GLOBAL CLIMATE CHANGE FORUM

LATHAM & WATKINS LLP

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GLOBAL CLIMATE CHANGE NEWS

DOMESTIC DEVELOPMENTS

Climate Coalition Prepares for Launch of Rapid Deployment Proposal for a Low Carbon Technology Solution in California

The California Climate Coalition – a group of proven companies in the transportation, energy, industrial and renewable technology sectors – is preparing to launch California First, a rapid deployment proposal designed to accelerate investment in low-carbon technologies and infrastructure within the overall context of the market-oriented regulatory program envisioned by the California Global Warming Solutions Act of 2006 (AB 32). (Latham & Watkins represents the California Climate Coalition.) Advanced low-carbon technology will be critical to meeting California Governor Arnold Schwarzenegger's goal of reducing global greenhouse gas (GHG) emissions and shrinking California's carbon footprint to 1990 levels by 2020, while protecting and growing the California economy.

The California First rapid deployment proposal can stimulate investment in GHG-reducing technology before AB 32 goes into effect in 2012. AB 32 proposes to establish a baseline "cap" for total GHG emissions in California as of 2012, which will shrink over time. By 2020, the cap will decrease to the point that it will equal California's 1990 GHG emissions. By regulation and, if the California Air Resources Board (CARB) adopts a market program, through the allocation of emission allowances, emitters will be required to reduce their carbon footprints in order to meet the decreasing cap. To ensure that effective and reliable low-carbon technology is available to meet the needs of California's growing economy, the California First proposal encourages CARB to adopt a three-stage strategy for accelerating advanced technology deployment.

The three-stage strategy allows for a steady progression towards the successful implementation of low carbon technology in the

Other Domestic Developments

New Jersey and Florida Develop Plans to Cut GHG Emissions
New Jersey became the third state, behind California and Hawaii, to sign a law setting a statewide goal for reducing GHG emissions. The legislation, which will be implemented in parallel with the state's long term energy plan, calls for reducing GHG emissions by 20 percent to 1990 levels by 2020 followed by a further reduction to 80 percent below 2006 levels by 2050. Following on the heels of New Jersey's announcement, Florida's governor has created a task force to draft recommendations on ways to achieve an aggressive statewide emissions reduction plan. The plan calls for reducing GHG emissions in the power sector to 1990 levels by 2025 and by 80 percent of 1990 levels by 2050. In addition, Florida's governor recently announced that Florida, Germany and the United Kingdom are committed to working together to secure a global treaty to control GHG emissions after the Kyoto Protocol's 2012 commitment period expires.

Senators Join Forces to Draft Cap-and-Trade Bill
The US Senate moved closer to adopting climate change legislation in June when Senators John Warner (R-Va.) and Joseph Lieberman (I/D-Conn.) joined forces to draft a cap-and-trade bill focused on reducing US GHG emissions. The senators plan to have the bill ready for review by the global warming subcommittee of the US Senate Environment and Public Works Committee prior to the August recess. The bill would join several other pieces of legislation introduced in this Congress, including the recently unveiled legislation co-sponsored by Senators Jeff Bingaman (D-N.M.) and Arlen Specter (R-Pa.), S 1766; a bill proposed by Senators Barbara

state of California earlier than what is required by AB 32. By following the strategy outlined in California First and designing an initial technology selection process, CARB can immediately provide entities that promptly invest in low carbon or GHG-reducing technologies with initial emission allowances. The emission allowances can be based on a combination of criteria such as the dollar amount invested, the anticipated GHG reduction, and the likelihood of success.

Following the initial investment stage, CARB would develop validation protocols for the advanced technologies that reliably produce quantifiable GHG reductions, providing early adopters of these proven technologies with GHG-emission reduction credits (i.e., offsets) that could be banked or traded on the open market. Finally, after AB 32 is operational, the emissions-trading program established by CARB can be linked with other jurisdictions and integrated with other national and international climate change initiatives to fulfill AB 32's intent to combat global climate change.

Overall Impact

The California First proposal is designed to provide companies with a high-confidence path for receiving credit for early action. By ensuring California-serving strategic investments and an appropriate degree of scarcity in the program's allowances during the early years, it would make it unnecessary for the state to implement a more costly auction approach. The program would enhance California's position as home to the world's most innovative energy and transportation technologies while reducing the state's GHG emissions and carbon footprint. In addition, for many of the anticipated early projects, California First would provide local communities with the substantial co-benefit of cleaner, healthier air through the prompt reduction of combustion-related pollution, such as diesel particulate matter and nitrogen oxides, an ozone precursor.

