March 2013

Climate Change Update

Agency Nominees Signal Continued Focus on Climate Change Regulation

By Thomas Goslin

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On March 4, President Obama nominated Gina McCarthy to lead the US Environmental Protection Agency (EPA). Ms. McCarthy currently heads EPA's Office of Air and Radiation, where she oversees the development of greenhouse gas regulations for new power plants and tougher fuel economy standards for cars and trucks. Her nomination leaves little doubt of the Obama Administration's continued willingness to address climate change through the regulatory process, rather than seek legislation in the bitterly divided Congress.[1]

Ms. McCarthy is no newcomer to the climate change debate. She has more than 30 years of experience working on environmental regulations at the state and federal levels, five of which were spent as the head of the Connecticut Department of Environmental Protection, where she helped lay the groundwork for the multistate Regional Greenhouse Gas Initiative (RGGI), the nation's first greenhouse gas cap-and-trade program. Before that, she spent 25 years working as a state environmental protection official for Massachusetts, serving five governors from both parties, including then-Governor Mitt Romney, who assigned her the task of crafting a state climate change plan that would later form the predicate for the RGGI program.

Given her resume, it is no surprise that the environmentalist community generally was thrilled with her nomination. Natural Resources Defense Council President Frances Beinecke praised McCarthy in a press release as a "good listener, a straight shooter and someone who has what it takes to build consensus and find solutions. We can count on her to protect our environment and our health." What is surprising, however, is the response of many in the regulated community. John McManus, vice president for environmental services at American Electric Power - a major EPA critic - told Politico shortly after the nomination was announced that McCarthy "has always been willing to engage in a dialogue with the industry to understand our concerns….We're certainly not going to challenge…" her nomination. Reactions from the heads of the American Petroleum Institute and the American Coalition for Clean Coal Electricity, a coal industry lobby, were equally measured; however other conservatives did not hesitate to voice their displeasure with the selection. For example, Representative Shelley Moore Capito (R-W.Va.), a champion of the coal industry, issued a statement voicing her displeasure. "It is a shame the president continues to put his extreme partisan agenda ahead of jobs and energy security in West Virginia and across the country."

While Ms. McCarthy's nomination appears to have gone over relatively well in the private sector, she will face a somewhat less gracious reception in the Senate, where a nomination fight likely will serve as a proxy for the larger battles concerning the role of EPA and its impact on jobs and the economy. The Senate Environment and Public Works Committee soon will hold hearings on the nomination, and ranking member David Vitter (R-La.) has signaled that he will have pointed questions for Ms. McCarthy about EPA's transparency, citing several recent requests for more information on everything from ozone regulations to agenda publishing that he claims have gone unanswered. Senator Roy Blunt (R-Mo.) has already put a hold on Ms. McCarthy's nomination, although the reasons for the hold appear more to do with local politics than the nominee's qualifications as Senator Blunt announced he would lift the hold if EPA announces a timeline for releasing an environmental study of a flood-control project in his state. Senator John Barrasso (R-Wyo.), who put a hold on McCarthy's 2009 nomination to head the Office of Air and Radiation over concern about climate change regulation, issued a statement that he had "serious concerns about how the current EPA operates" and that he would "take a very close look at Ms. McCarthy's experience at the EPA and her vision for the agency." It is notable that those who have raised concerns over the nomination have not focused their criticism on the nominee, but rather on the agency she has been nominated to lead, which suggests that, after an airing of EPA grievances, Ms. McCarthy's nomination is likely to succeed.

If confirmed, Ms. McCarthy would face a raft of pending regulations, including rules on greenhouse gas emissions from new and existing power plants, as well as rules limiting sulfur in gasoline. Given her background, Ms. McCarthy is well-experienced in navigating the intricate technical, legal, and political issues that are inherent in these complex regulatory actions. That she was chosen for the Administrator's office signals that these efforts will take priority in the months and years ahead.

