SPRING 2016 ISSUE

REGULATORS SHIFT FOCUS TO GREENHOUSE GAS EMISSIONS FROM TRANSPORTATION SECTOR

On April 22, 2016, the Federal Highway Administration ("FHWA") published a proposed rule that would require states and localities to evaluate and report on transportation system performance, including travel time reliability, delay hours, peak-hour congestion, and freight movement. In addition, reductions in criteria pollutants resulting from federally funded projects would need to be estimated and reported. The proposed rule also contemplates addressing greenhouse gas ("GHG") emissions from the transportation sector, which has been identified as the second-highest GHG source category, accounting for 26 percent of total U.S. GHG emissions.

The proposed rule invites comment on whether FHWA should establish a performance measure to address GHG emissions. The agency is considering how GHG emissions could be estimated and used to inform planning and programming decisions, and to reduce long-term emissions. FHWA proposes that GHG emissions would be best measured as the total annual tons of carbon dioxide from all on-road mobile sources. Some of the suggested comment topics illustrate further how the agency may structure the GHG reporting requirement. For example, FHWA has asked whether the measure should include emissions generated upstream in the life cycle of a vehicle,

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in addition to tailpipe emissions. The agency has also questioned whether non-road sources, such as construction and maintenance activities, should be considered.

FHWA acknowledges the difficulty of establishing and executing a requirement of this kind, and it has asked for information from transportation agencies about data sources, tools, implementation timelines, and costs. The expenses associated with collecting, analyzing, and reporting GHG emissions from the transportation sector can be high, especially at a time when many states and localities area already facing budget crises. For example, when the state of Washington first adopted its greenhouse gas emission inventory program, it estimated that the cost of implementation would be between $1.4 million and $3.2 million per year.

Many other states and localities, such as California and Chicago, already measure GHG emissions, including from transportation. Because EPA and FHWA have in the past encouraged state and local agencies to track GHG emissions, and many do, the Obama administration may believe that this regulatory approach will face less resistance than other GHG regulations. However, some question whether the relevant authorizing legislation allows FHWA to establish a GHG performance measure and whether the move is politically motivated.

Comments on the proposed rule are due by August 20, 2016.

Jane K. Murphy
+1.312.269.4239
jkmurphy@jonesday.com

Alina Fortson
+1.312.269.1542
afortson@jonesday.com

CARB RELEASES SHORT-LIVED CLIMATE POLLUTANT REDUCTION STRATEGY

On April 11, 2016, the California Air Resources Board ("CARB") continued its efforts to implement the greenhouse gas emission reductions required by the Global Warming Solutions Act ("AB 32") and related legislation by issuing its Proposed Short-Lived Climate Pollutant ("SLCP") Reduction Strategy (the "Proposed Strategy"). Reducing SLCPs is one of "five pillars" of California's climate strategy, which seeks to reduce overall greenhouse gas emissions to 40 percent below 1990 levels by 2030. CARB was directed to prepare the Proposed Strategy pursuant to Senate Bill 605, the Short-Lived Climate Pollutants Act.

According to CARB, SLCPs such as black carbon, methane, and fluorinated gases have a significant impact on climate over the short term. SLCPs are more effective at trapping heat in the earth's atmosphere than the more ubiquitous greenhouse gas, carbon dioxide.

Among other things, the Proposed Strategy seeks to: (i) reduce wildfire risk (the largest source of black carbon emissions in California); (ii) eliminate the disposal of organic waste streams in landfills and reduce fugitive emissions from natural gas storage facilities and pipelines to reduce methane emissions; and (iii) incentivize the use of low global warming potential refrigerants to reduce fluorinated gas emissions. By deploying these and other strategies, CARB intends to reduce emissions of methane and fluorinated gases by 40 percent, and black carbon emissions by 50 percent, below current levels by 2030.

CARB will host several workshops over the coming months to discuss the Proposed Strategy and will vote to approve a final strategy in the fall of 2016. All regulatory measures implementing the strategies set forth in the Proposed Strategy will be subject to a separate notice and public comment process.

