, denied defendants' motion to dismiss. Thus, for now, the issue of whether the LCFS's ethanol provisions discriminate in purpose or effect remains pending before the court.

Finally, the court considered plaintiffs' argument that the crude oil provisions of the *amended* LCFS discriminate in favor of California crude oils by assigning them an artificially low deficit relative to out-of-state fuels (i.e., the amount by which a fuel's carbon intensity exceeds an average annual carbon intensity value). The court held that the amended LCFS was not implemented for a discriminatory purpose because, like the original LCFS upheld by the Ninth Circuit as nondiscriminatory, the amended LCFS was implemented for the *purpose* of reducing dependency on petroleum and stimulating the production and use of low-carbon fuels in California. Additionally, the court held that because the crude oil provisions of the amended LCFS benefit and burden both California and out-of-state interests alike, the provisions do not have an impermissible discriminatory effect on interstate or foreign commerce. The court, therefore, granted defendants' motion to dismiss plaintiffs' claims that the crude oil provisions of the amended LCFS discriminate in purpose and effect.

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CLEAN POWER PLAN RENEWABLE ENERGY INCENTIVES

The Clean Power Plan ("CPP") allows states to select either an emission standards plan—implementing either rate-based or mass-based emission standards for affected electric generating units ("EGUs")—or a state measures plan, under which the state's mass-based CO_2 emission goal serves as the metric for demonstrating plan performance. Under both plans, renewable energy will play an important role in helping states to achieve compliance. However, the incentives for development of renewable energy are different under the various approaches due to the different units and measures traded under the plan types.

Generation from renewable energy deployed to comply with a rate-based plan is "credited" as an emission reduction credit ("ERCs") under an credit issuance system. These credits can then be traded among affected EGUs within a state or within another state implementing a compatible ERC accounting system. Under a rate-based approach, newly installed renewable energy sources like new wind capacity count toward compliance with the state's regulatory obligations for the CPP by the state's issuance of ERCs for quantified and verified megawatt hours ("MWhs") of generation deployed after 2022. The MWh accounting method allows states to engage in a crediting system that is not dependent on the rate-based goals of individual states or the specific emission rate standards that states may apply.

In a mass-based approach under either an emission standards plan or a state measures plan, MWhs of generation from renewable energy sources are not "credited" and traded to meet compliance obligations. The unit traded under a mass-based program is a uniform CO_2 allowance. The incentive to deploy renewable energy exists to the extent that renewable generation displaces fossil generation at existing sources, not to the extent that ERCs are generated. Thus, generation from renewable energy implemented for compliance with mass-based goals does not need to be implemented after 2022 and does not require evaluation, measurement, and verification.

Only in limited circumstances under a mass-based system will such recordkeeping be necessary as renewable energy implemented in a mass-based state "automatically counts" toward compliance. First, if renewable generation takes place

in a mass-based state and there is a demonstration that the generation was delivered to meet the load of a state with a rate-based plan, the renewable generation will be eligible for generating ERCs and subject to crediting requirements. Second, if a mass-based state is an early actor implementing renewable energy projects under the Clean Energy Incentive Program prior to September 2018, a mass-based state may set aside allowances from the CO_2 emission budget it establishes for the interim plan performance period and allocate these allowances to eligible renewable energy projects for the MWhs those projects generate in 2020 and/or 2021. In both of these circumstances, renewable energy would not be automatically counted toward compliance and would require appropriate verification.

As a result of this difference in direct trading of zero-emitting generation under a rate-based program and trading of CO_2 allowances under a mass-based program, there appears to be less of a direct incentive to implement renewable generation in mass-based states. Nevertheless, the "automatic counting" of renewable energy in a mass-based system will presumably serve as an incentive for development of renewable energy sources in mass-based states.

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PROPOSED METHANE EMISSION REGULATIONS FOR OIL AND GAS INDUSTRY NEW SOURCES

On September 18, 2015, the EPA published in the *Federal Register* a proposed rule to amend the new, modified, and reconstructed source performance standards ("NSPS") for the oil and natural gas category to include standards for methane emissions. The proposed rule adopts the same best system of emission reduction for methane that is currently in place for volatile organic compounds ("VOCs") under the finalized 2012 NSPS. In addition, the proposed rule applies the methane and VOC emission limits to "downstream" sources currently unregulated under the NSPS and requires that new, modified, and reconstructed well sites and compressor stations conduct fugitive emission surveys and repair any sources of fugitive emissions found within 15 days. The requirements of the proposed rule and its potential industry and environmental implications are discussed in greater detail here.

