

# 2010 Quarterly Report on Climate Change – Regulatory Update

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# Future of Climate Action in Congress

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# Status report on Congressional action with regard to climate regulation

- With Republicans widely expected to gain seats in both the House and Senate this fall, many observers say the chances for sweeping energy legislation will worsen next year as gridlock intensifies

## Status report on Congressional action with regard to climate regulation (Continued)

- In July, Senate Democrats largely abandoned efforts to pass a climate bill in 2010.
- Now the action is shifting from legislation to regulation and litigation.
  - The Environmental Protection Agency is rolling out new rules regulating carbon emissions from power plants and large factories.
  - Lawsuits are being filed in response, two of which are before the Supreme Court for possible review
- But there is action in Congress...

# Senate

- On September 23 several key lawmakers did a postmortem on the Senate's failure to pass comprehensive climate and energy legislation, concluding that bigger energy legislation is not better.
  - The path to success, most agreed, may be taking it one small step at a time.
  - smaller energy bills with bipartisan consensus, such as measures promoting electric vehicles, a renewable electricity standard and renewable-energy production tax credits.
  - Rep. Ed Markey (D-Mass.), an author of the House-passed cap-and-trade climate bill, agreed that a piece-by-piece approach may be what is needed in the Senate.

# House of Representatives

- September 23: House Republican leaders rolled out their new conservative governing agenda, which focuses on reining in spending, national defense, repealing the new health care reform law and permanently extending the Bush tax cuts.
- The Republicans did not say much about energy or environment policy, but a document outlining their priorities says, "We will fight to increase access to domestic energy sources and oppose attempts to impose a national 'cap and trade' energy tax."
- But...House likely to stay firmly in Democrats' hands next year, giving a nod to the tea party-backed candidate Christine O'Donnell who ousted Delaware Republican Rep. Mike Castle in a primary last week.

# Is cap and trade dead?

- Asked whether substantive energy legislation is possible during the next two years of the Obama administration, most politicians predicted that oil prices would matter more than elections.
  - "If we have another spike on oil prices like we did in 2008," Sen. Susan Collins (R-Maine) said, "then the answer to that question almost certainly will be yes."
- More than oil prices: Depends on economy and unemployment: no movement on comprehensive climate change legislation (cap and trade included) until unemployment under 5% (is at 9% now) and economic growth hovers at 3% (is at 1.5% now)

# If cap and trade likely feigning death until economy improves, what should we look for by way of legislation this Congress?

- Sens Bingaman and Brownback introduced an RES stand-alone bill last week with 18 Democrats and four Republicans co-sponsoring the legislation, [S. 3813](#). The bill would require utilities to source 15 percent of their electricity from renewable sources by 2021.
- Problem: RES without other aspects of comprehensive climate legislation (that is, a price on the cost of carbon) makes little economic sense
- Even though four Republicans have signed onto the bill, Democrats do not have the full support of their own caucus.
  - Democrats Ben Nelson of Nebraska and Blanche Lincoln of Arkansas have both voiced concerns with RES language. Nelson told reporters Tuesday he would not support an RES like the one in the energy bill that passed out of the Energy and Natural Resources Committee last summer. The stand-alone measure is nearly identical to that measure.
  - Other Democrats want to see the RES legislation tied to oil spill clean up measures – and Republicans have stated they will drop support for the measure if any other legislation is piggy-backed on to it



# Questions?

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# AB 32 versus Proposition 23: Back to Ground Zero, or Something More?

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# Proposition 23

- Public Initiative: “California Jobs Initiative”
- November Election
- Overview: Proposes Postponement of Regulations implementing AB 32 (California Global Warming Solutions Act)

# Text

- **38600. (a) From and after the effective date of this division, Division 25.5 (commencing with Section 38500) of the Health and Safety Code is *suspended* until such time as the *unemployment rate in California is 5.5 percent or less for four consecutive calendar quarters.***
- **(b) While suspended, *no* state agency shall propose, promulgate, or adopt any *regulation implementing Division 25.5* (commencing with Section 38500) and *any regulation adopted prior to the effective date of this division shall be void and unenforceable* until such time as the suspension is lifted.**
- *Cal. Health and Safety Code, DIVISION 25.6. SUSPENSION OF AB 32*

# Issue: Scope of Impact

- Cap and trade program
- Low carbon fuel standard
- New landfill methane capture standards
- Shipping speeds in coastal waters and auxiliary power at dock
- Acceptable trucks for use at ports
- Aerodynamics of trucks
- Tire pressure program
- Recent restrictions on high global warming potential refrigerants
- Executive Order re 33% Renewable Portfolio Standard by 2020?



