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Air & Climate Forecast

July 2013

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Agenda

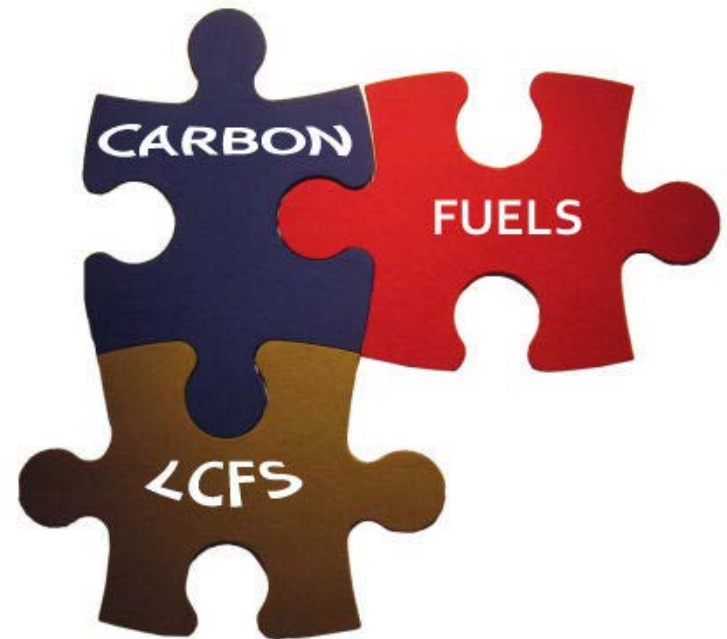
- The recent decision in the California Low Carbon Fuel Standard case and its implications for the implementation of the LCFS
- Greenhouse gas emissions trading for airlines
- How climate change issues are addressed under the recently revised Equator Principles
- President Obama's newly-released Climate Action Plan and its implications for new greenhouse gas standards for power plants and incentives for carbon capture and sequestration (CCS) projects

The Recent Decision in the California Low Carbon Fuel Standard Case and Implications for Implementation

Presented by: Joshua T. Bledsoe

LCFS Will Remain Operative Despite APA & CEQA Violations

- Low Carbon Fuel Standard (LCFS) is a core component of California's climate change strategy
- LCFS survives state court challenge and will remain operative (for now)
- But LCFS was improperly adopted and must be fixed (or else)



POET v. ARB: High Level Summary

- California Court of Appeal for the Fifth Appellate District issued decision on July 15, 2013
- Air Resources Board (ARB) violated the California Environmental Quality Act (CEQA) and California's Administrative Procedures Act (APA) in adopting LCFS
- ARB must set aside its approval of the LCFS
- Court is allowing LCFS to remain in effect while ARB reapproves the regulation
- Technically a ruling against ARB; nevertheless, a significant win for ARB because it avoids market disruption and confusion of injunction (for now)

LCFS Background



- LCFS requires fuel suppliers to reduce the Carbon Intensity (CI) of certain transportation fuels, including gasoline and diesel, by 10 percent below 2010 levels by 2020
 - Alternative fuel market value significantly affected by approved/assigned CI.
- LCFS adopted pursuant to the state's climate change law, the Global Warming Solutions Act of 2006 (AB 32)
- AB 32 requires that the state's GHG emissions be cut to 1990 levels by 2020

POET Legal Challenge to LCFS

- Out-of-state ethanol company POET challenged LCFS on CEQA and APA grounds in 2009
 - Underlying dispute concerns CI of ethanol and indirect emissions attributable to land-use changes
- POET alleged that approval process associated with ARB's LCFS rulemaking failed to:
 - disclose significant environmental impacts
 - evaluate alternatives
 - follow CEQA's and APA's procedural rules



Procedural Background

- The Fresno County Superior Court ruled against POET in November 2011
- POET appealed
- Fifth Appellate District signaled in February 2013 that it might reverse the Fresno County Superior Court
- Fifth Appellate District issued a tentative ruling in June 2013 soliciting feedback from parties on potential remedies
- Opinion issued last week



POET v. ARB: Holding

- ARB violated CEQA by:
 - “Approving” the LCFS before completing environmental review
 - Splitting the authority to approve the LCFS from responsibility of completing environmental review
 - Deferring the formulation of mitigation measures to address an increase in NO_x emissions that could result from increased biodiesel use without setting a “performance standard”
- ARB violated APA by failing to compile appropriate Administrative Record via exclusion of expert emails questioning CI values assigned to ethanol



POET v. ARB: Remedies

- Trial court must issue a writ of mandate directing ARB to set aside its approval of LCFS
- Within 30 days, ARB must file an Initial Return to the writ setting forth a plan and schedule for corrective actions
 - Plaintiffs have 15 days to file a response
 - ARB has 15 days to reply
- Status quo will be maintained by ARB continuing to implement LCFS's 2013 carbon intensity requirements
 - “[W]e will avoid the irony of violations of an environmental protection statute being used to set aside a regulation that restricts the release of pollutants into the environment.”