* * *

President Obama's nominees to two other key climate-related agencies – the Department of Interior (DOI) and Department of Energy (DOE) – have faced far less scrutiny. The nomination of Sally Jewell, the CEO of outdoor retailer REI, to be the next Secretary of the Interior was approved by a Senate committee on March 21. Her nomination will soon be voted on by the full Senate, which also is expected to approve. If confirmed, Ms. Jewell will hold enormous sway over decisions to use federal lands for oil, gas, and renewable energy development. Ms. Jewell began her career as an engineer for Mobil Oil Corp. and then spent nearly two decades in corporate banking before joining REI. She is relatively unknown in Washington. As a result, her nomination was greeted with reserved judgment by many in the regulated community; though environmental groups almost universally praised the nominee. Ms. Jewell, in the past, has been linked to efforts – some controversial – to expand federal protection of wilderness areas; however, it is unclear whether her participation was driven more by personal or corporate interests, given that REI's interest are tied to those of outdoor enthusiasts. At her nomination hearing, Ms. Jewell stressed her commitment to the Administration's "all of the above" energy strategy, even highlighting her experience drilling and "fracking" oil and gas wells in the 1970s. While the nominee was on the receiving end of some tough questions concerning Department of Interior rules concerning coal mining and her possible support for a carbon tax, her nomination was approved by the Committee by a vote of 19-3, signaling an easy road to confirmation before the full Senate.

President Obama's nominee to serve as the Secretary of the Department of Energy, MIT Professor Ernest Moniz, is slightly better-known in Washington. Professor Moniz previously worked in the Clinton Administration, first as an associate director in the White House Office of Science and Technology

Policy, and later as undersecretary of energy. He also is known as an advocate for natural gas, nuclear energy, and clean coal, which has rankled some environmental groups, but not to the level that could endanger his nomination. A confirmation hearing has been set for April 9. If confirmed, Professor Moniz would assume the reins of an agency in transition, from one with substantial resources that had been dedicated to advance renewable energy technology and development, to one focused on implementing federal energy policy at the state and regional level.

President Obama's nominees to head EPA, DOI and DOE are each likely to be confirmed. What remains unclear is the extent to which they will succeed in achieving the President's agenda when it comes to climate change and renewable energy development. While each nominee is well-credentialed, given the hostile political environment and the limited amount of time to advance major policy initiatives before the midterm elections in 2014 kickoff the next presidential race, it remains to be seen whether any major regulation concerning climate change will be in place before the end of the Obama Administration.

Investors Continue to Pressure Governments and Companies on Climate Change

By Matthew Morton

As the volume of greenhouse gas emissions continue to increase across the globe, investors worldwide continue to compel governments and companies to take meaningful action to address risks related to climate change. Induced, in part, by high profile and costly extreme weather events, such as Hurricane Sandy, investor interest in mitigating climate risk and enhanced corporate disclosure regarding climate-centric issues is likely to increase into the foreseeable future. Such interest likely will include advocating for more robust and certain government policy regarding carbon emissions, persuading regulators or industry to require corporate disclosure of the business impacts of climate change and favoring direct investment in clean technology assets over investments more prone to result in stranded assets in a low-carbon economy. Below are a few examples of such initiatives.

Investor Coalitions

One prominent example of investor action involves the recent formation of the Global Investor Coalition on Climate Change ("GICCC"), a coalition of four regional climate change investor groups that collectively represent more than 200 institutional investors with more than $22.5 trillion in assets.[2] Convinced that "[c]urrent policies are insufficient to avert serious and dangerous impacts from climate change" the GICCC aims to provide a global platform for dialogue among investors and governments on international policy and investment practice related to climate change.[3] Seeking to influence governments of the world's largest economies to redouble efforts to enact more robust and consistent policies to address climate risks, GICCC issued an open letter containing several action points on climate policy, including clearly identifying policies that encourage low carbon investment, boosting the development of broader and more liquid carbon markets, and phasing out fossil fuel subsidies.[4] According to GICCC, taking these steps should benefit the planet, but also spur institutional investors to increase investments in low-carbon enterprises and energy efficiency.[5]