Although both industry and environmental groups recognize the value of reducing methane emissions, the reactions to the proposed rule predictably have been mixed. In a series of public hearings held in Denver and Dallas, representatives from the American Petroleum Institute ("API")—a trade association representing the oil and gas industry—asserted that the industry already works to reduce methane emissions in a cost-effective manner due to free-market measures and industry innovation incentives. According to the API, these additional methane regulations would be both "duplicative and costly" and potentially could lead to higher energy costs for consumers.

At the same time, some environmentalist groups have criticized the proposed rule as "low hanging fruit" because the technological equipment necessary to comply is both available and affordable. According to a representative from the Environmental Defense Fund, compliance with the rule is "not hard" and would not require the oil and gas industry to make major adjustments in their operations. For these groups, the preferred target for regulation is existing or abandoned operations, which a Natural Resources Defense Council representative claims is the largest source of methane emissions.

While the proposed rule describes the preferred compliance technologies in great detail, the EPA solicits comments on a wide array of alternative technologies, detection and monitoring capabilities, and "next generation" compliance verification via independent third-parties. Similar to the 2012 NSPS, the numerous and varied solicitations for comment potentially foreshadows the EPA's approach to future regulations. Indeed, simultaneous to the proposed rule, the EPA issued nonbinding recommendations for reducing VOC and methane emissions from existing equipment and processes, effectively providing the framework for the future regulation of existing sources.

Comments submitted to this proposed rule, therefore, similarly should anticipate subsequent rounds of regulation pertaining to oil and gas industry emission standards and regulatory enforcement.

The comment period for the Proposed Rule closes on December 4, 2015.

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CLIMATE CHANGE ISSUES FOR MANAGEMENT

Christine Morgan, Editor

SENATORS WRITE LETTERS TO U.S. CHAMBER OF COMMERCE CEOS REGARDING CLIMATE CHANGE

On September 18, 2015, 12 U.S. senators, 11 of whom are Democrats and one of whom is an independent, sent a letter to the CEOs of all 108 member companies of the U.S. Chamber of Commerce's ("COC") Board of Directors, asking them to clarify their stances with respect to the COC's position on the recently finalized Clean Power Plan.

The letter, citing to a *New York Times* article as its source, argues that the COC was coordinating an effort to "undermine" the Clean Power Plan—an effort that *The New York Times* said had "expanded into a vast network of lawyers and lobbyists." In the letter, the Democratic senators attacked COC for being "long opposed" to action to prevent climate change and for supporting political leaders "who are among the most extreme climate change deniers." Also, the letter questioned how COC has claimed it supports reducing CO_2 emissions and encouraging new technologies and increased use of natural gas and renewable fuels, while not supporting the Clean Power Plan. Although couched as a letter to seek input from the member companies, the letter largely focuses on the senators' support for the Clean Power Plan.

COC took immediate and significant exception to the conclusions drawn by the senators in the letter to the CEOs. On September 28, 2015, COC posted a press release that describes the errors in the letter and reiterates its position, as follows:

> We believe that in order to succeed, any climate change response must include all major CO_2 emitting economies, promote new technologies, emphasize efficiency, ensure affordable energy for families and businesses, and help create American jobs and return our economy to prosperity. The Congress should carefully deliberate on and enact legislation that meets these goals.

COC goes on to further describe its position, as follows:

> Some in the environmental movement claim that, because of our opposition to a specific bill or approach, we must be opposed to all efforts to reduce greenhouse gases, or that we deny the existence of any problem. They are dead wrong. The Chamber has in its public documents, Hill letters and testimony, as well as dozens of concrete policy recommendations, supported efforts to reduce greenhouse gas emissions in the atmosphere while keeping our economy healthy.
>
> We have vigorously supported the production and use of renewable and alternative energy. We have repeatedly supported tax incentives and credits, appropriations, and stimulus funding to promote the accelerated development of new technologies. We are leading the fight to clear the regulatory, legal and Not-In-My-Backyard roadblocks that are currently delaying promising wind, solar, nuclear, and other renewable or emissions-free energy projects across the nation.

While the letter requested that member companies provide certain information with respect to the relationship with COC, it is unclear whether any member companies have elected to voluntarily respond, beyond the COC's affirmative response on September 28.

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COMPANIES COMMITTING TO SCIENCE-BASED TARGET FOR REDUCING EMISSIONS

More and more companies are joining the fight against climate change by committing to adopt a science-based emission reduction target to limit the increase in global average temperature to below 2 degrees Celsius (3.6 degrees Fahrenheit). This commitment is part of an initiative, named Science Based Targets, led by the World Wildlife Fund, CDP (formerly the Carbon Disclosure Project), the World Resources Institute, and the United Nations Global Compact. According to CDP, more than 80 percent of the world's 500 largest companies established emission reduction or energy-specific targets in the 2014–15 financial year; however, thus far, only 65 companies have made the science-based target commitment.

