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Welcome to the Dentons' Climate Change Newsletter. Combining our regional practices from around the world, we intend in upcoming newsletters to provide short articles from several of our offices to present an overview of current developments globally in the climate change space. Please do not hesitate to reach out to any of these authors, to any member of the Environment and Natural Resources practice or to our Energy group for information on these or other topics of interest.

Topics

- The UN Climate Conference
- Structural reform of the EU ETS
- Canadian provinces continue to take the lead on climate change initiatives
- New guidance on consideration of climate issues in US projects
- President Obama seeks to build a climate legacy

The UN Climate Conference

By Jeffrey Fort and Susan Wood

Readers of this newsletter have no doubt already read or heard about the UN Climate Conference which concluded two days later than scheduled, early on Sunday, December 13, 2014. Rather than repeat, we wish to call to your attention a few key take-aways from this 20th Conference of the Parties (COP).

1. This COP was designed to establish a framework for a new global agreement (something less than a treaty) to succeed the Kyoto Protocol. Some would say the Lima COP met that expectation, but there are still very many issues to be negotiated and resolved by the Paris COP in December 2015.
2. The US – China agreement (discussed below) became the model for one of the key agreements reached. Each country is expected to set forth what it can do to help the globe stay within the 2°C increase which is the scientific consensus for the maximum tolerable increase in global temperatures to maintain the current climate conditions (Intended Nationally Determined Contributions). The goals become a bottom-up approach augmented by public perception. It leaves the decision on "how much" and "how to" to each country.
3. A draft negotiating text for the expected 2015 agreement was finalized, but the negotiations are just beginning.
4. Many were disappointed that the avoided deforestation topic (REDD+) did not proceed further, after strong commitments from the Warsaw COP. A key issue remains in how to involve private capital in this effort, a topic

covered by a side event which Dentons sponsored (see below).

5. A new financing device, the Green Climate Fund, received substantial commitments from several developed countries, totaling over US\$10 billion. This GCF is a tool for the financing of developing countries for clean energy and climate protection measures using resources of developed countries. The split of countries into Annex I and "other" countries is receding but moving into debates on financing of development projects. The terms and governance for this GCF are in early stage.

In this context, Dentons sponsored two "side events" in the delegate space with the International Emission Trading Association. Jeffrey Fort (Chicago) and Susan Wood (Houston) presented.

Cambodia carbon credits

The use and need for REDD+ projects was featured in many discussions and side events at this COP. The Oddar Meanchey (Cambodia) project has earned not only REDD and CCSB recognitions (including double gold validation), it captured the attention of The American Lawyer, a magazine focused on the global legal business. As noted in our last newsletter, Dentons was honored as "Citizen of the Year" for its pro bono work for the Forestry Administration of Cambodia.

This project provides several instructions on the measures needed to take a bottom up project, which the national government then captured and focused onto a single province, and create a tool for bringing those credits to verification and to a private CSR market, as well as to government buyers. Begun several years ago, it is an exemplar of initiatives and collaboration among private and public sectors.

Offset for taxes and fees

Offsets are not simply for cap-and-trade systems. Offsets are growing in variety and utility for emissions reductions. They are also increasingly being used (or considered) by national and sub-national governments who are implementing a range of market mechanisms to tackle climate and reach greenhouse gas targets. This session featured speakers covering six jurisdictions who are using or preparing to use carbon offsets under non cap-and-trade programs worldwide: three Canadian provinces, South Africa, Mexico and the Ukraine. The outlook from this panel would suggest that the certainty of carbon pricing with a sensibly set fee or tax had many benefits, including taking advantage of non-regulated activities to produce more cost-effective reductions than simply an added cost on covered sectors. These "hybrid" market approaches to reducing emissions and nurturing market links and entrepreneurs may become more common in the near term.