Thomas M. Donnelly
+1.415.875.5880
tmdonnelly@jonesday.com

Daniel L. Corbett
+1.415.875.5885
dcorbett@jonesday.com

Jeffrey E. Brandt
+1.415.875.5840
jbrandt@jonesday.com

CLEAN POWER PLAN COMPLIANCE DEADLINES UNCERTAIN

On February 9, 2016, the U.S. Supreme Court issued a stay of the Clean Power Plan pending the disposition of petitions for review currently before the Court of Appeals for the District of Columbia Circuit and any subsequent petitions for a writ of certiorari in the Supreme Court. Oral argument before the D.C. Circuit is scheduled for September 27, 2016, and an appeal to the Supreme Court is almost certain following the D.C. Circuit's decision. A lift of the stay may therefore not occur until 2017 or 2018. This timeline conflicts with some of the initial deadlines in the Clean Power Plan.

Although the Environmental Protection Agency ("EPA" or "Agency") was not successful in preventing the stay, the Agency has failed to expressly acknowledge that compliance deadlines must therefore be postponed. To the contrary, EPA has stated that the Agency will "continue to provide tools and support" to "states that choose to continue to work to cut carbon pollution from power plants." EPA's statements create uncertainty about the Clean Power Plan's implementation schedule, and on May 13, 2016, the House Committee on Energy and Commerce sent a letter to EPA asserting that the Agency is circumventing the Court's order and undermining the relief provided by the stay.

Further information about the impact of the stay is available here.

Charles T. Wehland
+1.312.269.4388
ctwehland@jonesday.com

Alina Fortson
+1.312.269.1542
afortson@jonesday.com

CLIMATE CHANGE ISSUES FOR MANAGEMENT

Christine Morgan, Editor

ACTIVIST INVESTORS' GROUP ISSUES GUIDE TO INVESTORS ON ENGAGEMENT WITH ELECTRIC UTILITY SECTOR BOARDS AND MANAGEMENT REGARDING CLIMATE CHANGE RISK

On April 29, 2016, the Institutional Investors Group on Climate Change ("IIGCC") released the latest publication in a series of guides aimed at increasing investor activism at the corporate board and senior management levels regarding potential risks associated with climate change. The report, titled *Investor Expectations of Electric Utilities Companies: Looking down the line at carbon asset risk*, targets the electric utility industry, with the purpose of setting out "guidance for constructive engagement by investors with the boards and management of electric utilities." Report at 2. IIGCC prepared the report in coordination with the Investor Network on Climate Risk (a project of Ceres), the Investor Group on Climate Change, and the Asia Investor Group on Climate Change. Each of these organizations represents investors, asset managers, and financial institutions in voicing their positions on public policies, investment strategies, and corporate best practices related to the "risks and opportunities" associated with climate change.

IIGCC Goals for the Report. In the report, the IIGCC suggests that a lack of transparency exists in the electric utility sector with respect to climate risk disclosure, and it concludes that this lack of transparency affects the investment community's ability "to calculate their portfolio's carbon intensity, assess carbon asset risk and evaluate dependence upon 'reliable' water resources." Report at 4. The report further cites to recent actions by the G20 Finance Ministers asking the G20's Financial Stability Board to convene dialogues with public- and private-sector participants regarding opportunities to improve climate risk disclosures. The IIGCC report focuses on the energy sector, and the recommendations are intended to operate in coordination with the IIGCC's 2012 report titled *Institutional Investors' Expectations of Corporate Climate Risk Management*.

In support of its conclusions that the energy sector would benefit from increased investor dialogue, the report concludes that changing business models in the electric utility sector as well as the expanding nature of the regulatory framework for this sector drive the need for increased discussion and reporting. Specifically, the regulatory drivers cited are emission reduction targets, incentives for renewable energy, carbon pricing, and water resource management policies and rules. Report at 5-7. Demand dynamics involved in the changing business models include shifts in growth markets, corporate demand for renewable energy and renewable sources, and legacy assets associated with high-carbon power plants. Report at 9.