Under the initiative, "[t]argets adopted by companies to reduce GHG emissions are considered 'science-based' if they are in line with the level of decarbonization required to keep global temperature increase below 2°C compared to preindustrial temperatures, as described in the Fifth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC)." CDP has identified at least two methodologies available to companies to support them in setting these targets. One is the "Sectoral Decarbonization Approach," which "divides the annual global GHG emissions budget at the sector- and then company-specific level by calculating each company's share of total sector activity and determining their individual emissions budgets." The other is the "3% Solution," which is "based on the idea that U.S. corporations should cut their carbon emissions by about 3 percent each year to achieve the 2020 carbon reductions scientists say are needed."

Science Based Targets identifies several benefits to companies that make the commitment, including: (i) building credibility and reputation, (ii) saving money and increasing competitiveness, (iii) driving innovation, and (iv) influencing and preparing for shifting public policy. One company, for example, that committed to reduce the carbon footprint of its manufacturing 25 percent by 2020 over a 2002 baseline has already cut its energy use and saved $425 million in avoided energy costs. Also, another company that researched the 3% Solution methodology estimated that companies could save up to $190 billion in 2020, if followed.

Leaders of the initiative hope to have 100 companies signed on by year's end, ahead of the UN Climate Change Conference in Paris in December 2015. They hope to have 250 companies with science-based targets by 2020. Companies interested in potentially making the commitment can learn more here.

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RENEWABLE ENERGY AND CARBON MARKETS

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STATE ACTION UNDER THE CLEAN POWER PLAN

As detailed in previous editions of *The Climate Report*, the Obama administration announced in August 2015 its final Clean Power Plan, under which the Environmental Protection Agency ("EPA") will require reductions of carbon dioxide ("CO_2") emissions from existing fossil fuel power plants to 68 percent of their 2005 levels by 2030. Ultimately, while the Clean Power Plan sets targeted emission reduction levels for the states, each state must determine for itself how to meet its goal by developing a State Implementation Plan ("SIP"). This SIP must demonstrate how the power plants within the state's borders will meet the standard set by EPA; initial plans are due September 6, 2016, and final plans must then be delivered to EPA within two years. And while it is still early, it is evident that some states will face more difficulty in complying than others, and that they are likely to employ a wide variety of strategies in order to hit their targets.

Staying the Course. For some states, compliance with the EPA targets may prove as easy as staying the course. In Washington and California, existing state-level CO_2 reduction policies mean that the state's power plants will already emit less CO_2 in 2020 than will be required by 2030. In Washington, the state's last operational coal-fired power plant is scheduled to shut down one of its boilers in 2020 and the other in 2025. In California, a demanding renewable portfolio standard and an economy-wide cap-and-trade program will allow the state to comply easily by 2030. Other states in this category include New Hampshire, Oregon, Delaware, and Maine.

Nascent Regional Efforts. For most states, however, determining how to meet Clean Power Plan goals will be a long process. Among the most discussed methods are a variety of multistate strategies, which expert analysts believe would make compliance cheaper and more efficient by enlarging the "market" for such reductions. These generally take one of two forms: under the first, states would aggregate their CO_2 reduction goals across a region and comply as a group, while under the second, they would trade emissions credits or allowances among themselves.

Such strategies could take hold between states served by the same regional transmission organization, because they share a transmission grid and wholesale electricity markets. For example, reports indicate that most of the states served by the PJM Interconnection (which includes all or parts of Delaware, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, West Virginia, the District of Columbia, and several other states) are holding initial discussions into how they might coordinate their compliance efforts. The Southwest Power Pool (which serves all or parts of Nebraska, Kansas, Oklahoma, New Mexico, Texas, Missouri, Arkansas, Louisiana, and several other states) held a meeting last month to introduce itself to state environmental regulators tasked with developing SIPs and pitch regional compliance as a cheaper option. Another group, comprising environmental and energy regulators in states served by the Midcontinent Independent System Operator (including all or parts of Minnesota, Wisconsin, Michigan, Iowa, and parts of Illinois, Indiana, Missouri, Arkansas, Louisiana, Mississippi, and several other states), has held a series of meetings on collaboration and even filed joint comments to EPA's proposed plan late last year.

One specific option available for states in the northeast is to leverage the existing Regional Greenhouse Gas Initiative ("RGGI") to achieve compliance. RGGI is market-based regulatory program whose members include New York, Maryland, Delaware, and the New England states and that has already capped and begun reducing CO_2 emissions from the region's power sector. Pennsylvania's governor is in favor of his state joining RGGI, and many advocates are pushing the same for Virginia, New Jersey, and others.