For more information about the activities of the California Climate Coalition, contact Robert Wyman at Latham & Watkins at +1.213.891.8346.

Boxer (D-Ca.) and Bernard Sanders (I-Vt.), S 309; a separate bill proposed by Senator Lieberman with Senator John McCain (R-Ariz.), S 280; and a fourth bill spearheaded by Senators John Kerry (D-Mass.) and Olympia Snowe (R-Maine).

Automakers Join Coalition to Support US Cap-and-Trade Legislation
On June 27, the Chrysler Group and Ford Motor Company announced their intent to join the US Climate Action Partnership. The Partnership is a group of businesses and leading environmental organizations that have come together to call on the federal government to enact national legislation to require significant reductions of GHG emissions. Other members include General Motors Corporation, Alcoa, Boston Scientific Corporation, BP America, Caterpillar, Dow Chemical Company, DuPont, General Electric, PG&E Corporation and Shell.

Senate Committee Directs EPA to Issue Rule on Reporting GHG Emissions
In the wake of the US Supreme Court decision in *Massachusetts v. EPA* (U.S., No. 05-1120, 4/2/07), the Senate Appropriations Committee approved a provision in a spending bill requiring EPA to issue a final rule within the next 18 months requiring businesses across the US to report GHG emissions. The legislation requires the EPA to publish a proposed rule by April 2008 and a final rule by December 2008. It will apply to all industry sectors, but EPA has the authority to determine the appropriate level of emissions above which reporting will be required.

INTERNATIONAL DEVELOPMENTS

Increased Activity on International Climate Change Negotiations Following The G8 Meeting

World leaders attending the June 2007 G8 Summit in Germany took up the issue of climate change and the prospect of a new international agreement following the end, in 2012, of the mandatory caps

Short Takes

- The European Climate Exchange (ECX) will launch Certified Emissions Reduction (CER) futures and options contracts, subject to regulatory approval, in September providing those companies participating in the EU ETS with another regulated exchange offering CER trading. Osloset by the Kyoto Protocol. Although there was no consensus on post-2012 reductions, the parties adopted a negotiation schedule under which they agreed to put post-2012 commitments in place by 2009. The pace of international negotiations will accelerate over the next year as countries put post-2012 options on the table.

Outcome of the G8 Summit

Prior to the recent G8 Summit, President Bush called for a meeting of the major emitting nations to set a long-term "aspirational" goal for reducing emissions. At the same time, the President continued to oppose mandatory emissions caps and advocated an international framework under which countries would adopt non-binding national reduction targets reflecting their individual circumstances. At the June Summit, members of the G8 pressed for a binding goal of reducing worldwide emissions by 50 percent by 2050. After resisting this goal, the US ultimately agreed to "consider [it] seriously." The G8 also called on all parties to participate actively in the UN climate process with the goal of agreeing on a new global framework by the end of 2008, which would include all major emitters (developing as well as developed countries).

Where the Major Emitters Stand

Notwithstanding the consensus that an agreement on post-2012 reductions must be reached, perspectives among the major developed countries on the nature and scope of new climate change commitments differ substantially. The European Union, in particular France, Germany and the United Kingdom, are proponents of a post-2012 global cap-and-trade system modeled on the Kyoto framework with aggressive reduction targets. For example, Germany is aiming for a 40 percent reduction in GHG emissions by 2020, while the UK anticipates adopting emissions reduction targets of 26 to 32 percent by 2020 and 60 percent by 2050. Japan also favors aggressive reduction targets, but not cap-and-trade programs or other mandatory measures; instead, the Ministry of Economy, Trade and Industry proposes to achieve reduction targets through energy conservation, promotion of innovation and voluntary reductions. Australia, which declined to sign the Kyoto Protocol, has recently shifted ground and now supports a global emissions trading system. The US government supports neither mandatory reduction targets nor emissions trading, although both the US House and Senate are considering legislation with both elements.

In contrast to the negotiation of the Kyoto Protocol in the late 1990s, all of the developed nations are stressing the importance of obtaining reduction commitments from China and India and, possibly, other developing countries. This change is the

based Nord Pool has offered CER credits since June 1, 2007. The futures and options contracts provide companies with the opportunity to receive a locked-in price for project-based contracts delivered at pre-specified dates in the future. By utilizing the futures and options contracts exchange, companies can reduce their financial risk by securing transparent prices at the start of a project.