IIGCC's Guide to Investors in the Electric Utility Sector. Based on these underlying premises, IIGCC presents a guide for expectations and key questions that they believe the boards and senior management of electric utilities should be considering. Referred to as "investor expectations," the report describes six key categories of factors related to climate change on which corporate boards should focus, as follows:

1. **Governance.** The report encourages utility boards to establish procedures for climate risk accountability, including management responsibilities, capabilities, and processes. Investors are directed to ask of utility boards: "Who is responsible for managing climate risk?"
2. **Carbon Stress Testing.** This category involves a review of the target utility's plan to move to a lower-carbon business model, recognizing that traditional power generation will take time to transition. The report presents a series of detailed questions that IIGCC believes investors should pose to utilities regarding long-term planning for a "2 degree scenario stress test" and other technology and regulatory-based changes in business models. Report at 11.
3. **Consumer-Facing Strategy.** With a focus on "business model innovation," the report asks investors to query how the company will develop its consumer-facing services. The report cites examples of Smart Meter marketing, energy efficiency, and energy services as areas of potential growth.
4. **Operational Efficiency / Resource Management.** The report presents questions for investors to pose regarding the operational goals for electric utilities with respect to efficient use of existing assets and natural resources, such as water resources. It also focuses on the extent of water scarcity risks.
5. **Public Policy.** Consistent with recent public efforts of similar groups, the IIGCC report asks electric utilities to make public their positions regarding environmental legislation, such as climate-related initiatives, and their lobbying efforts related to these measures. Investors are asked to avoid investment in companies that lobby against these types of measures, either directly or indirectly via associations with which they are a member.
6. **Transparency and Disclosure.** This component focuses on the IIGCC's primary conclusion: that electric utilities should disclose in annual reports or through other corporate venues, such as their website or CDP (formerly the Carbon Disclosure Project), their views of and response to carbon asset risks.

The report encourages investors to use data generated by CDP in developing questions and expectations for target utilities. The CDP data is correlated to the IIGCC findings and recommendations in a report published in conjunction with CDP.

Importance for Utility Sector Boards and Management. Many electric utilities already keep information relevant to these categories as part of their routine management business operations. What is different about the six categories is that much of this routine business information is not currently disclosed, and the report and the recommendations suggest that some investors may now want to have it. A close understanding of IIGCC's conclusions and the guidance it is giving investors will allow utilities to better respond promptly and robustly to investor inquiries. It also may be appropriate to review existing disclosures with a view to their responsiveness to the issues identified in the six categories. Finally, the electric utility sector is encouraged to continue tracking similar studies and reports, including the recent release by the Task Force on climate-related Financial Disclosure's Phase I report, dated March 31, 2016, to the Financial Stability Board as described above.

Christine M. Morgan
+1.404.581.8215
cmmorgan@jonesday.com

HIGH COURT DECIDES *HUGHES V. TALEN ENERGY MARKETING, LLC*

In a landmark decision, *Hughes v. Talen Energy Marketing, LLC*, 136 S.Ct. 1288 (2016) ("*Hughes*"), the U.S. Supreme Court invalidated a Maryland program aimed at incentivizing new in-state power generation as preempted by federal law. *Hughes* found that Maryland's scheme, which centered around the capacity auction administered by PJM Interconnection ("PJM"), the regional transmission operator overseeing the grid, inappropriately intruded on the Federal Energy Regulatory Commission's ("FERC") exclusive authority to regulate interstate wholesale electricity sales.

In the capacity auction, PJM predicts electricity demand three years ahead of time and assigns a share of that demand to each participating load serving entity ("LSE"). Owners of capacity available to produce electricity in three years bid that capacity into the auction at proposed rates. PJM accepts bids, beginning with the lowest proposed rate, until it has purchased enough capacity to satisfy expected demand. *Id*. at 1293. However, all accepted bidders receive what is known as the "clearing price," which is the price paid for the highest bid accepted, no matter each bidder's proposed price. *Id*.

Maryland electricity regulators had grown concerned that the prices set in the PJM capacity auction were insufficient to attract development of new in-state generation to enter the market. To remedy this, Maryland regulators implemented a program in which Maryland solicited proposals from various companies for construction of a new gas-fired power plant at a particular location. Maryland accepted a proposal by CPV Maryland, LLC ("CPV"), after which Maryland required its LSEs to enter into a 20-year "contract for differences" with CPV at a rate that CPV had specified in its accepted proposal. *Id*. at 1294-95.

