

Climate Law Update

SIGNIFICANT CLIMATE-RELATED DEVELOPMENTS IN THE UNITED STATES AND EUROPE

Environmental Practice Group

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US Developments

Senators Kerry and Lieberman Release “Discussion Draft” of American Power Act

On May 12, 2010, Senators John Kerry and Joseph Lieberman released a “discussion draft” of the American Power Act, or APA, to the Senate. Under this draft bill, allowances would be purchased and sold on a regulated market. The federal government would initially issue a percentage of the required allowances free, gradually phasing those out by 2030. The bill would pre-empt greenhouse gas, or GHG, regulation by the Environmental Protection Agency, or EPA, as well as state cap-and-trade regimes. The House of Representatives has already passed a climate change bill, the American Clean Energy and Security Act, which has similar provisions, although the Kerry-Lieberman draft differs in some of its timetables and incentives.

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The key provisions of the bill include the following:

- The regulated market would cover operations that emit more than 25,000 tons of CO₂ equivalent, or CO₂e, each year. Electric utilities and petroleum producers would be covered starting in 2013, while energy-intensive manufacturers (e.g., cement and steel) and natural gasoline local distribution companies would be covered starting in 2016. In total, approximately 7,500 power plants and factories would participate in the regulated market.
- A price floor for allowances of \$12/ton that would rise at a rate 3% above inflation per year would apply to all allowances, and a price ceiling of \$25/ton that would rise at a rate 5% above inflation per year would apply to a pool of 4 billion allowances that could be purchased by entities to satisfy up to 15% of their emission requirements.
- Refined petroleum product providers (oil companies) would be required to purchase non-marketable allowances at a set price and would not be permitted to purchase other allowances.

- Up to 2 billion tons of emissions per year could be offset through emission reduction efforts; 75% of the offsets would come from domestic projects and 25% from international projects. Refined petroleum product providers could not use offsets.
- Overall emissions levels would be capped at 4.75% lower than 2005 levels in 2013, 17% lower in 2020, 42% lower in 2030 and 83% lower by 2050.
- The bill promotes nuclear power (by increasing loan guarantees for new plants from \$18.4 billion to \$54 billion), off-shore drilling (by providing that 50% of profits are shared with states, and by permitting states to prohibit drilling within 75 miles of their coastlines) and carbon sequestration (by creating a national program for demonstration of carbon capture and sequestration financed by a 10-year, \$2 billion annual levy on all fossil-fueled power generators).
- During Phase 1, from January 2, 2011 to June 30, 2011, only those sources currently subject to the PSD permitting program (*i.e.*, new sources that will emit over a certain amount of non-GHG pollutants and certain existing sources that are modified so as to significantly increase non-GHG pollutants) would be subject to a PSD permitting requirement for GHGs. For these projects, only increases of 75,000 tons per year, or tpy, of CO₂e, would trigger the need to install BACT. Moreover, only sources currently subject to the operating permit program would be subject to Title V requirements for GHGs. No sources would be subject to PSD or Title V permitting requirements based solely on GHG emissions.
- During Phase 2, from July 1, 2011 to June 30, 2013, PSD permitting requirements will also apply to new projects with GHG emissions of at least 100,000 tpy and modifications to existing facilities that increase GHG emissions by at least 75,000 tpy (even if no non-GHG PSD thresholds are exceeded). Facilities that emit 100,000 tpy of CO₂e will be subject to Title V permitting requirements.
- The EPA estimates that 550 sources (mostly solid waste landfills and industrial manufacturers) will need to obtain Title V permits for the first time, and 900 additional PSD permitting actions per year will be triggered.
- The EPA is committed to additional rulemaking potentially to establish a Phase 3. The rulemaking will conclude no later than July 1, 2012. Phase 3 would not require permitting for sources with GHG emissions below 50,000 tpy. Permitting for smaller sources would not be required until at least April 30, 2016.

The bill is available at:

<http://kerry.senate.gov/americanpoweract/pdf/APAbill.pdf>

Environmental Protection Agency Issues New GHG Emissions Control Rules

On May 13, 2010, the EPA issued the final Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule. Under the current Prevention of Significant Deterioration, or PSD, program, certain new, large emitters of specified non-GHG pollutants and certain existing emitters that make major modifications that significantly increase non-GHG emissions, must install the best available control technology, or BACT, in conjunction with construction activities or plant modifications. Similarly, under the current Title V program, large emitters of specified non-GHG pollutants must obtain Title V operating permits.