Accelerating the Coal-to-Gas Trend. Many analysts believe that states will lean heavily on coal plant retirements and coal-to-natural gas conversions to meet their goals. In Michigan and Minnesota, for example, utilities have already announced that they will shutter coal-fired units earlier than they had anticipated, replacing the capacity with some combination of natural gas and renewable generation. But the possibility is not without its detractors: Environmentalists have long argued that upstream methane emissions in the production

and transportation of natural gas reduce or cancel out any reduction in CO_2 emissions that come from switching from coal to natural gas. Natural gas infrastructure, too, could pose a problem in regions like New England, where transportation supply constraints cannot be solved quickly.

Lawsuits, Holdouts, and the Federal Implementation Plan. While numerous lawsuits have already been filed against the Clean Power Plan, many expect that the most significant legal action will occur only after it has been published in the *Federal Register*, which is expected in late October. Unsurprisingly, many of the states expected to file or join such lawsuits also face the most daunting compliance challenges. Political leaders in states dependent on coal generation, such as Montana, Wyoming, and Utah, have bemoaned the aggressive targets set for them by EPA. Even still, states such as Arkansas, Colorado, and South Carolina are poised to employ a two-track strategy of suing while developing a compliance plan.

Other states have announced that they will not comply with the Clean Power Plan at all, including Indiana, Louisiana, Wisconsin, Oklahoma, and Texas. This does not mean, however, that their power plants will not reduce CO_2 emissions. While EPA has announced that it will not sanction states by withholding a portion of their federal highway funding, EPA will impose a Federal Implementation Plan ("FIP") in lieu of a SIP. EPA released a model FIP the same day as the Clean Power Plan, and once finalized, it would become the basis for a compliance plan for states without a SIP, either because the state did not produce one or because EPA rejected its proposed SIP. And so, should the Clean Power Plan survive the series of legal challenges facing it, power plants will reduce CO_2 emissions one way or another. We will find out over the next several years how states decide to comply.

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AS YIELDCOS FACE UNCERTAINTY, RENEWABLE ENERGY FIRMS ASSESS THEIR OPTIONS

In recent months, dramatic share price declines across the yieldco sector have generated extensive commentary on the future viability of yieldcos as a means of financing renewable energy projects. While analysts have adopted divergent viewpoints, a number of alternatives to the prevalent yieldco model may constitute more promising avenues for future project development if yieldcos continue to struggle. In particular, companies may look to third-party sales or move projects to warehouse funds, and potential changes to the Internal Revenue Code could ultimately facilitate the use of master limited partnerships ("MLPs") as an alternative to yieldcos.

Renewable energy firms form yieldcos to hold operating power generation assets, which generate stable cash flows that the companies then use to develop additional projects in addition to providing investors with generous returns. The success that yieldcos have enjoyed since 2013 has created high demand for contracted assets, driving up prices and forcing yieldcos to consider acquisition of riskier projects. Faced with the attendant risk of lower returns, many investors have retreated from the yieldco market, forcing renewable energy firms to consider new ways of raising capital. The companies maintain that the overall market for renewable projects remains strong, and observers have suggested that new categories of investors, such as pension funds, may take the place of hedge funds and others that have departed.

While the future of yieldcos in their current form remains to be seen, renewable energy companies are also revisiting their strategies moving forward. New yieldcos are hesitant to proceed with IPOs in the face of the current uncertainty, and a number of publicly traded yieldcos have already stopped issuing equity for new project acquisitions, at least for the present. In addition, one company has announced that it will discontinue dropdowns of assets into its yieldco for the time being. The company will instead market its projects to third parties or move them into warehouse funds.

Warehouse funds, which have sometimes been called "private yieldcos," are a new variation on a financial structure that MLPs have used to acquire assets. The funds serve as vehicles for companies to hold projects outside yieldcos, providing liquidity while allowing companies more flexibility in timing the eventual dropdown of the project assets. However, the introduction of warehouse funds to hold projects that companies would otherwise drop into yieldcos has raised new concerns. The

need for warehouses reflects yieldcos' inability to acquire the warehoused projects at the best possible prices, and companies forego significant profits by electing to warehouse projects instead of selling them to third parties. Still, at least some renewable energy firms appear confident that the options offered by warehouse funds justify the drawbacks.