Under the contract for differences, CPV would sell its capacity in the PJM market and would, through the contract for differences, receive the contract price, rather than the clearing price established in the auction. If CPV's capacity cleared the auction, and the clearing price was below the price guaranteed in the contract for differences, Maryland LSEs would be required to pay CPV the difference between the contract price and the clearing price. If CPV's capacity cleared the auction and the clearing price exceeded the price specified in the contract for differences, CPV would be required to pay the LSEs the difference between the two prices. LSEs would pass either the higher costs or savings on to their retail electricity customers. Because CPV could receive the difference between the clearing price and the price set forth in the contract, CPV would be incentivized to bid its capacity at the lowest possible price. *Id*. at 1295. If the capacity failed to clear the market, CPV would receive no payment from Maryland LSEs.

The Supreme Court struck down Maryland's program, finding that it effectively set an interstate wholesale rate, contrary to the Federal Power Act's ("FPA") division of jurisdiction between state and federal regulators, and impermissibly guaranteed CPV a rate distinct from the auction clearing price for interstate sales of capacity to PJM. *Id*. at 1297. The Court determined that the FPA allocates to FERC exclusive jurisdiction over rates and charges received for or in connection with interstate wholesale electricity sales. *Id*. (citing 16 U.S.C. § 824d(a)). Through the contract for differences program, Maryland inappropriately undermined FERC's approval of the PJM capacity auction as the exclusive rate-setting mechanism for sales of capacity to PJM. The Court noted that "[b]y adjusting an interstate wholesale rate, Maryland's program invades FERC's regulatory turf[,]" as it violates the Supremacy Clause. *Id*. (citing *FERC v. Electric Power Supply Ass'n*, 136 S.Ct. 760, 780 (2016) ("The FPA leaves no room either for direct state regulation of the prices of interstate wholesales or for regulation that would indirectly achieve the same result.") (internal quotations omitted in original)).

Further, the Court found that Maryland's motivation behind implementing the program—encouraging construction of new in-state generation—could not save its program. States may not seek to achieve ends, however legitimate, through regulatory means that impinge on FERC's authority over interstate wholesale electricity rates. *Id*. at 1298-99 (citing *Mississippi Power & Light v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986)).

The Court, however, made clear that the decision is to be construed narrowly, as the Court's only concern with Maryland's program was that it "disregard[ed] an interstate wholesale rate required by FERC." *Id*. at 1299. *Hughes* does not rule on the merits or permissibility of various other measures that states could employ to encourage development of new or clean generation, "including tax incentives, land grants, direct subsidies, construction of state-owned generation facilities, or re-regulation of the energy sector." *Id*. The Court continued: "Nothing in this opinion should be read to foreclose Maryland and other States from encouraging production of new or clean generation through measures 'untethered to a generator's wholesale market participation.' So long as a State does not condition payment of funds on capacity clearing the auction, the State's program would not suffer from the fatal defect that renders Maryland's program unacceptable." *Id*. (internal citation omitted). Thus, *Hughes* permits states to implement programs aimed at promoting new clean or renewable in-state generation, as long as they do not supplant FERC's regulation over wholesale interstate electricity markets.

However, questions regarding whether other types of similar arrangements—e.g., power purchase agreements entered into by FirstEnergy Solutions Corporation and American Electric Power, which guarantee income associated with a number of generators for purposes of reliability and cost stabilization—still remain.

Andrew Mina
+1.202.879.3837
amina@jonesday.com

ENVIRONMENTAL GROUPS CHALLENGE EPA'S TIMING ON REGULATION OF EMISSIONS FROM AIRCRAFT

In the U.S. District Court for the District of Columbia, the Center for Biological Diversity and Friends of the Earth filed a civil lawsuit in mid-April 2016 against the U.S. Environmental Protection Agency ("EPA" or "Agency") alleging "unreasonable delay" in "issuing an endangerment finding" regarding aircraft emissions and promulgating regulations to curb aircraft emissions. The plaintiffs seek a declaration that the delay is unreasonable, an injunction to require EPA to issue an endangerment finding and propose regulations within 30 days of the court's judgment, and litigation costs.