Without this tailoring rule, on January 2, 2011, permitting emission thresholds for GHG emissions based on the non-GHG emission thresholds would have taken effect, resulting in the need for tens of thousands of new PSD permits and millions of new Title V operating permits. However, the tailoring rule changes the need for PSD and Title V permits as follows:

The final rule is available at:

<http://www.epa.gov/nsr/documents/20100413final.pdf>

An EPA fact sheet regarding the rule is available at:

<http://www.epa.gov/nsr/documents/20100413fs.pdf>

ASTM Issues Guide for Financial Disclosures Related to Climate Change

On April 1, 2010, ASTM International issued its Standard Guide for Financial Disclosures Attributed to Climate Change, or the Guide. The Guide provides financial disclosure instructions that are “consistent with good commercial and customary practice.”

- The Guide lists six major circumstances that might give rise to financial impacts attributed to climate change that may warrant disclosure:
 - (1) enforcement of laws or regulations regarding GHG emissions levels and other government climate change mitigation measures;
 - (2) changes in resource cost and availability due to climate change;
 - (3) changes in asset value due to climate change;
 - (4) contractual assumption of climate change risk;
 - (5) litigation related to climate change; and
 - (6) other information known by the reporting entity.The Guide indicates that a reporting entity should estimate the likelihood and materiality of each of the potential climate change impacts and determine whether disclosure is warranted in a manner similar to the disclosure of any other risk.
- The Guide lists four sources of information related to climate change that should be reviewed by a reporting entity: (1) publicly available environmental records; (2) internal records; (3) current and proposed laws and regulations; and (4) publicly available studies.
- If it is determined a disclosure should be made, the reporting entity should disclose the potential financial consequences of any particular set of circumstances, including mitigation costs, physical costs, changes in markets, and litigation costs. If the financial consequences cannot be quantified, the entity should explain the reasons why the consequences are unquantifiable.
- An overall analysis of potential climate change costs should be provided in addition to disclosures relating to any particular set of circumstances.
- The SEC provided guidance on climate change disclosure in its February 2, 2010 release “Commission Guidance Regarding Disclosure

related to Climate Change.” (see our previous client publication at: <http://www.shearman.com/sec-votes-to-issue-interpretive-guidance-on-climate-change-disclosure-01-29-2010/>).

New Fuel Economy and GHG Emission Rules Are Published for Cars and Light-Duty Trucks and Expected for Medium-Duty and Heavy-Duty Trucks

On May 21, 2010, President Obama signed a Presidential Memorandum directing the EPA and the U.S. Department of Transportation, or DOT, to increase fuel efficiency and decrease GHG emissions in medium-duty and heavy-duty trucks for model years 2014-2018. The final rule is expected to be issued in 2012. At this stage, the precise levels of the standards have not been set.

Medium-duty and heavy-duty trucks currently are not subject to fuel economy standards, although they are subject to emission limits for pollutants such as particulate matter and nitrogen oxides. President Obama’s directive also includes support for the development of electric vehicles and other advanced-vehicle technology.

On April 1, 2010, the EPA and the National Highway Traffic Administration issued final rules setting new fuel economy standards for cars and light-duty trucks for model years 2012-2016. For the first time the standards include limitations on GHG emissions. By 2016, combined fuel economy standards for cars and light-duty trucks will increase from 25 miles per gallon to 35 miles per gallon. As part of the May 21 announcement, President Obama directed the EPA and DOT to develop new fuel economy and GHG emission standards for cars and light-duty trucks for model year 2017 and beyond.

More information is available at: <http://www.epa.gov/otaq/climate/regulations.htm>

European Union Developments

European Commission Publishes its Draft Auctioning Regulation under the EU Emissions Trading Scheme

Following a public consultation, on 6 April 2010 the European Commission published its draft carbon auctioning regulation. The Commission is required to adopt the final text of the regulation by 30 June 2010, although the necessary period for review of the regulation by the European Parliament may delay this adoption.

Thus far in phases I and II of the EU Emissions Trading Scheme, or EU ETS, which cover the years 2005-07 and 2008-12, respectively, emissions allowances have generally been allocated by Member States to regulated installations free of cost. Only a small proportion of allowances in phase II are being allocated by way of auction. Under phase III of the EU ETS, which begins on 1 January 2013, allowances will be allocated increasingly, and ultimately predominantly, by way of auction.

In keeping with policy objectives of the EU directive that allowances in phase III should be allocated on the basis of harmonised rules, rather than by Member States through individual national allocation plans, the draft regulation requires Member States, in conjunction with the Commission, to appoint a single auction platform that will function across Member States. However, the draft does provide an "opt-out" for Member States to operate their own auction platform. This is seen as a concession to Member States such as Germany, the United Kingdom, Spain and Poland, which are said to have strongly opposed a central auction platform.

The draft regulation further sets out in detail the timing, administrative, sequencing, access and other aspects of the proposed auction process in an effort to ensure auctions are conducted in an open, transparent, harmonised and non-discriminatory manner.