It is also possible that, given the opportunity, renewable energy firms will choose to shift away from the yieldco structure in favor of MLPs. While traditional oil and gas assets are commonly held in MLPs, the Internal Revenue Code currently does not grant renewables the same favorable tax treatment. The MLP Parity Act (S.1656, H.R. 2883), a bill that was reintroduced this summer after failing to pass in a previous session of Congress, would amend the Internal Revenue Code's definition of "qualifying income," set forth at 26 U.S.C. § 7704(d)(1)(E), to include renewables among the types of assets that may be held in MLPs. Identical versions of the bill are currently before the Senate Finance Committee and the House Ways and Means Committee. Should the MLP Parity Act become law, and should certain passive activity loss rules change, it could spark a rush toward renewables by acquisition-starved MLPs while also offering renewable energy firms a promising alternative to their current options. That outcome of course will also be a function of whether the pipeline of contracted renewable projects is sufficiently large enough to accommodate any new demand.

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CLIMATE CHANGE LITIGATION

Shimshon Balanson, Editor

D.C. CIRCUIT TO HEAR CONSOLIDATED CHALLENGES TO EPA'S NEW STARTUP-SHUTDOWN-MALFUNCTION RULE

On May 22, 2015, the U.S. Environmental Protection Agency ("EPA") issued a final rule requiring 36 states to revise their State Implementation Plans ("SIPs") under the Clean Air Act ("CAA"). *See* 80 Fed. Reg. 33839 (June 12, 2015). The rule requires states to revise their plans to disallow "affirmative defense" provisions, which protect industrial facilities from civil penalties for violations of the National Ambient Air Quality Standards ("NAAQS") that occur during periods of equipment startup, shutdown, or malfunction ("SSM").

The rule was issued in response to a 2011 Sierra Club petition. EPA promulgated the rule under § 110(k)(5) of the CAA, which provides a mechanism, commonly referred to as a "SIP call," allowing EPA to require states to revise SIPs that the Administrator of the EPA finds to be "substantially inadequate to meet CAA requirements." The new rule gives states until November 22, 2016 to revise their SIPs.

The rule is a change of course in the long-standing EPA practice of allowing SIPs to include affirmative defenses, or provide automatic exemptions from emissions limits, during SSM periods. EPA stated that the decision to eliminate SSM affirmative defenses from SIPs arose out of the April 2014 case *NRDC v. EPA*, 749 F.3d 1055 (D.C. Cir. 2014). There, the U.S. Court of Appeals for the District of Columbia ruled that EPA lacked authority under the CAA to grant affirmative defenses to manufacturers of Portland cement that exceeded emissions limits during SSM periods. The court held that such affirmative defenses must be heard at the judicial level, and thus EPA exceeded its statutory authority by including affirmative defense provisions in the regulations. Following the decision in *NRDC*, EPA adopted the position that the CAA does not permit the agency to include affirmative defense provisions in its regulations. In this most recent rule, the EPA extended its position to SIPs.

Not surprisingly, the rule was met with legal challenges by both states and industry. On August 11, 2015, 17 states filed a petition for review of EPA's SSM rule in the D.C. Circuit Court of Appeals, arguing that the rule impermissibly usurps the authority that the CAA gives states to develop SIPs. Thus, the D.C. Circuit must decide whether to agree with EPA that the reasoning in *NRDC* extends to affirmative defenses in SIPs, or to limit *NRDC*'s reach to EPA regulations because states have broader authority in enacting SIPs than EPA does in promulgating regulations.

Separately, on June 16, 2015, Texas and several industrial companies and organizations located in Texas challenged the SSM rule in the U.S. Court of Appeals for the Fifth Circuit. On July 17, 2015, EPA objected to the jurisdiction of the Fifth Circuit to hear the case and requested that the court dismiss the case or, in the alternative, transfer it to the D.C. Circuit. In support of its argument, EPA pointed to a provision of the CAA requiring that petitions for review of "nationally applicable" agency action be filed in the D.C. Circuit. *See* 42 U.S.C. § 7607(b).

In response, petitioners argued that the Fifth Circuit was the appropriate forum because petitioners presented a "narrow challenge" to only those portions of the rule that applied to Texas and regulated entities in Texas. EPA countered that petitioners mischaracterized the issue: "The fact that EPA's national action may apply to individual states, or individual petitioners within those states, differently based on state-specific circumstances is not determinative."

The Fifth Circuit agreed with EPA and, on August 28, 2015, transferred the Texas case to the D.C. Circuit. Petitioners then requested that the D.C. Circuit send their claims back to the Fifth Circuit, because, according to petitioners, the claims they present are unique to Texas. On October 27, 2015, the D.C. Circuit denied petitioners' motion, ruling that "Texas petitioners have demonstrated no need to depart from the court's usual practice of consolidating 'all petitions for review of agency orders entered in the same administrative proceeding.'"