In June 2015, EPA proposed an endangerment finding that greenhouse gas ("GHG") emissions from certain classes of aircraft engines contribute to climate change and endanger public health and welfare. EPA's proposed endangerment finding, which the Agency anticipates finalizing in 2016, did not recommend a U.S.-specific regulatory regime but instead indicated that EPA would later seek to implement the international carbon standards then expected to be issued by the International Civil Aviation Organization ("ICAO") in February 2016.

ICAO is a 72-year-old international body that issues consensus international standards and recommended practices and policies to its 191 member states regarding safety, accident investigation, environmental impacts, and other aviation-specific concerns. At the February 2016 ICAO meeting, the Committee on Aviation Environmental Protection proposed an emission standard to apply to (i) new aircraft type designs as of 2020 and (ii) new deliveries of current in-production aircraft models from 2023. The proposed standard included a cutoff date of 2028 for production of aircraft that do not comply with the standard. ICAO also anticipates developing a market mechanism to curb emissions, which in conjunction with the proposed standard, will likely be approved at the ICAO General Assembly meeting in October 2016.

The current lawsuit arises from a previous decision of the District of Columbia District Court in 2011 requiring EPA to

issue an endangerment finding determining whether emissions of GHGs contribute to air pollution or may reasonably be anticipated to endanger public health or welfare. The plaintiffs allege that EPA's proposed timing of finalizing the endangerment finding sometime in 2016, publishing proposed regulations in 2017, and promulgating final regulations in 2018 is unreasonable. The plaintiffs point out that EPA's proposed timeline would result in adopting a final rule seven years after the district court's holding and 11 years after the plaintiffs submitted a 2007 petition to EPA for issuing an endangerment finding and promulgating aircraft emission standards.

The plaintiffs' current complaint does not acknowledge that EPA's timing for finalizing the endangerment finding and promulgating the regulations is partially tied to ICAO's timeline for finalizing its proposed carbon standard. The complaint also does not mention ICAO, ICAO's current process for adopting international standards, or the six-month delay in the yet-to-be-detailed market mechanism that is to complement the carbon standards recommend in February 2016. Rather, the complaint focuses on EPA's repeated delay in responding to the plaintiffs' petition and in proposing the endangerment finding. The plaintiffs contend that EPA's lack of action constitutes unreasonable delay under the Clean Air Act's citizen suit provision. To demonstrate legal standing, the plaintiffs allege that their members have suffered and continue to suffer the following harms: (i) injury related to "professional, scientific, educational, spiritual, aesthetic and other interests in a stable climate"; (ii) harms from secondary effects of global warming like intensified air pollution; and (iii) procedural and informational injuries arising from EPA's delay in initiating a rulemaking procedure to regulate emissions from aircraft.

Judge Saundra Brown Armstrong has set a Case Management Conference in the case for July 6, 2016. Since the suit was filed on April 12, 2016, the Climate Change Law Foundation, the Association of Irritated Residents, and Sierra Club have filed a Certificate of Interested Entities with the court.

John D. Goetz
+1.412.394.7959
jdgoetz@jonesday.com

Rebecca B. MacPherson
+1.202.879.4645
rmacpherson@jonesday.com

Jane B. Story
+1.412.394.7294
jbstory@jonesday.com

Jennifer M. Hayes
+1.412. 394.7992
jhayes@jonesday.com

D.C. CIRCUIT REJECTS STATES' CHALLENGE TO EPA'S VEHICLE EMISSIONS MODEL

On April 15, 2016, the United States Court of Appeals for the District of Columbia dismissed a challenge brought by Kansas and Nebraska to EPA's new vehicle emissions model, "MOVES2014." *State of Kansas et al. v. EPA et al.*, No. 14-1268. The model notably discourages the use of ethanol in gasoline, concluding that it leads to higher fuel emissions.

Kansas and Nebraska, two of the nation's largest corn-producing states, brought a lawsuit to overturn the model. The lawsuit alleged that EPA relied on flawed data in reaching its conclusions concerning ethanol. The states alleged potential injury in the form of future ozone nonattainment area designations, which would require the states to limit the use of ethanol in fuel as part of compliant State Implementation Plans ("SIPs"). The states also alleged "secondary injury" under the theory that other nonattainment states will use MOVES2014 and decrease their ethanol use as well. Finally, the states claimed that EPA issued the model without the required notice and comment.