# Proponents Focus on Jobs

- Over 1.1 million jobs at issue
- Up to 60 percent in higher electricity rates
- \$3.7 billion a year in higher gasoline and diesel prices
- Up to 56 percent increase in natural gas rates
- Local governments: hundreds of millions in additional budget cuts

# Prop. 23 Funding

- \$8.2 million raised (9/21/10)
  - \$1 mm: Koch (energy) interests
  - \$4 mm: Valero Energy Corp.
  - \$1.5 mm: Tesoro Energy Corp.
- source: NY Times: 9/21/10

# The Sides Square Off

## YES

- <http://www.yeson23.com/>
- <http://www.cmta.net/>
- <http://cicc.org/>

## NO

- <http://www.standagainstprop23.com/>
- <http://energy.sourceguides.com/businesses/byGeo/US/byS/CA/byB/trade/trade.shtml>
- Jerry Brown
- Meg Whitman\*

# Public Polls

	Support Prop 23	Oppose Prop 23	Don't Know
Early July 2010	36%	48%	16%
9/24/10	40%	38%	22%
	7/10 Field Poll	9/10 LA Times-USC	



# Planning?

- Toss up
- Analysis of related regulations that could impact your business
- Hedging
  - guarantees or options
    - fuel and energy sources
- Insurance coverage?
- Get involved – 2% spread



## Questions?

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# Anticipating Issues with the Tailoring Rule, EPA Wants States to Address GHGs – or Else

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# How Did We Get Here?

- EPA's Endangerment Finding and Mobile Source Rule triggered GHG regulation under the Clean Air Act's Prevention of Significant Deterioration (PSD) program
- New and modified facilities emitting more than 100 or 250 tons per year (depending on source type) of any pollutant needs a PSD permit

# GHGs are Everywhere



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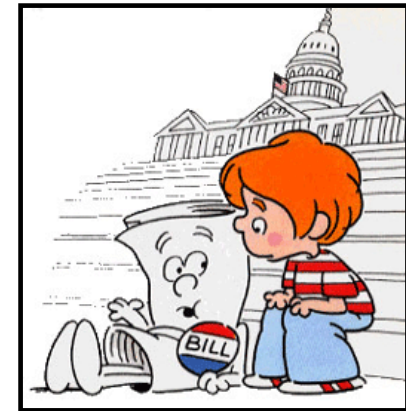


# EPA's Tailoring Rule

- Phased-in compliance for power plants, refineries and other large sources
- First 6 months of 2011, GHG permitting limited to sources already required to obtain a PSD or Title V operating permit due to other emissions
- Sources with GHG emissions over 75,000 tons per year – for the PSD program, these would be new or increased GHG emissions

## Clean Air Act and Cooperative Federalism

- EPA establishes NAAQS
- EPA designates areas as attainment, nonattainment or unclassifiable for each air pollutant
- States develop State Implementation Plans to implement, maintain and enhance NAAQS
- SIPs include PSD requirements



# The SIP Call

- Proposed finding that SIPs in 13 states are “substantially inadequate” with respect to PSD permitting for GHGs
- Reasons:
  - SIPs in some states listed individual pollutants by name
  - Some states could not adopt requirements that weren’t adopted by state legislature
  - CT specifically excludes CO<sub>2</sub> as pollutant

## The SIP Call

- EPA wants these states to revise SIPs and address air permitting requirements by December 2011
- State reactions →
- Some uncertainty in unlisted jurisdictions (e.g., Allegheny County and some California counties)





# Federal Implementation Plan (FIP)

- In a related rule, EPA proposes assuming responsibility for PSD permitting for states that cannot (or do not) revise their SIPs
- EPA would become the PSD permitting authority for GHGs consistent with the Tailoring Rule



# Possible Result: Permitting Gap

- January 2, 2011: Tailoring Rule in effect
- December 2011: deadline for states to submit corrective SIPS
- Without an approved SIP or FIP in place, new or modified GHG sources may not be able to obtain PSD permits
- Or state permit for everything but GHGs under SIP and a federal permit for GHGs?