The draft regulation is available at:
http://ec.europa.eu/environment/climat/emission/pdf/proposed_auctioning_reg.pdf

European Commission Publishes Analysis of Move Toward a 30% GHG Reduction by 2020

On 26 May 2010, the European Commission released an analysis to the European Parliament and Council of the costs, benefits and options for moving beyond the EU's greenhouse gas reduction target for 2020 from 20 per cent. below 1990 levels to 30 per cent. The stated purpose of the document is not to decide on a move towards the 30 per cent. target but rather 'to facilitate a more informed debate on the implications of the different levels of ambition.'

In the document, the Commission expresses its view that the absolute costs of meeting the 20 per cent. reduction target have decreased substantially since 2008, primarily because of decreased industrial output during the recession. Further reductions potentially will be less costly than originally anticipated. The Commission examines options for moving to the 30 per cent. target and also examines measures to support energy-intensive industries against the risk of carbon leakage.

Under the existing EU Directive, the 2020 target is set at 20 per cent. with an explicit intention to move to 30 per cent. if, among other things, other developed countries commit to comparable emission reductions within the framework of a global agreement.

The Commission's communication is available at:

<http://ec.europa.eu/environment/climat/pdf/2010-05-26communication.pdf>

Developments in France

Forthcoming Grenelle II Law Introduces Greenhouse Gas Emissions Inventory Requirement

A significant proposed piece of environmental legislation in France, "*Loi portant engagement national pour l'environnement*", also called the Grenelle II law, provides a comprehensive package of measures on buildings, transportation, energy and climate, biodiversity, health risks and waste, and governance. The law is expected to be adopted before summer 2010 after a final vote on the revised draft of the law.

With respect to climate change, Article 26-5 of the proposed legislation provides that companies with over 500 employees must prepare an inventory of their greenhouse gas emissions. In addition, the company must attach to the inventory a summary of actions to reduce its greenhouse gas emissions. The inventory must be made public and updated at least every three years. The first inventory is to be submitted by 31 December 2012.

A methodology for compiling the greenhouse gas inventory will be available. It is likely that the methodology will be based on the French Environment and Energy Management Agency's (ADEME) "Bilan Carbone® tool". The "Bilan Carbone® tool" assesses greenhouse gas emissions that are both direct (from sources owned or controlled by the company) and indirect (that are a consequence of the activities of the company, but occur at sources owned or controlled by another company).

The draft law is available at:

http://www.assemblee-nationale.fr/13/dossiers/engagement_environment.asp

Developments in Germany

Germany Begins to Auction Allowances under Phase II of the EU ETS

As discussed earlier, some Member States, notably the United Kingdom thus far, have allocated a small number of allowances under the existing phase II of the EU ETS by way of auction.

Starting in January 2010, the Federal Republic of Germany has determined to auction 40 million emissions allowances annually under the supervision of the German Emissions Trading Authority (*Deutsche Emissionshandelsstelle* or *DEHSt*). This auctioning of allowances replaces some allocations previously made by way of a straight government sale and represents around nine per cent. of the annual national emissions trading budget. Both spot auctions and futures auctions are held weekly at the European Energy Exchange.

The procedure for the allocation of emissions allowances is regulated by the German Allocation Act 2012 (*ZuG 2012*) and it is this legislation which requires the German Government to conduct some allocation of allowances by way of auction for the years 2010 to 2012.

The German Allocation Act 2012 is available at:

http://www.gesetze-im-internet.de/zug_2012/BJNR178810007.html

Further information on the auction scheme is available at:

http://www.dehst.de/clin_162/nn_484538/SharedDocs/Presse_EN/Press_releases/2010/008_2010.html?nn=true

Developments in the United Kingdom

Registration Deadline Approaches for Carbon Reduction Commitment Energy Efficiency Scheme

The Carbon Reduction Commitment Energy Efficiency Scheme, or the CRC, is a mandatory emissions cap and trade system that came into force in the United Kingdom on 1 April 2010. The CRC's aim is to reduce the broad array of carbon dioxide emissions that are not regulated under other programmes already in force in the UK, such as the EU ETS and UK climate change agreements. As such, the CRC applies to a wide range of large private and public sector organisations. The deadline for registration with the Government under the introductory phase of the CRC is 30 September 2010.

Background to the CRC

Broadly, the CRC requires organisations that are responsible for significant carbon dioxide emissions outside the EU ETS and UK climate change agreements to begin to report these emissions to the Government, and subsequently to purchase and surrender to the Government a sufficient number of allowances to cover their emissions. The CRC will be enforced in England and Wales by the Environment Agency, in Scotland by the Scottish Environment Protection Agency and in Northern Ireland by the Department of the Environment.

The introductory phase of the CRC runs from 1 April 2010 to 31 March 2013, with subsequent seven-year phases running through to 31 March 2043.