EPA argued that the D.C. Circuit should dismiss the case on several grounds. First, EPA asserted that MOVES2014 is a policy statement that is an exercise of the agency's scientific judgment and expertise, and not a final agency action. According to EPA, it was therefore not required to submit the model for notice and comment, and the court lacked jurisdiction over the states' challenge.

EPA further argued that the states lacked standing because their claims were wholly dependent on speculation about the Agency's future conduct. EPA pointed out that states currently

are not obligated to use the model, and that the appropriate time for states to raise objections would be if and when they are required to use the model in future SIPs.

In dismissing the states' lawsuit, the D.C. Circuit agreed with EPA that the states lacked standing. The court found that EPA presented sufficient evidence to establish that the data necessary to determine if the states will be required to develop future SIPs in response to nonattainment area designations does not yet exist. The Agency plans to use data collected from 2014 through 2016; currently, however, only 2014 data is available, and that data shows that Kansas's and Nebraska's ozone levels are in attainment. The court also rejected the states' secondary injury claims, finding the claims to be too speculative and lacking in evidence to survive summary judgment.

Despite the outcome in this case, given the vigorous opposition to MOVES2014 by corn-producing states, ethanol groups, and other clean energy groups, the issue is likely to reemerge if EPA requires states to use the model and decrease ethanol use in future SIPs.

Daniel P. Hido
+1.412.394.9558
dhido@jonesday.com

FEDERAL MAGISTRATE JUDGE DENIES GOVERNMENT'S MOTION TO DISMISS KIDS' CLIMATE CHANGE LAWSUIT

On April 8, 2016, in a decision lauded by the plaintiffs as a "landmark" ruling, U.S. Magistrate Judge Thomas Coffin of the United States District Court for the District of Oregon denied motions to dismiss a lawsuit filed against the federal government by a group of plaintiffs ranging between ages 8 and 19, along with associations of climate change activists. *Juliana et al. v. USA et al.*, No. 6:15-cv-01517. The suit seeks relief from government action and inaction that allegedly results in carbon pollution of the atmosphere, climate destabilization, and ocean acidification.

Specifically, the plaintiffs assert that "the government has known for decades that carbon dioxide (CO_2) pollution has been causing catastrophic climate change and has failed to take necessary action to curtail fossil fuel emissions," which makes it "extremely difficult for plaintiffs to protect their vital natural systems and a livable world." The plaintiffs seek immediate action "to restore energy balance and implementation of a plan to put the nation on a trajectory (that if adhered to by other major emitters) will reduce atmospheric CO_2 concentrations to no more than 350 parts per million by 2100."

The plaintiffs allege several violations of their constitutional rights, including a violation of their equal protection rights under the Fifth Amendment; a violation of their right to a stable climate and an ocean and atmosphere free from dangerous levels of CO_2 via the Ninth Amendment; and a violation of the public trust doctrine secured by the Ninth Amendment. The government, joined by several organizations representing various entities in the coal, oil, and gas industry that previously intervened in the action, moved to dismiss the complaint on the grounds that the plaintiffs lacked standing, raised nonjusticiable political questions, and failed to state a constitutional claim.

Judge Coffin addressed each of the movants' arguments in his findings and recommendation. He held that the plaintiffs' allegations established "action / inaction that injures plaintiffs in a concrete and personal way." On whether a court could fashion a remedy to address the alleged harm, Judge Coffin noted that the court could fashion an order requiring EPA to act to protect the public health, including, by way of example, the particular harms allegedly afflicting youths. He opined that "[w]hile courts cannot intervene to assert 'better' policy, they can address constitutional violations by government agencies and provide equitable relief." As to the constitutional claims, Judge Coffin concluded that whether the government's action or inaction "shocks the conscience" and infringes on the plaintiffs' right to life and liberty cannot be determined on a motion to dismiss.