POET v. ARB: Remedies

- Any re-approval of LCFS must be performed by decision-maker with appropriate authority
- ARB must allow public comments (45-day period) “on all issues” – including CI values attributed to land use changes
- Rulemaking record must include disputed emails from ARB’s consultants concerning carbons emissions attributable to ethanol-related land use changes (to remedy APA violation)
- ARB must address whether LCFS will have significant adverse environmental impact as a result of increased NOx emissions and adopt mitigation measures in the event the environmental effects are found to be significant

POET v. ARB: Takeaways

- LCFS survived the state court challenge
 - But ARB must fix CEQA and APA deficiencies and reapprove LCFS
- 2014 LCFS standards will not phase-in unless ARB acts quickly
- The Initial Return to the writ is critical
 - ARB must set realistic schedule and meet it
 - If ARB fails to “proceed in good faith and without delay,” LCFS will be suspended

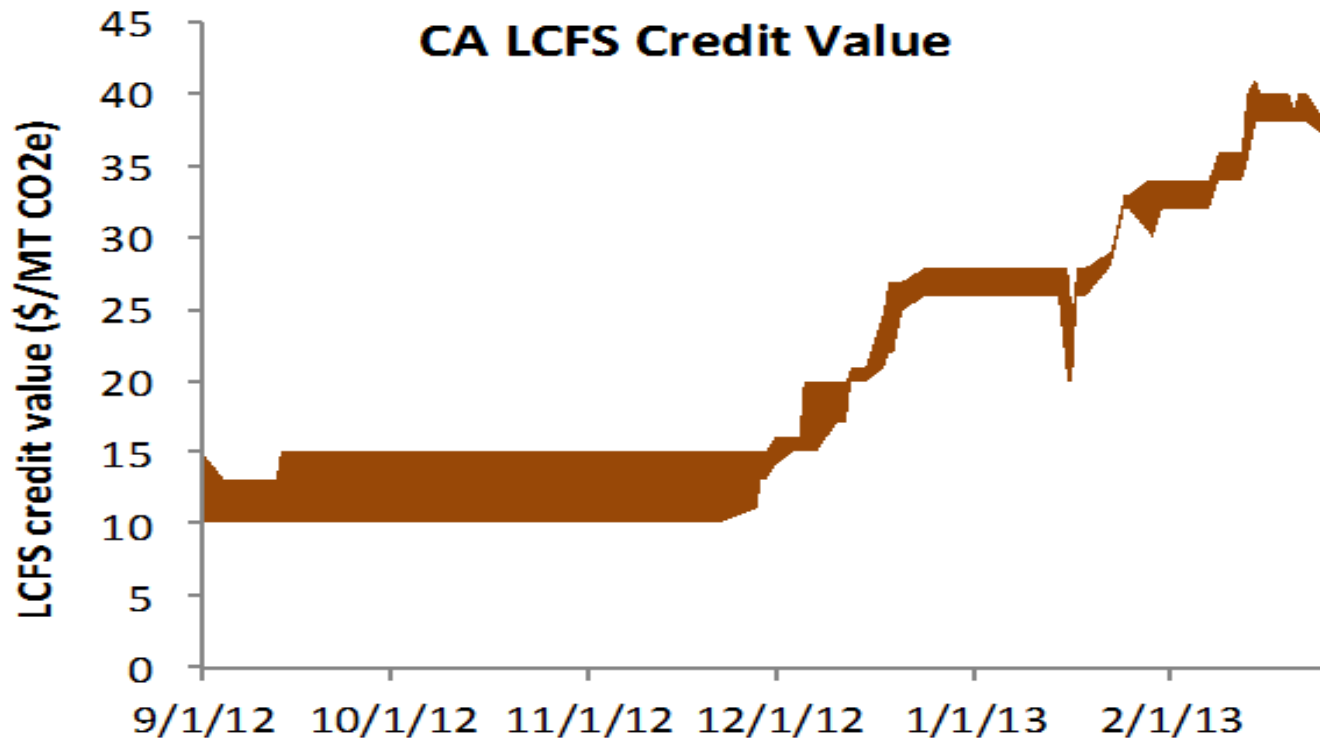
LCFS Challenge in Federal Court

- LCFS also being challenged in federal court
- United States District Court for the Eastern District of California held in December 2011 that LCFS violates the Dormant Commerce Clause of the United States Constitution
- District court issued preliminary injunction
- 9th Circuit Ct. of Appeals stayed injunction
- 9th Circuit heard oral argument in October 2012