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D.C. CIRCUIT DENIES PETITIONS FOR EMERGENCY STAY OF CLEAN POWER PLAN

In yet another challenge to the Clean Power Plan, the United States Court of Appeals for the District of Columbia again ruled in favor of EPA by denying petitions for an emergency stay of the Plan's deadlines. In re: State of West Virginia, et al., No. 15-1277 consolidated with No. 15-1284. This decision comes on the heels of the D.C. Circuit's recent dismissals of Murray Energy and a group of states' challenges to EPA's legal authority to promulgate the Clean Power Plan, as discussed in the Summer 2015 issue of *The Climate Report*.

A large coal company and 15 states ("petitioners") brought emergency petitions on August 13, 2015, 10 days after EPA finalized the Clean Power Plan and several weeks before the Plan's publication in the *Federal Register* on October 23, 2015.

In support of their petitions, petitioners asserted that because the Clean Power Plan was final, the matter was ripe for review, notwithstanding the fact that it had not yet been published in the *Federal Register*. Petitioners argued that the final rule exceeded EPA's legal authority, in part because coal-fueled power plants were sources already regulated under Section 112 of the Clean Air Act, but EPA impermissibly was attempting to regulate them simultaneously under Section 111(d) of the Clean Air Act.

Petitioners further argued that, absent a stay, they faced irreparable harm. They contended that it could have been months before the final rule was published in the *Federal Register*, while the deadlines for submission of State Plans under the Clean Power Plan—September 6, 2016 and September 6, 2018—remained firm. Petitioners explained that their primary concern was the significant time and resources they would have to expend, beginning immediately, in order to comply with the Plan's strict deadlines, without first being able to challenge the final rule.

In response, EPA countered that the All Writs Act, 28 U.S.C. § 1651(a), remained unavailable to petitioners and that the court lacked jurisdiction because the Clean Air Act prescribes a particular time period (60 days following publication in the *Federal Register*) and a particular procedural mechanism (a

petition for review) for challenging final rules. Additionally, EPA argued that petitioners failed to demonstrate irreparable harm because the compliance deadlines were still far off and petitioners would not be injured by waiting until publication of the final rule to challenge it.

On September 9, 2015, the D.C. Circuit issued a *per curiam* decision denying petitioners' applications for an emergency stay of the Plan's deadlines:

> [I]t is ORDERED that the petitions be denied because petitioners have not satisfied the stringent standards that apply to petitions for extraordinary writs that seek to stay agency action. *See Reynolds Metals Co. v. FERC*, 777 F.2d 760, 762-63 (D.C. Cir. 1985); *Washington Metro. Area Transit Comm'n v. Holiday Tours, Inc.*, 559 F.2d 841, 843 (D.C. Cir. 1977).

The cases cited by the court, *Reynolds* and *Washington Metro*, set forth the factors the D.C. Circuit considers when ruling on an emergency stay. Both cases emphasize the requirement that irreparable injury must be likely to occur for the stay to be granted. Although not expressly stated in the decision, the references to *Reynolds* and *Washington Metro* suggest that the D.C. Circuit agreed with EPA that petitioners did not demonstrate irreparable harm sufficient for an emergency stay of the final rule's deadlines.

Upon publication of the Clean Power Plan in the *Federal Register* on October 23, dozens of states and industry groups, including each of the states that sought an emergency stay before the Plan was published, launched petitions challenging the final rule. On October 26, the D.C. Circuit consolidated those challenges. On November 2, the coal company, which also previously sought an emergency stay, moved to intervene in support of the petitions in the consolidated suit.

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KANSAS AND NEBRASKA CHALLENGE EPA'S VEHICULAR EMISSIONS MODEL

In October 2014, U.S. EPA released and published the MOVES2014 Motor Vehicle Emissions Model, an emissions model that states must use to craft future State Implementation Plans ("SIPs") and, starting in October 2016, to demonstrate that their transportation projects conform to their SIPs. *See* 79 Fed. Reg. 60343 (Oct. 7, 2014). In December 2014, the states of Kansas and Nebraska, and two environmental organizations, petitioned the United States Court of Appeals for the District of Columbia to strike down the model on procedural and substantive grounds. *State of Kansas et al. v. Environmental Protection Agency et al.*, No. 14-1268.

Petitioners argued that EPA's promulgation of the model was procedurally flawed and violated the Administrative Procedures Act ("APA") because EPA implemented the model without providing the public notice or an opportunity for interested parties to comment. On the merits, petitioners alleged that the model was unsound because it was based, in part, on a significantly flawed fuel effects study. According to petitioners, the study's conclusions regarding increased emissions generated by ethanol use were spurious because, among other things, the study's test fuels contained more toxic components than actual market fuels.

