Environmental Client Alert

BRYAN CAVE

March 12, 2008

ALERT CONCERNING REGIONAL INITIATIVES

In recent years, climate change and greenhouse gas ("GHG") emissions have become priorities among a large and diverse group of states. These concerns – combined with the lack of federal action on climate change – have resulted in states banding together to form coalitions with the intent to reduce GHG emissions. There are now three major regional coalitions: the Regional Greenhouse Gas Initiative ("RGGI"), the Western Climate Initiative ("WCI"), and the Midwestern Greenhouse Gas Reduction Accord ("MGGRA"). Once implemented, the programs being developed by these three initiatives will result in widespread GHG regulation in both the public and private sectors.

RGGI

RGGI – the oldest regional pact – will go into effect on January 1, 2009. There are currently ten RGGI participants, all from the Northeast and Mid-Atlantic: Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont. The basic RGGI commitments and understandings are reflected in a Memorandum of Understanding ("MOU") originally signed in December 2005. The more specific substantive requirements are set forth in a Model Rule finalized in August 2006. Participating states agree to implement the Model Rule's requirements through legislation and/or regulation. Six states – Connecticut, Maine, Maryland, Massachusetts, New York and Vermont – are in the process of finalizing regulations to implement RGGI. New Jersey and Rhode Island have passed legislation authorizing RGGI, while New Hampshire and Delaware anticipate that RGGI legislation could be passed this spring.

RGGI's central feature is a CO_2 Budget Trading Program under which CO_2 emissions from the power sector will be capped and CO_2 emissions allowances distributed to electricity generating units. The cap will stay at the same level for the first six years of the program (2009-2014). Starting in 2015, the CO_2 emissions cap will be reduced by 2.5 percent each year for four years so that the 2018 cap will be 10 percent below the initial cap. Under the Model Rule, states may choose how to allocate their CO_2 emissions allowances, although they are required to allocate at least 25 percent of the allowances "for a consumer benefit or strategic energy purpose," which may include, among other things, the promotion of energy efficiency, the direct mitigation of electricity ratepayer impacts, or the promotion of renewable or non-carbon-emitting energy technologies. A number of the states have already decided to distribute all or most of their allowances through an auction process and use the proceeds of the auction for such purposes. Five of the states intend to participate in the initial auction of allowances in June 2008.

Although RGGI's CO_2 emissions restrictions will apply only to fossil fuel-fired electricity generating units with a rated capacity equal to or greater than 25 megawatts, other sectors will have the opportunity to participate in the CO_2 Budget Trading Program through RGGI's offsets program. Currently, only five categories of offset projects have been approved: (1) landfill methane capture and destruction; (2) reduction in emissions of sulfur hexafluoride; (3) sequestration of carbon due to afforestation; (4) reduction or avoidance of CO_2 emissions from natural gas, oil or propane end-use combustion in an existing or new commercial or residential building by improving the energy efficiency of fuel usage and/or the energy-efficient delivery of energy services; and (5) avoided methane emissions from agricultural manure management operations. Offset credit is not currently slated to be available for carbon capture and geologic sequestration. The MOU provides that additional types of offset projects may be added to the program upon the approval of participating states. Allowances may be awarded for approved offset projects commenced on or after December 20, 2005; offset allowances are in addition to those that will be allocated to power-generating facilities. Under the Model Rule, offset projects may be located in any participating state or in any state or other U.S. jurisdiction that has an inter-agency agreement with a participating state to monitor the offset project sites and report violations.

Power companies which have facilities subject to the CO_2 Budget Trading Program may purchase CO_2 offset allowances to cover no more than 3.3 percent of their CO_2 emissions for a given control period. Under the Model Rule, this percentage increases to 5 percent if the price for CO_2 allowances reaches a "stage one threshold price" (based on $7.00 per ton in 2005 dollars) for a period of twelve months, and to 10 percent if the price reaches a "stage two threshold price" (based on $10.00 per ton in 2005 dollars). In addition, if the price reaches the "stage two threshold price," the MOU provides that "offset allowances may be awarded for the retirement of allowances or credits from international trading programs." This provision has the potential for creating some connection between RGGI and the up-and-running European Union Emissions Trading System.