LCFS Credit Prices

- LCFS credit prices steadily rising
- November 2012 = \$10-15 (source ARB data)
- Today: \$65-70 (source: Atlas Markets, Kees Woodward)



LCFS Developments to Track

- As it defends LCFS from legal challenges, ARB is considering significant changes to the regulation
- Potential changes include modifications relating to cost containment and electricity use provisions
- Rulemaking occurring now
- Scheduled for adoption in October 2013

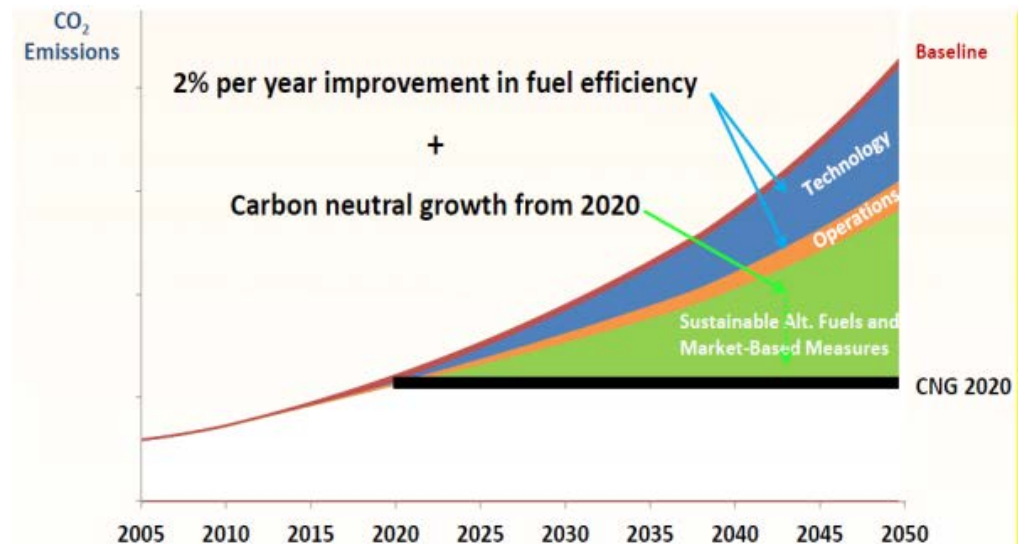


Greenhouse Gas Emissions Trading for Airlines

Presented by: Benjamin Lawless

Airline GHG Emissions

- Global air traffic increased by a factor of 2.5 between 1990 and 2010
 - 28% increase between 2005 and 2010



- Airline CO₂ emissions account for roughly 2 – 2.5% of present day emissions
 - Annual civil aviation emissions estimated at 630 Mtonnes (2006)
 - International flights estimated to account for 62% of CO₂ emissions

Regulation of Aircraft Emissions

- Kyoto Protocol only covers domestic civil aircraft emissions
 - Domestic emissions account for only 38% of civilian emissions
- Chicago convention established the International Civil Aviation Organization (ICAO)
 - Prohibits taxation of airline fuel on international flights
- Existing national carbon pricing mechanisms only impact domestic airline emissions
 - New Zealand Emission Trading Scheme
 - Australian carbon tax charges AU\$23 per ton of carbon emitted on domestic flights



EU Emission Trading Scheme

- EU passed directive to include the aviation industry in EU-ETS in 2008, effective Jan. 2012
 - ETS would cover inter-EU flights and international routes landing or departing from EU airports
 - Applied to non-EU airlines
- European Court of Justice upheld extra-territorial application of ETS in December 2011
- “Stop the Clock” – Commission deferred extension of ETS to extra-EU flights until Jan. 1, 2014



International Civil Aviation Org.



- The International Civil Aviation Organization (ICAO) is a specialized UN agency
 - Kyoto Protocol called for member states to address int'l aircraft GHG emissions through ICAO
- ICAO initially preferred to promote and facilitate state and regional action rather than work toward global measures
 - EU's inclusion of airline industry prompted ICAO to act
- 37th General Assembly (2010) established goals for industry
 - Annual 2% increase in fuel efficiency
 - Carbon-neutral growth by 2020
 - Reduce carbon emissions by 50% by 2050 relative to 2005 levels

ICAO 38th General Assembly

- ICAO “High Level Group” established to consider variety of measures to reduce Aviation GHG emissions
- Non-market “basket of measures”
 - Sustainable alternative fuels
 - Aircraft CO₂ standard
 - Operational measures
- Market Based Measure “Framework”
 - Provide guidance on how states/regions should set up MBMs