EPA's response focused on the deficiencies in the states' and organizations' efforts to establish standing. EPA argued that the neither the organizations nor the states had demonstrated standing because none of their standing theories established that the model will cause them a concrete and imminent injury. According to EPA, the two states had no current or imminent legally binding obligation to use the model, and that any future obligation, air-quality harm, or negative economic impact was speculative. EPA also argued that the D.C. Circuit lacked jurisdiction to review the model because release of the model did not constitute final agency action and that, in any event, the notice-and-comment requirements did not apply to the model because it was a "nonbinding technical tool."

On October 14, 2015, petitioners filed their reply brief. Petitioners addressed EPA's arguments regarding standing, arguing that, on October 1, 2015, EPA finalized new ozone National Ambient

Air Quality Standards that would require the states to use the model in their SIPs. Petitioners also took issue with EPA's characterization of the model as "non-binding policy," noting that the official release for the model contained language indicating that states' use of the model was mandatory.

Oral argument has not yet been scheduled in the matter.

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CLIMATE CHANGE REGULATION BEYOND THE U.S.

Chris Papanicolaou, Editor

A NEW MARKET STABILITY RESERVE FOR THE EUROPEAN CARBON MARKET

On September 18, 2015, the European Council adopted a decision related to the creation of a market stability reserve ("MSR") for the European greenhouse gas emission trading system ("EU ETS"). This decision was initially proposed by the European Commission in January 2014 and approved by the European Parliament in July 2015.

The EU ETS was established by Directive 2003/87/EC of October 13, 2003 and launched in 2005. Based on this scheme, an EU-wide cap is fixed for the total emissions produced by European industries covered by the scheme. Concerned industrials are required to obtain emission allowances necessary to cover emissions from their activities, either for free or through an auctioning system, and can trade allowances on the market. The European strategy on greenhouse gas emissions was recently revised in October 2014 and set a new target for 2030 of lowering greenhouse gas emissions by 40 percent compared to 1990.

The post-2008 economic crisis led to a decrease in the need for emission allowances, and a large surplus of emission allowances emerged in the past few years, which led to a fall in prices for the allowances. As a consequence, low-carbon investments have decreased: the less expensive the allowances, the less attractive the investments to reduce greenhouse gas emissions. A quick fix, namely the "back-loading" of auction volumes through which the EC postponed the auction of 900 million allowances until 2019–2020 (Regulation 76/2014), was enforced on February 27, 2014, but structural reforms were still needed.

In this context, EU institutions adopted the MSR. It aims at addressing these supply–demand imbalances that would otherwise compromise the targets of the 2030 climate and energy policy framework. Such new MSR will come into force on January 1, 2019 and will bring substantial changes to the EU ETS. First, all the allowances that went unattributed between

2013 and 2020 will be placed in the MSR in 2020, as well as the 900 million allowances resulting from the "back-loading." Secondly, every year, 12 percent of the total number of allowances in circulation (whenever more than 100 million), as published by the Commission, will be deducted from trading volumes and placed in the MSR for a year.

Alternatively, whenever the total number of allowances in circulation is less than 400 million, 100 million allowances will be released from the reserve and added to the auctioning volumes. Finally, the European Commission will monitor the functioning of the MSR in its report, taking into account issues such as competitiveness or employment.

The MSR revision of the EU ETS scheme should leave industrials with a number of emission allowances in circulation easier to manage, but should also lead to higher prices. It paves the way for a broader revision of the European carbon market, which may include the creation of a fund to promote low-carbon industrial innovation projects, based on the auction of 50 million allowances before 2021.

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"PARIS 2015": VERY HIGH EXPECTATIONS TO TACKLE CLIMATE CHANGE

In December 2015, Paris will be the capital city of the environment, as it will be hosting the 21st Session of the Conference of the Parties to the United Nations Framework Convention on Climate Change ("UNFCCC"), also known as "Paris 2015," from November 30 to December 11, 2015.

For "Paris 2015," all members of the UNFCCC (195 nations plus the EU) have agreed to adopt a new global climate agreement, which would take effect in 2020. In short, this agreement aims to merge all binding and nonbinding arrangements under the UNFCCC and to rebuild into a single comprehensive regime in the form of a new protocol. This will replace the Kyoto Protocol and will be binding on all UNFCCC parties, with the aim of keeping global warming below 2°C compared to preindustrial times, to avoid the most dangerous impacts of climate change.

The draft agreement, which will serve as a basis for the negotiations in Paris, has been made public recently. Divided in two parts—the first part presenting the measures to be adopted and the second part explaining the implementation of these measures—this draft agreement has already been widely criticized for its lack of ambition, notably as regards the decarbonization of the global economy.