Nick Faas
+1.412.394.9550
nfaas@jonesday.com

PARIS CLIMATE AGREEMENT HEADS TOWARD RATIFICATION

The next significant step toward addressing climate change took place on April 22, 2016 in New York, when 175 nations signed the Paris Climate Pact following the agreement reached in Paris in December of last year. The agreement will take effect once at least 55 nations representing at least 55 percent of global emissions formally ratify the accord. Following the New York signing, the United Nations Secretary-General Ban Ki-Moon expressed confidence that this could occur much sooner than predicted, possibly as early as November 2016 when the 22nd Conference of Parties to the United Nations Framework on Conventional Climate Change ("UNFCCC") is held in Morocco.

At least 16 nations have already ratified the agreement, with at least 20 further commitments already in place to ratify by the end of this year. Ratification by the U.S., China, and the European Union, which have all committed to joining the deal, will be instrumental in taking the signatory parties to above the 55 percent emissions threshold. Until then, the signatories are bound not to take actions that could undermine the agreement objectives.

The Paris agreement aims at keeping global temperature rise well below 2°C and to make efforts to keep it to 1.5°C, compared to pre-industrial levels. Signatory countries, upon ratification, will have an obligation to take measures to reduce their emissions. This will involve taking steps to put in place infrastructure to transform themselves from high- to low-carbon economies. A review process will occur every five years to take stock and reconsider targets on a more ambitious basis. Intrinsic to this goal is that countries' progress will be tracked to ensure transparency and accountability.

Chris Papanicolaou
+44.020.7039.5321
cpapanicolaou@jonesday.com

SAFEGUARD MECHANISM KICKS IN FOR AUSTRALIA'S CLIMATE REGIME

The cornerstone of Australia's federal climate policy (as discussed in previous editions of *The Climate Report*) is known as the "Direct Action Plan," under which the federal government pays for emission reductions or abatements. This is done through a series of reverse-auctions, conducted by the Clean Energy Regulator via an emissions reduction fund ("ERF"), for lowest cost reductions.

Under this system, the Regulator issues one Australian Carbon Credit Unit ("ACCU") for each ton of emission reductions to be delivered by a particular project and enters into contracts with bidders guaranteeing payment to them by the government. Funded projects have included the regeneration of native forest, strategic burn-offs, and landfill gas collection. The third of the ERF auctions took place on April 27, 2016.

The ERF is complemented by a "Safeguard Mechanism" due to come into effect on July 1, 2016. This is designed to ensure that the emission reductions and abatements purchased by the government are not offset by increases in emissions over historic levels elsewhere in the economy.

Large facilities exceeding certain emission thresholds (direct "scope 1" emissions of more than 100,000 ton of carbon dioxide equivalence per year) must keep their emissions at or below a business-as-usual baseline enforced by the Regulator. These facilities—often operated by electricity generation, mining, manufacturing, transport, and construction businesses—collectively account for roughly half of Australia's greenhouse gas emissions.

The Regulator may seek financial penalties against companies and individuals who fail to comply with the baseline. However, facilities will be permitted to exceed the baseline in any given year provided that emissions over a two- to three-year monitoring period remain below the baseline. This is a significant concession—particularly given that the baselines for existing facilities are to be determined by reference to the facility's *highest level* of reported emissions in any year between 2009–2010 and 2013–2014. Businesses can also offset any excess emissions by surrendering ACCUs and can apply for exemptions in exceptional circumstances.

The data used for determining baselines for existing facilities will largely be obtained from the National Greenhouse and Energy Reporting Scheme, with most large emitters already a part of the scheme.

Facilities that are new, or that significantly expand after 2020, will be able to apply for a new or revised baseline in accordance with "emissions intensity benchmarks" applying to various sectors of the Australian economy. These benchmarks are intended to reflect "leading practice" in particular industries and will be updated over time, including in light of changes to "global warming potential" values.

According to draft guidelines released by the federal government in April 2016:

- The benchmarks will generally be based on outputs and be neutral to factors such as inputs, geography, location, technology, and production practices;
- Technical working groups will be established for each sector to define production variables (with the emissions intensity benchmark worked out as emissions per unit of the relevant production variable); and
- Alternate approaches may be used where there is insufficient data or no identified production variable.