ICAO MBM Options

- ICAO is considering three broad Allocation options for allocating emissions on international flights
 - **Departure** - Emissions allocated to State for departing international flights
 - **Operator** – Emissions allocated to a State for all international flights carried out by operators registered in that State
 - **Airspace** - Emissions allocated on basis of nationality of airspace traveled
- Global MBM measures considered have also been narrowed
 - Mandatory offsetting with revenue generation
 - Mandatory offsetting without revenue generation
 - A global cap and trade system

ICAO Stakeholders

- China reportedly is not opposed to some form of emission trading or mandatory carbon offsetting program
- US has proposed restricting coverage to arriving and departing flights within a national airspace
- International Air Transport Association resolution called for a single MBM that would allow for emission offsets
 - Does not support a global limit on GHG emissions for aircraft
- EU - Officially supports the “departure” allocation scheme and earmarking aviation revenues for climate finance fund

How Climate Change Issues are Addressed Under the Recently Revised Equator Principles

Presented by: Miles Farmer

International Standards for Infrastructure Projects

- Projects must satisfy specified environmental and social guidelines.
- OECD Common Approaches
 - Govern evaluation of the environmental impact of infrastructure projects supported by OECD countries' export credit agencies
 - Are not legally binding, but represent a political commitment from member countries
- IFC Performance Standards
 - Broad environmental and social standards that are the platform for the Equator Principles, the OECD Common Approaches, and various standards applied by Export Credit Agencies
 - Updated in 2012; changes included broader climate change reporting and other requirements

Equator Principles Background

- The Equator Principles (“EPs”) are a voluntary environmental and social credit risk management framework established by project finance lenders
 - Applied to project finance and project finance advisory services when total project capital costs exceed \$10 M, and to project-related corporate loans and bridge loans that meet certain criteria
 - Incorporates the IFC Performance Standards
 - 79 financial institutions representing over 70 percent of international project finance debt have adopted the EPs, adhering to the principles in financing projects

Equator Principles III

- In June 2013, the Equator Principles Association released the third draft of the Equator Principles (“EP III”)
- EP III will apply to all applicable project financings where lenders make commitments after December 31, 2013
- EP III resulted from a multi-year revision process which included a strategic review of the Equator Principles
- Prior to EP III, the Equator Principles did not mention climate change; among other key changes introduced by EP III reflecting the 2012 update to the IFC Performance Standards, the document addresses climate change for the first time



Climate Change Requirements in EP III

- EP III explicitly addresses climate change in a few key areas.
- These changes will affect the way the principles are applied.
- **Preamble**
- Scope
- Approach
- Principle 1: Review and Categorization
- **Principle 2: Social and Environmental Assessment**
- Principle 3: Applicable Social & Environmental Standards
- Principle 4: Action Plan & Management System
- Principle 5: Consultation & Disclosure
- Principle 6: Grievance Mechanism
- Principle 7: Independent Review
- Principle 8: Covenants
- Principle 9: Independent Monitoring & Reporting
- **Principle 10: EPFI Reporting**
- **Annexes and Exhibits**