# What to Look For

- Reactions/changes to state SIPs
- EPA draft guidance on determining Best Available Control Technology for various GHG sources
- Developments in the courts
- EPA restrictions on Capitol Hill

# Questions?

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# Clean Development Mechanisms Under Fire

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# The Clean Development Mechanism

- The Clean Development Mechanism (“CDM”) is one of the “flexibility” mechanisms provided for and defined in the Kyoto Protocol.
- It allows so-called Annex I parties to the Kyoto Protocol, a/k/a, industrialized nations, to invest in emission reductions in developing countries and use those reductions to create carbon credits (“CERS”) so they can hold enough allowances to meet their cap and trade obligations. For example, in the European Union its emission trading system allows companies to hold allowances equivalent to their emissions by buying offset CERS.
- The CDM is based on the idea of emission reduction production, i.e., emission reductions are produced and then subtracted against a hypothetical “baseline” of emissions predicted to occur in the absence of the CDM project.
- The CDM rewards emission reductions, but does not penalize emission increases. This can theoretically create an incentive for sources to raise their emissions in the short term with the aim of getting credits for emissions in the long term.
- The UN Executive Board has attempted to address this problem in the methodology it proscribes for calculating emission reductions.



## Example CDM Projects

- Destruction of HFC-23, a by-product of the production of the HCFC – refrigerant gas. HFC-23 accounts for 51% of the 400 million CERS issued through September of 2010.
- Recovery and utilization of gas from oil wells that would otherwise be flared or vented.
- Renewable energy projects replacing part of electricity production of fossil fuel fired power plants.
- By 2012, the largest potential for “production” of CERS is in China (52%), India (16%), Latin America and the Caribbean (15%).

# The United Nations CDM Executive Board

- The CDM Executive Board (“EB”) has ten members from different countries serving staggered two-year terms. The current Chairman is Clifford Mahlung of Jamaica and the Vice Chairman is Martin Hession of the United Kingdom. Mr. Mahlung is an Applied Meteorologist in the National Meteorological Service and Mr. Hession is head of Global Markets, Department of Energy Change.
  - The position of Chairman and Vice Chairman of the Executive Board must be held by an Annex 1 party and a person that is not.
- CERS are issued upon instruction from the EB to the CDM registry Administrator. The registry is used to ensure accurate accounting of the issuance, transfer and acquisition of CERS by parties not included in Annex I.

# The Attack on Carbon Credits Derived From Destruction of HFC-23

- The basis for the attack by several international NGO watchdog organizations is that producers of HFC-23 are gaming the system by producing HFC-23 at higher rates and quantities than necessary simply to earn more CERS.
- In response the CDM Executive Board at its 56<sup>th</sup> meeting in September 2010, ordered its methodologies panel to investigate whether safeguards against such activities already built into its methodology are adequate. (The methodology used is AM001, now in its fifth version).
- The Executive Board also indicated that requests for issuance of CERS for 19 registered projects would be suspended and review would be made of each project.
- The EB hired a consultant to help with its review and has requested that producers give it 10 years of detailed data on HCFC supply, demand, production and sales.

# The Fallout From The Executive Board's Decision

- The Executive Board has stated that it will make a decision at its 58<sup>th</sup> meeting in Cancun on (1) whether the CDM system has been gamed and/or (2) whether change needs to be made to its methodology. It has also called for public input on a draft of new methodology for HFC-23 destruction.
- The EB has floated a proposal making project auditors liable for replacing CERS if the EB concludes that manufacturers have exploited the system.
  - The International Emissions Trading Association has responded by saying that auditors might withdraw from the market projects.
  - IETA also reacted by saying it was unfair to make auditors liable without evidence they were at fault and voiced fears they might be punished for misrepresentations actually made by the Project Developer.
- Japan's government, which is involved in 8 of the projects, along with Japanese companies including Mitsui & Co., Mitsubishi and Tokyo Electric, China and the World Bank have opposed the request for any revision to the HFC-23 methodology.

## The Fallout From The Executive Board's Decision (continued)

- The Chinese Board member reportedly argued that revision of the methodology was “illegitimate” and that there should be no rush to put the methodology on hold, China hosts 11 out of 19 registered HFC-23 projects and imposes a 65% levy on all HFC-23 projects. The Chinese derive about 100 million dollars a year through this tax.
- The uncertainty about the supply of CDM credits has purportedly led to a surge in the price of carbon dioxide emission allowances under the EU Emission Trading System. The London-based European Climate Exchange reported a 12% increase around the time of the Board's decision.

# Conclusion

- If the Executive Board decides to deregister projects, it could have a destabilizing impact on the CER market.
- The CDM mechanism, (ironically originally introduced by the US into the Kyoto Protocol) and undertaken as a way of helping developing countries reduce GHG emissions, has been under constant attack by environmentalists who see HFC-23 as a very potent GHG, which should not be generated anywhere in the world. Deregistering HFC-23 could result in increased attacks on other projects.
- Holders of withdrawn CERS could find themselves scrambling to find replacements.



# Questions?

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