Organisations in the UK must assess their electricity usage in the relevant 'qualification year' to establish whether they are required to register with the Government under the CRC. For the introductory phase, organisations must assess their electricity usage in the 2008 calendar year, which has been fixed as the 'qualification year' for this phase.

The CRC applies to any organisation that, during the relevant 'qualification year', was supplied with:

- electricity by at least one half-hourly electricity meter settled on the half-hourly market; and
- 6,000 megawatt hours (MWh) or more of electricity through all such meters.

For the introductory phase, such an organisation must register with the Government by 30 September 2010. Subsequently, the organisation must report all of its energy usage to the Government and purchase allowances issued under the CRC to account for its emissions, as explained further below.

If, in the qualification year, an organisation was supplied by at least one half-hourly meter settled on the half-hourly market but used less than 6,000 MWh, the organisation will still be required to register with the Government by 30 September 2010 but thereafter will be subject only to the energy usage information reporting requirement and not to the requirement to purchase allowances.

The Government estimates that the CRC's allowance scheme will apply to approximately 5,000 organisations with electricity bills of around £500,000 per annum and over. Organisations that are likely to fall within the scope of the CRC include large retailers, manufacturers and construction companies, as well as corporates and professional services firms that have large office spaces. The Government estimates that another 20,000 organisations will be subject to the energy usage reporting requirement.

Reporting requirements

CRC compliance and reporting years run from April to March. Organisations caught within the scheme must assess their energy use during the first year of each phase and submit a 'Footprint Report' to the Government in July following the first year of the phase. For the introductory phase, this means submitting in July 2011 a Footprint Report for the year April 2010 to March 2011. The Footprint Report must report on all the energy sources to which the organisation is a counterparty to a supply contract and not just electricity usage, even though the qualification year threshold is measured simply according to electricity use. For reporting purposes, this will also include emissions covered by the EU ETS.

At the end of July in each year of a phase, participants must submit to the Government an 'Annual Report' setting out their emissions subject to the CRC for the preceding year.

Purchase and surrender of allowances

In April of each year, beginning in April 2011, participants may purchase allowances in Government-held auctions to cover their forecasted emissions for the next year of the phase. In July of each year, beginning in July 2012, participants must surrender a sufficient number of allowances to cover emissions made during the preceding year. If a participant has insufficient allowances to cover these emissions, it must purchase additional allowances to make up for the shortfall, which may be done through the Government sale process (for the introductory phase), the auction process (in later phases) or in a secondary trading market that is expected to develop.

For the introductory phase, allowances will be fixed at a price of £12 per tonne of carbon dioxide emissions. In subsequent phases, the Government will auction a limited number of allowances annually, in order to encourage participants to reduce their emissions.

Application of the CRC to group corporate structures

Where several companies form part of a group, in most cases the ultimate parent company (known in the context of the CRC as the highest parent undertaking) must register on behalf of the whole group of UK companies. The group's electricity and energy usage will be

aggregated to calculate whether it is obliged to register under the CRC and for the purposes of its CRC compliance. All members of the group will have joint and several liability to ensure compliance with the CRC by the group as a whole. The definitions of “parent” and “subsidiary” undertakings for this purpose are those set out in the UK Companies Act 2006.

Where a subsidiary within a group meets the qualification criteria in its own right through a high energy use, it will be a ‘significant group undertaking’, or SGU, and it may register for the CRC as a participant itself. This process is known as ‘disaggregation’ and it results in the SGU being treated separately from the rest of the group for the purposes of the CRC and for any liability for breaches of the CRC which may otherwise have arisen as a result of its joint and several liability with other members of the group.

For the introductory phase, an application to disaggregate an SGU must be made by 30 June 2010 and the SGU must register in its own right by 30 September 2010.

Where a company is not incorporated in the United Kingdom but has a UK subsidiary or has an energy supply in the UK that meets the threshold criteria for CRC applicability - for example, through a subsidiary’s ownership of large office space in the UK - then a UK incorporated company of the group (or a representative situated in the UK if no UK corporate entity exists) will need to register under the CRC for the UK activities.

Key deadlines for introductory phase of the CRC

30 June 2010	Deadline for application to disaggregate a significant group undertaking (SGU) – the SGU must then register for the CRC in its own right
30 September 2010	Deadline for registration under the CRC
April 2011	First Government-led sale of allowances at a fixed price of £12 per tonne of carbon dioxide emissions to cover forecasted emissions during April 2011 - March 2012
July 2011	Deadline for submission of first Footprint Report and Annual Report covering April 2010 - March 2011
July 2012	First deadline for submission of allowances to cover emissions between April 2011 - March 2012

The CRC scheme was enacted into law by the CRC Energy Efficiency Scheme Order 2010, which is available at: http://www.opsi.gov.uk/si/si2010/uksi_20100768_en_1

This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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