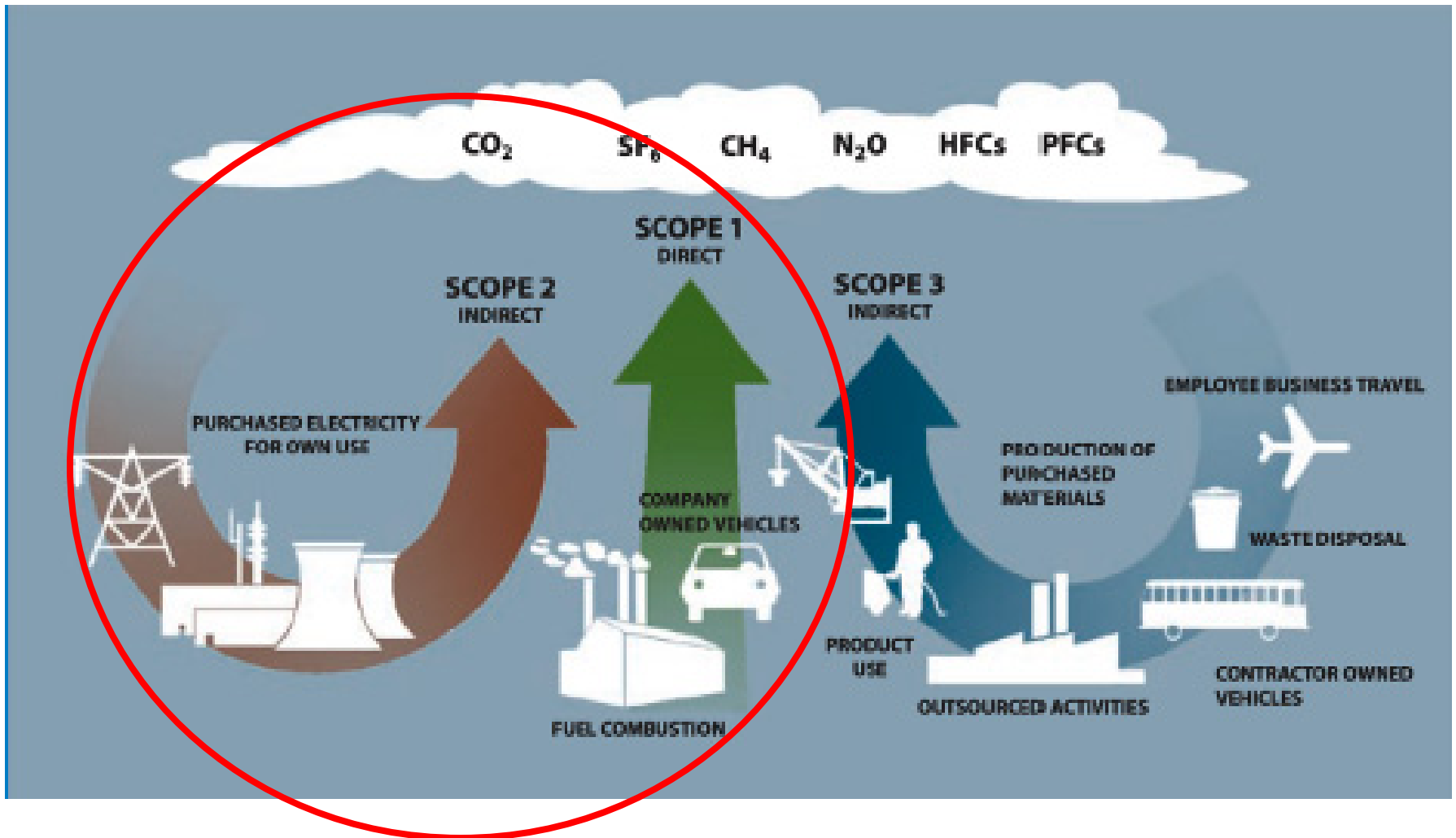
EP III Preamble

- The Preamble now explicitly “recognize[s] the importance of climate change,” stating that “negative impacts on . . . the climate should be avoided where possible” and otherwise “minimized, mitigated, and/or offset”
- This recognition of the importance of climate change will influence the way projects are evaluated by Equator Principles Financial Institutions (“EPFIs”) and the Independent Environmental and Social Consultants (“IESCs”)

EP III Principle 2

- Principle 2 describes the Environmental and Social Impact Assessment that must be conducted for all Category A and Category B projects.
- The Assessment must now include an alternatives analysis evaluating less GHG intensive alternatives when combined Scope 1 and Scope 2 emissions are expected to be more than 100,000 tonnes of CO2 annually.

Scope of Emissions Analysis



Alternatives Analysis (Annex A)

- The alternatives analysis must evaluate “technically and financially feasible and cost effective options available to reduce project-related GHG emissions during the design, construction, and operation of the Project”
- If existing regulatory permitting processes require alternatives analysis, then the analysis proceeds according to the methodology required under those processes
- For Scope 1 emissions, this analysis must include consideration of alternative fuel or energy sources if applicable
- For high carbon intensity sectors, analysis focuses on other viable technology used in the same industry and country or region

EP III Principle 10

- EPFI clients must publicly report GHG emissions levels (combined Scope 1 and Scope 2 Emissions) for projects which will emit over 100,000 tonnes of CO₂ equivalent during the operations phase
- Clients are encouraged but not required to report publicly on projects emitting over 25,000 tonnes of CO₂ equivalent
- Reporting requirements can be satisfied via regulatory requirements or environmental impact assessments
- Public disclosure of alternatives analysis and project-level emissions is not firmly required; Annex A to the Principles states that public disclosure “may not be appropriate”