Structural reform of the EU ETS

By Helen Bowdren

In Europe, discussions continue in relation to structural reform of the European Union Emissions Trading System (EU ETS). The EU ETS has a growing surplus of carbon credits, estimated at over 2 billion allowances. This has led to a collapse in carbon prices, and reduced incentive on participants to reduce emissions. The European Commission has proposed two measures to address this:

Backloading

As a short-term measure, the Commission is postponing the auctioning of 900 million allowances until 2019-2020 to allow demand to pick up. This "backloading" of auctions is being implemented through an amendment to the EU ETS Auctioning Regulation. Back-loading does not reduce the overall number of allowances to be auctioned during phase 3, only the distribution of auctions over the period. In 2014 the auction volume will be reduced by 400 million

allowances, in 2015 by 300 million and in 2016 by 200 million.

Proposal for market stability reserve

As a more long-term solution, the Commission proposes to also establish a market stability reserve (MSR) at the beginning of the next trading period in 2021. The MSR will reduce the amount of EU Allowance Units (EUAs) that are auctioned if an upper threshold of EUAs in circulation is exceeded and releases them if the EUAs in circulation fall short of a lower threshold. The change in auctioning volume is triggered by the volume of banked credits, not by credit prices. The Commission put forward a proposal in January 2014. Both the European parliament and the EU Council, representing the EU 28 national governments, have to agree a common text before the proposal can become binding. Not all EU Member States are in favor of the MSR, either in its proposed form or at all.

The UK Government supports the introduction of an MSR and calls for:

- Implementation by 2017, to urgently address the surplus.
- Backloaded allowances to be cancelled and/or enhancement of the proposed mechanism to smooth auction volumes so that backloaded allowances are placed directly into the reserve.
- Amendments to ensure allowances are retained in the reserve under "business as usual circumstances" and therefore remain available to provide protection against insufficient liquidity and prices rising too quickly should these occur in the future.

Canadian provinces continue to take the lead on climate change initiatives

By Alex MacWilliam

In the absence of recent activity at the federal government level, Canadian provinces continue to take the lead on climate change initiatives. In late November, Canada's two most populous provinces, Ontario and Quebec, issued a Memorandum of Understanding in which they agreed to collaborate on "concerted climate change actions" said to include harmonizing data collection and GHG reporting requirements, exploring the use of market based mechanisms in Ontario, sharing knowledge and promoting the transition to a low carbon economy through initiatives such as setting a price on carbon and adopting cleaner fuel standards. The MOU also says the two provinces will strengthen joint efforts to increase collaboration with the government of Canada and provincial and territorial governments. The MOU specifically states that it does not create legally binding obligations on Ontario and Quebec and it may be terminated by either province on two months' notice.

In early December, on the eve of the COP20 negotiations in Lima, the governments of Ontario, Quebec and British Columbia, together with the government of California, United States issued a "Joint Statement on Climate Change" in which they stated they will collaborate on mid-term greenhouse gas emissions reductions to maintain momentum toward 2050 targets. Ontario also announced that this year it will release a comprehensive action plan to reduce emissions.

Meanwhile in Alberta, the government has just extended the Specified Gas Emitters Regulation to the end of June 2015. The regulation has been in place since 2007 and provides the framework for requiring the reduction of GHG emissions intensity levels from large industrial emitters. In addition to being necessary to maintain the regulatory framework, the extension was said to "ensure the smooth transition from the current strategy to the new framework

expected be in place in the new year". Alberta says it is currently "exploring options to address climate change". No indications have been given as to what those options include.

New guidance on consideration of climate issues in US projects

By Matthew Adams

The White House Council on Environmental Quality (CEQ) has proposed guidance to federal agencies regarding agency analyses of climate change under the National Environmental Policy Act (NEPA). The guidance replaces a prior draft that was issued in 2010 but never finalized.

NEPA mandates that federal agencies identify, evaluate and disclose to the public the environmental consequences of their proposed actions and consider reasonable alternatives thereto. The Act applies to virtually all discretionary federal decision-making — everything from general federal land management planning processes to the permitting of specific private energy generation and transmission projects.

Federal agencies are legally responsible for compliance with NEPA. But, as a practical matter, the Act's compliance costs and litigation risks are frequently borne by private project developers who have applied for federal permits.

For example, earlier this year the United States District Court for the District of Colorado invalidated a pair of mining lease approvals granted to private developers because the relevant federal agencies (there, the United States Forest Service and Bureau of Land Management) had failed properly to address climate change issues in their NEPA documents (*High Country Conservation Advocates v. United States Forest Service*, D. Col. Case No. 13-cv-1723).