Shareholder Proxies and Resolutions

Shareholder proxy actions related to environmental issues, such as climate change, are filed by a wide range of shareholders, including pension funds, foundations, and socially responsible investment funds, and continue to increase in popularity. According to Ernst & Young, 44 percent of the approximately 600 shareholder resolutions submitted in 2013 related to environmental and social issues as compared to approximately 30 percent in 2011.[6] These proxy resolutions are increasingly asking companies to set greenhouse gas reduction goals as well as disclose physical risks from climate change and target not only emissions-sensitive industries such as utilities and mining companies, but other industries such as retail and the energy-intensive information technology sector. Of note, Ernst & Young reports that environmental-related resolutions accounted for the largest proportion of resolutions withdrawn, approximately 33 to50 percent, which Ernst & Young attributed to corporate concessions or corporations' willingness to engage in dialogue on these issues. For example, in 2012, the New York State Comptroller's Office filed a resolution with CMS Energy asking the company to adopt quantitative goals for the reduction of greenhouse gas and other air emissions in anticipation of emerging US Environmental Protection Agency (EPA) regulations. The resolution was withdrawn after the company agreed to address the shareholders' concerns.

Climate change-related shareholder resolutions also are targeting financial institutions that underwrite the energy industry. Of note, a January 30, 2013, letter addressed to the Securities and Exchange Commission's ("SEC's") Office of Chief Counsel, Division of Corporation Finance by PNC shareholder Boston Common Asset Management, LLC, requested that PNC report to shareholders by September 2013 PNC's assessment of the greenhouse gas emissions resulting from its lending portfolio and its exposure to climate change risk in its lending, investing, and financing activities.[7] PNC had previously asserted to Boston Common that the proposal is excludable under Rule 14a-8(i)(7) (ordinary business) an exception the Securities and Exchange Commission ("SEC") has allowed financial firms to use in the past to omit resolutions related to disclosure of climate change risks. In a staff decision issued February 13, 2013, the SEC's Division of Corporate Finance required PNC Financial Services to consider the shareholder proposal.[8] If adopted by a majority of PNC shareholders, the resolution will require PNC to disclose to shareholders its potential exposure to climate change. While it appears that this decision is wholly consistent with the SEC's 2010 guidance that companies should disclose their climate change risk because it had become a significant policy issue,[9] the SEC has since signaled that the PNC staff decision should not be viewed as an industry-wide directive. Rather, the SEC has indicated that the decision is specific to the particular facts surrounding the shareholder request, including PNC's own lending criteria and public statements, and that in evaluating such request the specific facts should be assessed to determine whether the institution's investments could potentially impact climate change.[10]

Publicly Traded UK Companies to Report on Greenhouse Gases Beginning in April 2013

By Nick Flynn

The content of narrative reporting or disclosure for publicly traded UK companies is in a state of flux as the government attempts to develop an improved policy. Since 2010, the UK government has been consulting with businesses on how to achieve more transparent and better structured reports to assist investors. This process is not yet complete, but the government has made a decision about greenhouse gas reporting. As has been widely reported, the UK is committed to reducing its greenhouse gas emissions by 50 percent against 1990 levels by 2025 and by 80 percent by 2050. To support this goal, regulations are expected to be introduced in April 2013 which will make it compulsory for UK quoted companies to include emissions data for their entire organization in their annual reports. As a result, over 1000 businesses listed on the main market of the London Stock Exchange will have to report their global greenhouse gas emissions in their 2013/14 Annual Report and thereafter.