Major Takeaways

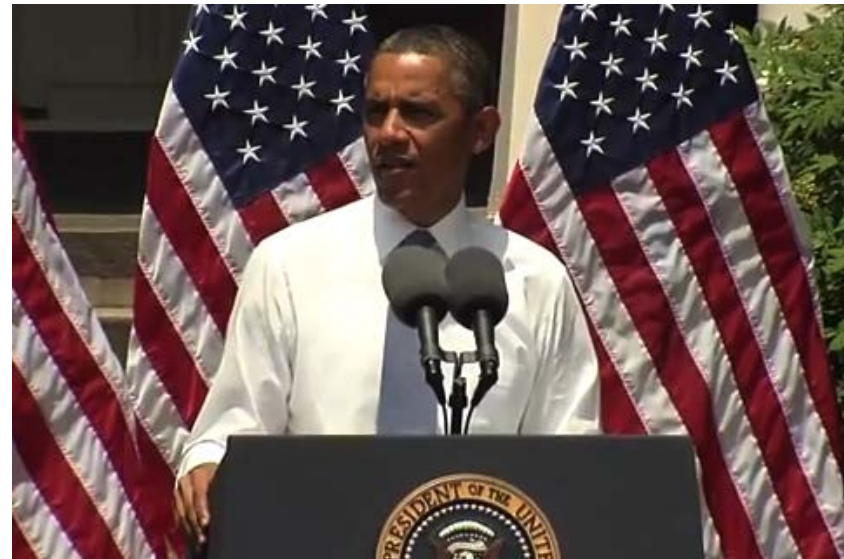
- The updates to the Equator Principles (*i.e.* EP III) takes climate change issues into account principally in terms of disclosure and alternatives analysis
- The changes thus bring the Equator Principles more in line with other prevailing international environmental and social guidelines including the IFC Performance Standards

**President Obama's Newly-Released
Climate Action Plan and its
Implications for New Greenhouse
Gas Standards for Power Plants and
Incentives for Carbon Capture and
Sequestration (CCS) Projects**

**Presented by: Marc Campopiano and
Stacey VanBelleghem**

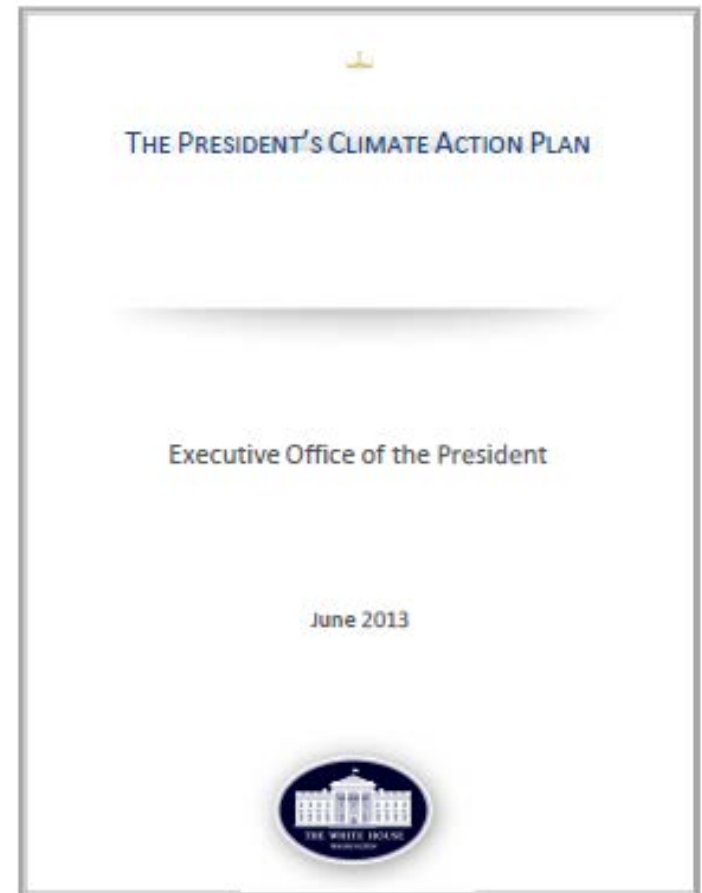
President Obama's Climate Announcement

- On June 25, 2013, President Obama announced his Climate Action Plan
- Action Items to Reduce CO₂ Emissions:
 - *Deploy Clean Energy*
 - Build 21st Century Transportation Sector
 - Cut Energy Waste
 - Reduce other GHGs
 - Lead at the Federal Level
 - *Cut Carbon Pollution from Power Plants*



Climate Action Plan directs EPA to complete CO₂ standards for new and existing power plants:

- building on state leadership
- providing flexibility
- taking advantage of a wide range of energy sources and technologies



June 25, 2013 Presidential Memorandum to EPA: Power Sector Carbon Pollution Standards

- Establishes timeline for EPA action
- Confirms that EPA will re-propose its standards for new power plants
- Directs EPA to establish guidelines under CAA § 111(d) for existing power plants



Administration's regulatory approach:

- *Massachusetts v. EPA*, 549 US 497 (2007)
- Endangerment and Cause or Contribute Findings
- Subsequent EPA stationary source-related interpretations
- **CAA § 111(b)**: “standards of performance” for new sources
- **CAA § 111(d)**: directing EPA to establish regulations outlining procedure (“guidelines”) by which states submit plans to establish “standards of performance” for existing plants
- **CAA § 111(a)(1)**: “degree of emission limitation achievable through the application of the best system of emission reduction which (taking into account the cost of achieving such reduction and any nonair quality health and environmental impact and energy requirements) the Administrator determines has been adequately demonstrated.”