- The European Commission announced its plans to launch the Clean Sky Joint Technology Initiative (JTI), a €1.6 billion public-private research initiative, to reduce GHG emissions in the EU caused by aviation emissions. The program aims to reduce airline carbon dioxide emissions by 40 percent, nitrous oxide emissions by 60 percent and aircraft noise by 50 percent by 2015. The program, funded equally by industry and the EU's main research instrument, the Seventh Research Framework Program, will have six subprograms covering fixed-wing aircraft, regional aircraft, helicopters, engine technologies, air traffic control and ground management, and raw materials and components.

- A report by Ernst & Young and York Aviation shows that the inclusion of aviation in the EU emissions trading scheme could cost the industry more than €45 billion from 2011 to 2022, potentially reducing aircraft operators' profits by more the €40 billion during the same period. These findings suggest that the inclusion of aviation as a key carbon dioxide emitting sector in the EU emissions trading scheme potentially could have significant economic impacts on the European aviation industry.

- The EU Commission has adopted a comprehensive strategy aimed at reducing carbon dioxide emissions from new cars and vans sold in the EU. The new strategy, combined with a revision of the EU fuel quality standards, strengthens the EU's commitment to reducing GHG emission targets under the Kyoto Protocol. Under this strategy, emissions from new cars and vans will create 25 percent less carbon result of the dramatic rise in emissions and rapid economic growth in China and India. However, a large gulf separates the developed and developing nations. Brazil has recently expressed a desire to negotiate post-2012 GHG emissions reduction strategies. China and India, however, have expressed their unwillingness to accept any international agreements requiring mandatory emissions reductions. China has asserted that it is unfair for developing nations to shoulder equal responsibilities with developed nations, when the latter have already reaped the benefits of economic growth. However, with the recent release of China's first national strategy on climate change, the nation appears to recognize the importance of responding to climate change in some manner. India also believes that the onus for reductions rests with developed nations, but is open to receiving technical assistance and training to facilitate emissions reductions and may be willing to discuss post-Kyoto international commitments.

What the Future Holds

In the next year, leading up to the 2008 G8 Summit in Hokkaido Toyako, Japan, there will be several important international meetings aimed at discussing different aspects of global climate change. Ranging from bi-lateral discussions to large multi-lateral conferences, these meetings will provide opportunities to lay the groundwork for an international agreement. Major meetings will include: a gathering of heads of state hosted by the UN Secretary General in September; the UN Conference of the Parties to the Framework Convention in Bali, Indonesia in December; and a meeting of major emitting nations hosted by the US in November or December.

European Union Emissions Trading System (EU ETS) Update

Proposed Amendments to National Allocation Plans

In an effort to retain the integrity of the EU ETS, the European Commission continues to adjust the total number of carbon credits for Phase Two of the Kyoto Protocol, set to begin in 2008. The initial allocations in Phase One included grants of carbon allowances that exceeded actual emissions, resulting in windfall profits for parties that received over-allocations. The Commission has committed itself to addressing this problem, and recently announced its rulings on proposed amendments to the second phase National Allocation Plans (NAPs) of Ireland, Latvia, Lithuania, Luxembourg and Sweden.

Under the rulings, the Commission approved Ireland's increase of total allowances awarded to industry for the 2008-2012 trading period to 22.3

dioxide emissions than those manufactured previously. To encourage manufacturers to adopt this new strategy, the Commission invited the manufacturers to sign an EU code of good practice on car marketing and advertising.

- The United Nations Framework Convention on Climate Change (UNFCCC), the organization responsible for issuing carbon credits to CDM and JI projects, has awarded a total of 62.7 million credits from 295 issuances. Recently, UNFCCC awarded more than 140,000 CERs to two separate projects – a biomass project in India received more than 111,000 CERs and a hydroelectric project in Ecuador received more than 31,500 credits.

- Norway has proposed establishing a fund to reduce emissions from sea transport by offsetting the sector's GHG emissions through Kyoto project mechanisms. The fund would be financed by ship owners. The environment committee of the International Maritime Organization continues to revise a resolution adopted in 2003 to address GHG emissions from ships as well as sulphur, nitrous oxide emissions and volatile organic compounds which are responsible for 2 to 3 percent of global GHG emissions.

- The Russian Federation recently adopted national procedures and guidelines to promote the use of the Kyoto Protocol's Joint Implementation (JI) Mechanism. By adopting these procedures and guidelines, Russia can submit its first 25 emission reduction projects to the UNFCCC JI approval process. The reduction of greenhouse gases through Russian JI projects potentially could generate more than 65 million tons of CO_2-equivalent over five years beginning in 2008.