These matters will be subject to public consultation and reviewed by an independent committee, which will make a final recommendation to the Minister for the Environment.

Tony Wassaf
+61.2.8272.0527
twassaf@jonesday.com

Jim Parker
+61.2.8272.0777
jimparker@jonesday.com

Clare Langford
+61.2.8272.0709
clangford@jonesday.com

THE FRENCH ENERGY ECONOMY CERTIFICATE SCHEME AND MARKET

On March 9, 2016, the French administrative Supreme Court ("*Conseil d'Etat*") issued a noteworthy ruling regarding the French Energy Economy Certificates ("*Certificats d'économie d'énergie*" or *CEE*).

The French CEE scheme was created in 2005, and it requires energy suppliers (including electricity, gas, fuel, and vehicle gas/petrol) whose sales are above a certain threshold to participate in energy saving, either through direct savings on their own installations or by helping their customers to save energy. Energy-saving actions eligible to obtain CEEs are defined and listed by ministerial orders. CEEs can be traded on a market that is not regulated by the authorities.

An association of alternative energy suppliers («*Association nationale des opérateurs détaillants en énergie*») brought an action before the *Conseil d'Etat* to obtain the annulment of a government decree dated December 20, 2013, modifying CEE obligations and the CEE scheme. The claimants stated that the CEE scheme qualified as a State aid, in violation of Article 107 paragraph 1 of the Treaty on the functioning of the European Union ("TFEU").

However, the *Conseil d'Etat*, which relied on precedents by the Court of Justice of the European Union, ruled that the CEE scheme, unlike greenhouse gas quotas, cannot be considered as a State aid at the European level since it does not create any aid directly or indirectly granted through State resources. As a consequence, it was not necessary to submit the disputed 2013 decree to the European Commission before its entry into force.

Also, the claimants stated that the 2013 decree created a difference of treatment between energy suppliers. Their point was that "historical" energy operators (in particular, the State-owned EDF and GDF (now Engie)) benefit more from the CEE scheme than "alternative" (i.e., more recent) energy operators. The amount of CEE that must be restituted by an energy operator is calculated based on the volume of sales to end-users as declared by energy suppliers, rather than their market shares. As a consequence, historical operators, who have more sales and therefore an important volume of CEE to obtain but also to trade, allegedly benefit from more negotiation power

on the certificates' market. The *Conseil d'Etat* rejected this last argument since the difference of treatment is created by the law itself and not by the disputed decree.

This recent dispute demonstrates the existence and significance for market players of an energy-saving market in France. From a business point of view, since the launch of the CEE scheme, 90 percent of CEEs have been obtained through standardized operations aimed at energy suppliers' customers (private households, companies, public entities). Additionally, 65 percent of energy savings were implemented in residential building. It led to the development of a new market of renovation / retrofitting works and service contracts and to the creation of companies specialized in the collection and sale of certificates. This rather recent market should participate in the energy transition currently carried out in France.

Armelle Sandrin-Deforge
+33.1.56.59.39.47
asandrindeforge@jonesday.com

Marion Cantegrel
+33.1.56.59.38.16
mcantegrel@jonesday.com

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EDITORIAL BOARD

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Cleveland Office
Business and Tort Litigation
+1.216.586.7151
sbalanson@jonesday.com

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Atlanta Office
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+1.404.581.8215
cmmorgan@jonesday.com

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

Gerald P. Farano
Washington Office
Energy
+1.202.879.4691
gfarano@jonesday.com

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

EXECUTIVE EDITOR

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

CONTACTS

CALIFORNIA

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

NEW YORK

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Energy
+1.212.326.7893
dchin@jonesday.com

TEXAS

Jason F. Leif
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+1.832.239.3727
jfleif@jonesday.com

ASIA

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Projects & Infrastructure
+81.3.6744.1616
kumino@jonesday.com

GEORGIA

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

OHIO

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

WASHINGTON, D.C.

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

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

ILLINOIS

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

PENNSYLVANIA

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

EUROPE

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

LATIN AMERICA

José A. Estandía
Mexico City
Energy
+52.55.3000.4081
jestandia@jonesday.com

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