What we know from the President's Plan and Memorandum:

1. EPA is directed to re-propose the rule, so we know will not be finalized as originally proposed in April 2012.
2. Deadline for re-proposal is September 20, 2013.
3. EPA sent the re-proposed rule to OMB for interagency review on June 28, 2013.

What we do not yet know:

1. What the re-proposal will look like and how it will differ from original proposal (i.e. single-fuel standard, or separate standards for natural gas- and coal-fired plants, how it addresses CCS, etc.).
2. What the actual standard or standards will be.

What we know from the President's Plan and Memorandum:

1. EPA will issue guidelines for CO₂ standards for existing power plants under CAA § 111(d); EPA is directed to propose by June 1, 2014, finalize no later than June 1, 2015, and require states to submit their plans under 111(d) by June 30, 2016.
2. Memo emphasizes engagement with states and stakeholders.
3. Memo directs EPA to consider cost, reliability, building on state efforts, and promoting clean technology and energy efficiency.
4. Memo directs EPA (to the extent possible) to develop approaches that “allow the use of market-based instruments, performance standards, and other regulatory flexibilities.”

The President's announcement and Memorandum leave many unanswered questions, and the dialogue that will likely follow the announcement will shape EPA's actions.



- The NCC--a Latham-facilitated, multi-industry coalition—has developed a detailed proposal for a regulatory program under 111(d). Recommendations include the following:
- EPA’s guidelines should:
 - express performance as an emissions rate (*i.e.*, carbon intensity);
 - sub-categorize sources according to fuel and technology type;
 - only mandate reductions based on emission reduction opportunities at the stationary source;
 - allow inter-source and inter-state emissions averaging, banking and trading.
- EPA should establish uniform credit-generation protocols for state crediting of qualified voluntary activities [*e.g.*, demand-side efficiency, renewable power, energy storage, carbon capture and sequestration (CCS)].
- EPA should establish a Model Rule, with building block components, that provides states the option of participating in an interstate trading program.

- EPA should identify alternative (*i.e.*, equivalency) paths states may use to demonstrate that existing or proposed state programs meet EPA guidelines.
- EPA should determine an appropriate mechanism for rewarding fuel switching and unit retirements and include it in the Model Rule.
- EPA's Model Rule should include a ceiling-price alternative compliance payment to fund state-directed cleantech investment as a safety valve if compliance costs are higher than anticipated.

Please email Stacey VanBelleghem, at the contact information provided on the last slide, for a copy of the full text of the NCC proposal.

How much detail will EPA provide in guidelines to the states? Will EPA provide a model rule?

- EPA's section 111(d) implementing regulations lay out detailed information that should be provided to the states to support their plans.
- There are benefits to uniformity in state programs.

If EPA provides uniform and detailed national guidelines, would EPA set up a trading framework for state election?

- The President directed EPA to develop approaches that “allow the use of market-based instruments...and other regulatory flexibilities.”
- EPA's previous rate-based programs have included averaging, banking and trading components .

Will EPA's guidelines be fuel-specific or fuel-neutral?

- There was strong opposition to the fuel-neutral standard proposed for new sources under CAA § 111(b) in April 2012 .
- EPA's implementing regulations provide for subcategorization, when cost or physical limitations support it. 40 C.F.R. § 60.22(b)(5).

How will EPA treat existing state programs?

- President's remarks noted that some states have implemented or are implementing market-based programs to reduce carbon emissions and that he is directing EPA to "provide flexibility to different states with different needs."
- The Memorandum directed EPA to "build on State efforts to move toward a cleaner power sector."

Will EPA set a tonnage emissions budget for each State?

- Unlike the criteria pollutant context, EPA lacks any air quality basis to set state budgets for CO₂.
- Energy markets are regional.

What, if any, implications will other EPA rules have on EPA's approach here?