The proposed guidance attempts to improve the efficiency and consistency of agencies' NEPA reviews (and, indirectly, to increase certainty for private project proponents) by setting forth a detailed series of instructions for addressing climate change in NEPA documents. Key aspects of the proposed guidance include the following:

- The guidance recognizes that many federal agencies have concluded that their actions will have little impact on climate change because they are a small percentage of total greenhouse gas emissions, and warns that boilerplate statements along these lines are not sufficient to satisfy NEPA: "[T]he statement that emissions from a government action or approval represent only a small fraction of global emissions is more a statement about the nature of the climate change challenge, and is not an appropriate basis for deciding whether to consider climate impacts under NEPA."
- The scope of an agency's analysis of climate change should not be limited to direct greenhouse gas emissions from specifically-permitted federal actions; analyses must also address upstream and downstream activities bearing a "reasonably close causal relationship" to those actions.
- The guidance affirms a "rule of reason" (for which there is also support in case law) granting agencies considerable discretion to determine the nature and extent of their NEPA analyses. At the same time, however, the guidance clearly states that proposed actions with the potential to result in more than 25,000 MT CO₂e per year should be the subject of quantitative analysis.
- NEPA analyses prepared in connection with federal land management decisions (e.g., leasing plans, resource management plans, etc.) should address biogenic sources of greenhouse gas emissions.

Although CEQ's NEPA guidance is not a rule or regulation within the meaning of the Administrative Procedure Act, it is "persuasive" authority applicable to all federal agencies. And, in a somewhat unusual move, CEQ has "encouraged"

agencies to apply the proposal to on-going NEPA reviews. There is no published timetable for finalizing the proposed guidance.

Dentons specializes in NEPA compliance and litigation for a broad range of infrastructure, energy and economic development projects. Our team includes the lead draftsman of NEPA's implementing regulations, and no NEPA document on which we have advised has ever been overturned in court.

President Obama seeks to build a climate legacy

by James Rubin and Jeff Lane

In his January 20, 2015 State of the Union address, President Obama stated, "And no challenge - no challenge - poses a greater threat to future generations than climate change." To meet this challenge, the President and his Administration are constructing a broad set of regulatory programs and agreements to reduce greenhouse gas (GHG) emissions, seeking to build a lasting legacy on addressing the challenge of climate change. It may be up to a new Congress, and, more likely, the federal courts to determine how lasting that legacy may be.

International agreements

On November 12, 2014, President Obama and Chinese President Xi Jinping jointly announced an agreement on reducing GHG emissions from their two countries by 2030, including new targets for emissions reductions by the United States and a first-ever commitment by China. The agreement, negotiated quietly through high level contacts, was intended to spur other nations, particularly in the developing world, to make their own cuts in GHG emissions as part of a new global agreement to be reached next year in Paris. The United States committed to reducing GHG emissions by 28 percent from 2005 levels by 2025, an increase in the reduction goal the President had set out in 2009. The President's recent Clean Power Plan (CPP) proposal, will be a key part of this commitment, setting a goal of a 30 percent reduction in GHG emissions from the power sector by 2030 based on 2005 emission levels.

President Obama also announced the United States will contribute US\$3 billion to the United Nations' Green Climate Fund over four years to help poor countries deal with the effects of climate change. The US pledge would take the fund a long way toward its initial investment goal of US\$10-\$15 billion.

These actions clearly had an impact at the recently concluded UN Climate COP in Lima (see above), helping to secure an agreement on a framework that could include broader participation by all nations in efforts to reduce GHGs globally. But it also engendered expected opposition from critics of the Administration's policies, many who are in power now that the newly elected Republican majorities in the House and Senate have begun their terms in 2015. The US financial commitment was already targeted by legislative riders in the waning days of last year's legislative session. Moreover, while the agreement with China is not legally binding, nor does it require congressional approval, it undoubtedly builds upon the recently-proposed CPP as well as potential measures to reduce methane leaks in oil and gas production. These regulatory programs, already highly controversial, will certainly be attacked in the new Congress and in the courts, leaving open to questions whether the United States will be able to live up to its commitments.