After the CO_2 Budget Trading Program for the power sector has been implemented, the RGGI states have indicated that they may consider expanding the program to apply to other kinds of sources and other greenhouse gases. As mentioned above, the states may also consider the inclusion of additional types of offset projects. These potential developments should be monitored since they could broaden RGGI's regulatory impact and also increase the opportunities it offers.

WCI

WCI was formed in February 2007 by the governors of California, Arizona, Washington, Oregon, and New Mexico. Since then Utah, Montana, British Columbia, and Manitoba have been added. The three major goals of the initiative are to:

1. Set an overall regional GHG reduction goal
2. Participate in a multi-state GHG registry
3. Develop a design for a regional market-based multi-sector mechanism to achieve the regional goal.

As to the first item, in August 2007 the initiative agreed to a regional GHG emission reduction goal - to reduce emissions by 15% below 2005 levels by the year 2020. The goal was set consistent with previously established individual state and provincial goals.

With respect to the multi-state GHG registry, WCI is expected to rely heavily on The Climate Registry, which is a non-profit corporation whose purpose is to establish a measuring and reporting program. Given that all WCI members are also members of The Climate Registry, progress towards the second goal is well underway.

The third goal – design of a regional market-based multi-sector mechanism – is by far the most complex goal. Although nothing has been finalized, WCI is steering towards a cap-and-trade system, whereby several industrial sectors would be directly affected and all six Kyoto GHGs would be covered. Under a cap-and-trade system, regulated sectors would be required to obtain emission allowances. At this point, WCI is determining whether such allowances should be given away, sold, or a combination thereof. Moreover, WCI is also determining whether the individual member states/provinces should handle the distribution of allowances to regulated entities or should a central entity perform this function. Also, yet to be determined is how should regulated entities that have performed early emission reductions be credited, including what is the cutoff date for eligible early actions.

Likely affected sectors include: electricity, transportation fuel distribution, residential and commercial natural gas distribution, stationary combustion sources, and large non-combustion industrial or waste management processes that emit GHGs.

Other aspects being determined include the role, if any, that offsets will play. Offsets typically would involve projects funded by a regulated entity, but that result in a GHG emission reduction by some other entity. WCI has not yet determined whether the program will allow offsets. However, if offsets are allowed WCI will need to determine what type of projects would be eligible, whether there is a cap in the amount of offsets, and whether projects outside the region would be eligible.

WCI is soliciting stakeholder input on virtually all aspects of the program. WCI plans on releasing its initial recommendation for the program in late Spring 2008 and then plans on completing design by August 26, 2008. As a result of this extremely expedited process, comments should be submitted as soon as possible.

MGGRA

In November 2007, the governors of Illinois, Iowa, Kansas, Michigan, Minnesota, and Wisconsin, and the premier of the Canadian province of Manitoba signed the Midwestern Greenhouse Gas Reduction Accord.

The Midwest Accord has four basic goals:

1. Establish greenhouse gas reduction targets and timeframes consistent with the Midwestern Governors Association members' targets, including a long-term target of 60 to 80 percent below current emissions levels
2. Develop a market-based and multi-sector cap-and-trade mechanism to help achieve greenhouse gas reduction targets
3. Join The Climate Registry to enable tracking, management, and crediting for entities that reduce greenhouse gas emissions
4. Develop and implement other associated mechanisms and policies as needed to achieve the greenhouse gas reduction targets, such as a low-carbon fuel standard and regional incentives and funding mechanisms.

The governors of Indiana, Ohio, and South Dakota signed the accord as observers to participate in the formation of the regional cap-and-trade system. Looking forward from November 15, 2007, the Midwest Accord requires members to create a work group within two months, establish targets for greenhouse gas emissions within eight months, complete development of the proposed cap-and-trade agreement within 12 months, and fully implement the accord within 30 months.

CONCLUSION

As evidenced by the three regional initiatives, the states are taking it upon themselves to place caps on GHG emissions. As early as the beginning of next year, GHG emissions will be regulated under a cap-and-trade system in the Northeast. In addition, more comprehensive cap-and-trade programs are being formulated in the West and Midwest. Although the details in the three programs have not yet been finalized, time for meaningful stakeholder input is quickly running out. The RGGI program is nearly complete, the WCI program is being developed at breakneck speed, and the MGGRA has set a timetable even more ambitious than WCI's. Thus, if not already there, stakeholders should reserve their seats at the table to provide input on the design of these programs.

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