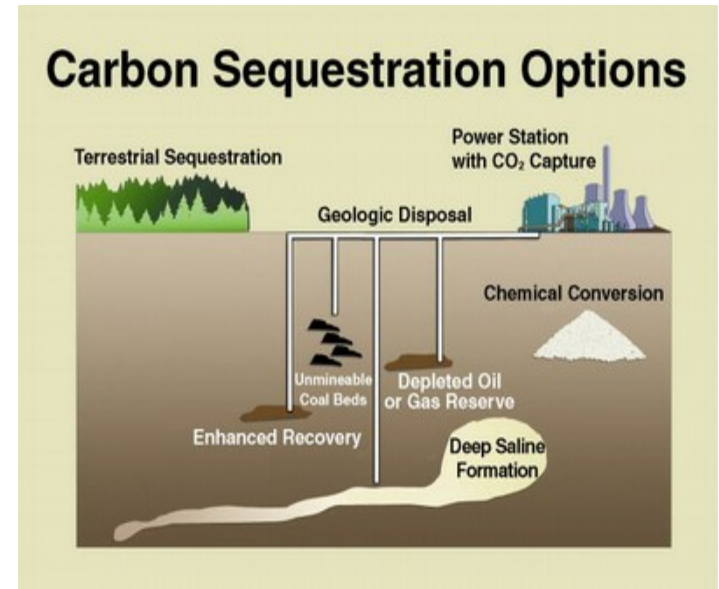
- Power plants are facing a number of other EPA rules that may require investments and upgrades.
- EPA should consider the interaction of its guidelines with the New Source Review program.

Must EPA promulgate a separate “modified unit” rule under section 111(b) or can it address modifications under section 111(d)?

- EPA can avoid duplicative programs by covering unit modifications through its existing source program under 111(d).

CCS generally involves:

- capturing CO₂ from stationary emission sources
- transporting the CO₂ to a storage site and pumping it underground
- using the CO₂ as a commodity or reacting it with other compounds



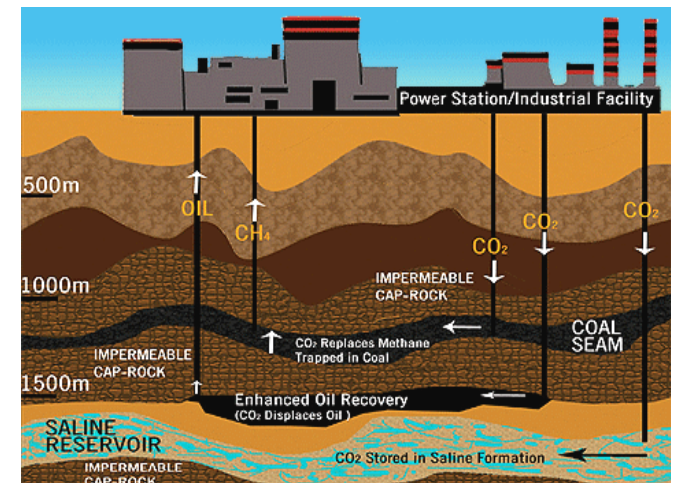
Source: <http://www.globalccsinstitute.com/ccs/what-is-ccs>, <http://meic.org/issues/montana-coal-facts/coal-plants-in-montana/carbon-capture-and-sequestration-in-montana/>

- CCS played an important role in previously proposed GHG NSPS. EPA identified CCS as a compliance alternative for new coal-fired power plants.
 - EPA recognized that CCS might not be available to new plants, even assuming financial subsidies would be available (which were not guaranteed).
- Commenters: CCS is not proven to be commercially available, creating a practical ban on new coal power plants.
- How will CCS factor into new rule?

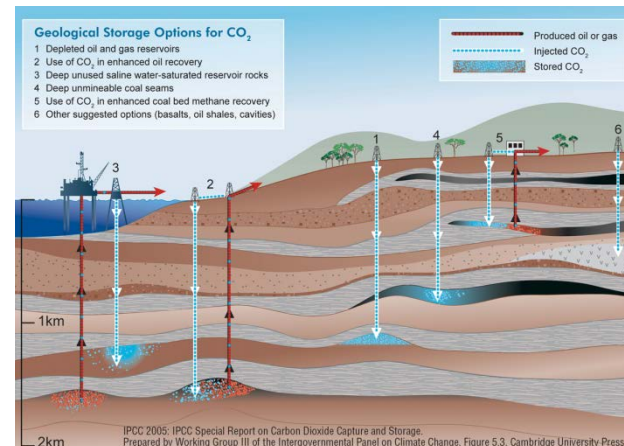


The plan supports CCS by:

- Making \$8 billion in loan guarantee authority available for advanced fossil energy projects.
- Limiting governmental support for public financing of most new overseas coal plants unless the facility uses CCS.
- Continuing to work with China and other countries to advance the development and deployment of CCS.



- Complimentary report issued on June 26, 2013: US Geological Survey determined that the United States has the potential to store a mean of 3,000 metric gigatons of CO₂ in geologic.
- Interior Secretary Sally Jewell: Report is “groundbreaking.”



- EPA proposed rule that would exempt CCS from RCRA requirements.
- Industry comments: Creates regulatory uncertainty for joint Enhanced Oil Recovery (EOR) and CCS projects. Sought broader exemption.
- DOE Secretary Moniz recently touted benefits of EOR to increase oil production and support CCS.
- Final EPA rule expected in July or August 2013.



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