

CLEARING THE AIR: WHAT COMPANIES NEED TO KNOW IN THE ABSENCE OF 2010 FEDERAL CLIMATE CHANGE LEGISLATION

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To Our Clients and Friends:

On July 22, 2010, Senate Majority Leader Harry Reid (D-NV) announced that he would not introduce a comprehensive climate change bill in the U.S. Senate this summer. Senator Reid's decision likely means that a bill aimed at regulating emissions of greenhouse gases ("GHGs") will not be passed by Congress this year. Instead, the Senate is pursuing more limited legislation focusing on specific energy issues, including a response to the oil spill in the Gulf of Mexico. In the absence of Congressional action on climate change, GHGs will be regulated by a variety of sources at the federal, regional and state levels.

CONGRESSIONAL EFFORTS

Senator Reid reached his decision after concluding that a climate change bill did not have the 60 votes necessary for passage in the Senate. Proponents of a climate change bill had hoped Congress would pass legislation this year given that the U.S. House of Representatives had passed a climate change and energy bill, commonly known as the Waxman-Markey bill, in June 2009. The Waxman-Markey bill provided for a cap-and-trade system which capped GHG emissions and allowed companies to purchase and sell emissions allowances.

Drafts of a Senate climate change bill, including one announced by Senators John Kerry (D-MA) and Joe Lieberman (I-CT), were discussed with representatives from several industries. However, Congressional leaders decided to prioritize healthcare reform over climate change legislation, and, partly in response to concerns over the U.S. economy, postponed efforts on a Senate climate change bill.

EPA REGULATION

Regulation of GHGs. Following a 2007 U.S. Supreme Court decision authorizing the U.S. Environmental Protection Agency ("EPA") to regulate tailpipe emissions of GHGs, EPA issued an endangerment finding under the Clean Air Act, determining that six GHGs endanger public health and welfare. Once EPA made the endangerment finding, it began to regulate certain sources of GHG emissions under the Clean Air Act.

The most significant effort to address climate change on a national level takes effect on January 1, 2011 when EPA will apply New Source Review Prevention of Significant Deterioration permitting requirements to large stationary sources of GHG emissions. At that

time, approximately 15,000 facilities already subject to Clean Air Act permitting requirements will have to include information about their GHG emissions in their permits. As of July 2011, approximately 550 additional large emitters of GHGs that do not currently submit permits under the Clean Air Act – primarily solid waste landfills and industrial manufacturers – will be required to seek Title V operating permits solely as a result of their GHG emissions. According to EPA, facilities responsible for nearly 70 percent of U.S. GHG emissions from stationary sources will be subject to permitting requirements under these new requirements.

Permitting requirements under the Clean Air Act are implemented by states according to state-specific implementation plans which set out an approval process for permits and provide for permitting requirements to be enforced. New and upgraded facilities with significant GHG emissions may be required to install “best available control technologies” (“BACT”) to control their GHG emissions. BACT is determined on a case-by-case basis taking into account various factors including the cost and effectiveness of the control. EPA is preparing to issue guidance for permitting authorities and industries about how it will define the BACT standard with respect to GHG emissions.

Failure to comply with permitting rules under the Clean Air Act could subject companies to liability at both the state and federal levels, as well as government or citizen-initiated lawsuits. Companies should acquaint themselves with applicable permitting requirements under the Clean Air Act as well as the permitting procedures employed by the states in which they operate to ensure compliance and minimize liability.

Reporting Obligations. EPA implemented rules this year requiring large emitters of GHGs to report their annual emissions to EPA. Certain facilities, including those that emit more than 25,000 tons of GHGs per year, now need to monitor their emissions and report such emissions to EPA by March 2011. An expansion of this rule was recently finalized requiring companies that operate certain mines, industrial landfills, wastewater treatment facilities and magnesium production facilities to monitor and report their emissions to EPA beginning next year. EPA is also planning to expand reporting requirements to include additional facilities in the oil and natural gas industries.

Challenges to EPA Regulation. EPA faces some potential hurdles in regulating GHG emissions. Although EPA recently denied ten administrative petitions from industry groups, the U.S. Chamber of Commerce, the states of Texas and Virginia and others asking EPA to reconsider its endangerment finding, 17 petitions challenging EPA’s ability to regulate GHGs under the Clean Air Act are proceeding in federal court. The U.S. Court of Appeals for the D.C. Circuit is currently in the process of coordinating 24 petitions challenging various aspects of EPA’s inclusion of GHGs in permitting requirements under the Clean Air Act. A

coalition of 13 states recently requested permission to join EPA in defending such requirements.

Additionally, there are proposals in the U.S. Senate and House of Representatives to place a two-year moratorium on EPA's authority to regulate GHG emissions. If passed, the Obama Administration has indicated that President Obama would likely veto any such legislation.

REGIONAL INITIATIVES

Over the last few years, regional initiatives have been formed to reduce GHG emissions. The Regional Greenhouse Gas Initiative ("RGGI"), a cap-and-trade program for the power sector adopted by ten Northeastern and Mid-Atlantic states, has been operational since 2009. The Western Climate Initiative and the Midwestern Regional Greenhouse Gas Reduction Accord, two regional initiatives that were established after RGGI, have been developed and implemented more gradually due in part to the struggling economy.

Federal climate change legislation was expected to preempt regional cap-and-trade systems such as RGGI. However, now that Congressional leaders have postponed climate change legislation, attention may shift back to regional initiatives as mechanisms for regulating GHG emissions.

STATE INITIATIVES

California's Global Warming Solutions Act of 2006, known as AB32, requires the state to reduce its GHG emissions to 1990 levels by 2020. To achieve this goal, state regulatory agencies are proposing to adopt several mechanisms, including a cap-and-trade system. However, there is some uncertainty surrounding implementation of AB32. AB32 allows the California governor to delay implementation of some or all of its provisions in the event of threatened "significant economic harm." In addition, a November 2010 ballot initiative, if passed, would suspend AB32 until the rate of unemployment in California dips below a set threshold.

Other states have not yet followed California's lead in regulating GHG emissions. While there has been some effort at the state level to pass laws mandating a reduction of GHG emissions, most states focus on their participation in regional climate change initiatives. Other states have opted not to regulate GHG emissions.

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With Congress currently stalled on climate change, regulation of GHGs may come from a variety of sources. Companies should consider the industries in which they operate, as well

as the locations where they conduct their businesses, as these two factors will determine whether or not, and to what extent, a company's GHG emissions are subject to regulation.

We will continue to monitor developments related to climate change legislation and regulation. Please feel free to contact us with any questions.

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