- The EU and Japan have announced their commitment to take a lead in securing post-2012 GHG reductions under the Kyoto Protocol. The goal is to have the world's eight largest economies commit to limiting global temperature increases to two degrees Celsius and reducing GHG emissions million tons, an increase of 1.18 million per year. However, Ireland must reduce its Joint Implementation (JI) and Clean Development Mechanism (CDM) limits. As a result, Ireland will only be able to use carbon credits to meet 10 percent of its second phase emissions quota rather than its previously requested 20 percent. The Commission also increased Latvia's total number of allowances by .04 million, taking its total annual allocation to 3.43 million. Latvia's carbon credit limits were also increased from 5 to 10 percent. Neighboring Lithuania will see an increase only in its carbon credit allowances, from 8.9 to 20 percent.

globally to 50 percent below 1990 levels.

At the same time that the Commission marginally increased the allowances for Ireland, Latvia and Lithuania, it dismissed Sweden's request for an increased allocation plan. Sweden had questioned the Commission's methodology in determining the annual allocation levels, arguing that the country's 2005 emissions were lower than normal due to wet and warm weather, allowing increased hydroelectric levels and suppressing typical power demands. The Commission rejected Sweden's proposed increase, however, and cut its total allocation plan to 22.8 million per year. Despite the rejection, the Swedish environment minister accepted the Commission's decision in part because of a recognition that a lower allocation is necessary to sustain the carbon market, as well as to decrease overall European emissions.

Unlike Sweden, several member countries have not accepted the Commission's decision to reduce the total number of allocations in Phase Two. The Czech Republic, Poland, Hungary, Slovakia and Estonia have announced intentions to take the Commission to court over the number of allocations the Commission approved. Each of the countries is seeking a higher carbon budget for Phase Two after seeing their total budgets cut by a combined 117 million allowances per year, a 24.2 percent total decrease, under the Commission's proposed plans.

A Change of Season?

In addition to reviewing proposed amendments to Phase Two NAPs, the Commission is in the process of developing proposed changes to the EU ETS that are likely to be presented towards the end of the year. These changes, which are part of the effort to ensure a more viable carbon market, will include a proposal on how differing Member States should contribute to meeting the overall EU target of reducing greenhouse gas emissions by at least 20 percent by 2020. In addition, the Commission is likely to recommend that the total allocation be set at European levels then distributed to countries and sectors, doing away with the individualized process of National Allocation Plans.

CDM/JI Update

As of July 10, 2007, the CDM Executive Board has registered 729 CDM/JI projects and rejected 20. An average of nearly 153 million CERs are expected to be generated from the registered projects, with more than 970 million CERs expected by 2012. India continues to lead as host country for CDM projects accounting for a little more than a third of the total projects, with 255 registered, followed by Brazil (103 projects), China (93 projects) and Mexico (89 projects).

Overall, the majority of the approved projects involve either energy production or waste handling and disposal. In India, renewable electricity generation projects continue to dominate. Brazil is moving forward with several renewable and cogeneration energy projects, as well as a number of projects that capture methane via animal waste management practices. In recent months, China has seen an increase in approved CDM projects with more than half involving wind farms and other renewable energy projects. China's approved projects are expected to create a 42 percent average annual reduction – the most of any country to date.

Methodology Update

In the May 2006 edition of *Global Climate Change News*, we reported that the CDM Executive

Board had approved only one baseline and monitoring methodology for an Afforestation and Reforestation project, and that there had yet to be an Afforestation or Reforestation project registered with the Executive Board.

Over the course of the year, the CDM Executive Board has approved seven large scale methodologies for Afforestation and Reforestation projects, and one forestry-related project has been registered with the Board – a reforestation project in watershed areas along the Pearl River Basin in the Guangxi Province of China.

Global Warming and the Future of Coal: The Path to Carbon Capture and Storage

The Center for American Progress recently released a report entitled “Global Warming and the Future of Coal: The Path to Carbon Capture and Storage” co-authored by Robert Sussman, a partner in Latham & Watkins’ Washington, D.C. office and former Deputy Administrator of EPA. The report analyzes policy tools to be utilized in developing a comprehensive legislative plan to begin the capture and storage of the carbon dioxide produced by coal combustion so that new coal plants do not worsen global warming. The policy tools discussed and evaluated in the report include a variety of potential regulatory approaches, including a cap-and-trade program; carbon taxes; defining carbon capture and storage (CSS) systems as a so-called Best Available Control Technology for new power plants under the Clean Air Act’s New Source Review program; establishing a “low carbon portfolio” standard that would require utilities to provide an increasing proportion of power from low-carbon generation sources over time; and identifying an “emission performance” standard that would limit carbon dioxide emissions from new coal plants.

This report will likely play an important role in shaping the debate on the impact of climate change legislation on industry and the responsibility of industry to invest in advanced coal technologies. To download a free copy of the report, click here.

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