Therefore, "Paris 2015" is facing very high expectations, and an agreement on the climate will be difficult to achieve. In this context, France and all its representatives will be playing a leading international role to ensure negotiations toward the adoption of a new global climate agreement.

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REGIONAL CLEAN ENERGY INVESTMENT HUB ESTABLISHED IN BANGKOK

In August 2015, the UNFCCC launched the fifth Regional Collaboration Centre ("RCC") in Bangkok, Thailand, to promote clean energy investment in the Asia-Pacific region. The Bangkok RCC joins four other regional centers established by the UNFCCC to support the Clean Development Mechanism ("CDM"), a market-based mechanism forming part of the Kyoto Protocol that allows developed countries to offset their carbon emissions by funding emission reduction projects in developing countries. The CDM allows such projects to earn certified emission reductions, thereby encouraging clean energy investment.

The RCCs are designed to assist nations in identifying and developing CDM projects while reducing investor risk and transaction costs. The Bangkok RCC will partner with the Japanese Institute for Global Environmental Strategies and collaborate with the other RCCs in Togo, Uganda, Grenada, and Colombia. At present, there are approximately 7,000 CDM projects in the Asia-Pacific region, more than half of which are located in China. The new center aims to source funding for

roughly 300 projects a year, with a focus on countries such as Cambodia, Laos, Myanmar, and Vietnam.

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JAPAN DIVERSIFIES ITS ENERGY MIX

In September 2015, Japan's Ministry of Economy, Trade and Industry ("METI") created a new council for the development of renewable energy policy and flagged the establishment of common energy-mix targets for Japan's power sector. The Subcommittee for Reforming Systems Related to the Introduction of Renewable Energy, a body made up of legal experts, engineers, scientists, and economists, is responsible for formulating and reviewing policies for the "sustainable introduction and spread" of renewable energy in Japan.

METI's energy-mix plan would require liquefied natural gas ("LNG") to account for at least 50 percent of power companies' energy production deriving from fossil fuels, with coal and other sources to account for 50 percent or less. Entities that fail to comply with these requirements after a grace period may be subject to improvement orders and fines.

Japan has an emissions reduction target of 26 percent (on 2013 levels) by 2030 and a renewable energy target of 22 to 24 percent by 2030. By that year, the country hopes to rely on coal for 26 percent of its energy needs, with LNG to account for 27 percent.

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AUSTRALIAN GOVERNMENTS COMMIT TO RENEWABLE ENERGY

In August 2015, Australia submitted its intended nationally determined contribution to the UNFCCC, which included an emission reduction target of 26 to 28 percent (on 2005 levels) by 2030 and a renewable energy target of 23.5 percent by 2020. The cornerstone of Australia's federal climate change policy, the "Direct Action" reverse-auction plan covered in previous editions of *The Climate Report*, has survived the leadership challenge in September 2015 that saw Malcolm Turnbull replace Tony Abbott as Australia's Prime Minister and leader of the conservative party.

However, there has been a significant change in the federal government's policy with respect to renewable energy investment. Responsibility for Australia's green investment bank, the Clean Energy Finance Corporation ("CEFC"), and the Australian Renewable Energy Agency, has been shifted back to the Federal Department of the Environment in a move widely interpreted as signaling a departure from the previous government's policy favoring the abolition of both entities.

A directive from the Abbott government to the CEFC not to invest in wind or solar energy has also been quietly dropped. In October 2015, the Federal Minister for the Environment announced that the CEFC would finance an AU$30 million program of works aiming to reduce emissions in the city of Melbourne. The program will include rooftop solar power as well as upgrades to commercial buildings and public infrastructure.

There have also been some major developments at a provincial level. In September 2015, South Australia announced that it would increase its renewable energy target to 50 percent by 2025, having met its prior target of 33 percent by 2020. Queensland has pledged to source 50 percent of its energy needs from renewable sources by 2030, while the two largest states, New South Wales and Victoria, have each set a renewable energy target of 20 percent by 2020. The Australian Capital Territory, home to the nation's capital, aims to generate 100 percent of its energy needs from renewable sources by 2025, with wind farms, solar farms, and rooftop solar expected to meet 60 percent of its energy requirements by 2017.

Several of Australia's major capital cities have likewise adopted ambitious targets. Adelaide and Melbourne are in competition to become the world's first carbon-neutral city by 2020, while Sydney has an emission reduction target of 70 percent (on 2006 levels) by 2030.

Notwithstanding the above, Australia and New Zealand have rejected a push by smaller Pacific nations for the region to unite in advocating that climate change be limited to an increase of 1.5°C (compared to the United Nations' current target of 2°C).

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