Regulatory programs

EPA has proposed two major regulatory pieces to reduce GHGs from the power sector under the New Source Performance Standards (NSPS) program of the Clean Air Act. The first proposal, which would place limits on GHG emissions from new fossil-fuel power plants, ("new unit rule") was originally due in final form in January 2015. It has raised significant concerns by proposing that new coal-fired plants be capable of partial carbon capture and sequestration (CCS) while new gas plants achieve the highest standards of a combined cycle natural gas plant. The

new unit rule will certainly be challenged in court upon publication, which is significant because it provides a condition precedent for regulation of GHG emissions from existing power plants. Hence, were the new unit rule to be invalidated by a court, it could potentially impact EPA's even more controversial rule, the CPP.

EPA published its proposed CPP in June 2014, setting out NSPS for GHG emissions from existing fossil-fuel power plants. In its proposal, EPA considered emission reduction strategies that went far beyond efficiency improvements at existing plants, looking at a broad range of actions across the energy sector that would reduce energy demand and so reduce GHG emissions. Based on these actions, EPA established strict targets for carbon emission rates per state to be achieved by 2030 with interim targets set in the 2020-2029 period. After extensive outreach to stakeholders, EPA provided an extended period for public comment, which ended on December 1, 2014. EPA now must consider over a million comments, many of which are very critical of the fundamental scope and authority underlying the proposal. Even EPA's staunchest allies have pressed for modifications to allow states more time and leeway to meet their 2030 targets and guidance on what actions may be acceptable, requests EPA may honor in some manner. EPA has also recently said it would issue a model rule for the CPP as guidance to states as they begin to plan for compliance and to show what requirements might apply if states do not act.

The CPP has already come under attack both in Congress and in the courts, and the new Republican majorities are likely to consider ways of thwarting both the NSPS proposals in 2015, whether through legislation, appropriation riders or congressional review act challenges. The final CPP was originally expected in June 2015, but EPA just recently announced it would publish both the new unit rule and CPP in final form at the same time by the middle of summer 2015, reflecting the volume of comments EPA must review but also the controversy surrounding the proposals and their inherent linkages. Once published, both rules will then begin to wind their inevitable way through the courts. An administration veto and split Senate may be all that protects this rule in Congress while a potential judicial resolution may not occur for several years. Since the interim target dates for the CPP may begin soon thereafter, states will need to consider how they might comply through a combination of heat rate improvements at coal plants, natural gas dispatch and increases in zero-carbon generation and energy efficiency measures, among others.

Other climate-related programs

EPA has plenty more on its plate relating to GHG regulation and emission reductions, including:

- Implementing its pre-construction permit program for GHG emissions from major industrial sources following the Supreme Court's partial reversal of its Tailoring Rule in July 2014;
- Determining how to handle carbon dioxide emissions from biomass fuel in current and potentially future GHG rulemakings;
- Determining new volumetric requirements for its Renewable Fuels Standard (RFS) program. EPA recently put off its 2014 RFS volumetric determination until early 2015, explaining that it needed to consider multiple comments to its proposal to lower statutory volume requirements for the first time in the program's history; and
- Proposing a potentially broad set of initiatives to reduce releases of the potent GHG methane from the oil and gas sector. On January 14, 2015, the White House announced it would propose regulatory and voluntary measures aimed at reducing methane emissions from the sector to between 40-45% below 2012 levels by 2025. The regulatory measures would, in the first instance, be limited to new oil and natural gas production sources and natural gas processing and transmission sources for methane while reductions from existing sources would likely be based initially on state or industry-initiated practices. Regulatory proposals are expected in the Summer.

These programs have drawn congressional scrutiny and have been or will be subjects of judicial review, so their future is just as unclear.

All of the above elements are important components to the President's Climate Change Action Plan and thus are bricks in the edifice the Administration is constructing as a lasting legacy to address climate change. But they face an uncertain future with a new Congress hostile to allegedly "unilateral" exercises of executive authority with potentially significant impacts on power pricing, reliability and economic development. The President and his Administration will no doubt be quite busy in the next two years, trying to finalize this construction while fending off multiple and continued political and legal challenges. Ultimately, like many other Administration programs, the final word may lie with the federal courts well after the President's term ends in 2016.

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