The intention is to enable investors to see which companies are effectively managing the hidden long-term costs of greenhouse gas emissions. Although the majority of businesses responding to the government's consultation on this issue support the change, a vigorous debate has now begun over whether the new requirements are fit for purpose. Quoted companies will now have to report on their historic annual emissions. However, a recent report into "un-burnable" carbon by HSBC[11] questions whether climate risk is properly taken into account by key sectors of typical stock exchanges such as oil, gas, and coal mining companies. Information about such companies' historic emissions is arguably less relevant to investors than forward-looking information about the global warming potential of their declared fossil fuel reserves and the risk of such assets becoming "stranded" in a carbon-constrained world. This forward-looking aspect is not yet included in the UK reporting requirements, but arguments are being made that it should be on the basis that the issue has profound implications for current stock market values and could become the next systemic threat to financial markets.

It is clear that the direction of travel in the UK is toward more extensive narrative reporting. A requirement for listed companies to begin reporting on human rights issues is also expected in late 2013 with further developments on other strategic issues to follow. At present, the required content for such reporting is vague. In relation to greenhouse gases, the regulations due in April are unlikely to specify rules or guidance to follow, but instead will allow companies to choose and disclose the methodology, and framework or standard, they use. This has led to criticisms over whether the resulting information will be consistent and comparable enough for investors' purposes. Regardless, the UK is taking a lead in requiring more transparent presentation of risks and opportunities and it will be interesting to see whether investor confidence increases or declines as a result.

Undeterred, California Pushes Ahead with Plans to Curb Greenhouse Gas Emissions

By Erin Yates

Challenges – both legal and political – abound to California's program for reducing greenhouse gas emissions, but to date have not stopped the state from moving forward with its plans. Pursuant to the California Global Warming Solutions Act, more commonly known as Assembly Bill 32 or AB 32, which the California legislature passed and Governor Arnold Schwarzenegger signed into law in 2006, the California Air Resources Board (CARB or the Board) has developed and is in the process of implementing a multi-faceted approach for reducing California's greenhouse emissions to 1990 levels by 2020.[12]

The cornerstone of California's plan is its cap-and-trade program, which imposes a declining aggregate limit on greenhouse gas emissions from covered entities. Compliance with the limits can be achieved by purchasing allowances, each of which is equivalent to the right to emit one metric ton of carbon dioxide equivalent, and a limited amount of so-called "offsets," which are credits issued by CARB for achieving emission reductions through approved projects. Each offset is equivalent to one emission allowance. At the end of each compliance period, covered entities must surrender enough compliance instruments to match the volume of greenhouse gases they emitted during the period.[13] California has taken a hybrid approach to distributing allowances: for the first compliance period, which runs from 2013 through 2014, the state is distributing 90 percent of emission allowances for free and is auctioning the remaining 10 percent of allowances through quarterly auctions.[14] Over time, the percentage of allowances distributed for free will decline.

Cap-and-Trade Program Holds First Auctions

In November 2012, CARB successfully launched its cap-and-trade program. Despite a challenge to CARB's authority to auction emission allowances for revenue generating purposes – filed by the California Chamber of Commerce (California Chamber) on the eve of the first auction – all 23.1 million allowances offered to cover emissions for the 2013 to 2014 period were purchased, albeit at a price only pennies above the $10 floor price.[15] At the time, the state also auctioned 39.5 million allowances to cover emissions for the 2015 to 2016 period, though only 5.6 million were sold at the floor price.[16] Subsequently, CARB filed an answer to the California Chamber's complaint denying the allegations and the National Association of Manufacturers filed a motion to intervene to join the California Chamber in challenging the state's authority to generate revenue through the auction of allowances and, in the alternative, challenging that it is an impermissible tax under the California Constitution.[17] The Sacramento Superior Court is scheduled to hear arguments on May 31, 2013.

In the meantime, CARB held its second scheduled quarterly auction on February 19 of this year. Emission allowances for the 2013 period sold out at a price of $13.62 per allowance. Approximately 47 percent of the allowances available for sale for the 2015 period were purchased at a price of $10.71 – above the floor price of $10 per allowance.[18] This suggests that – despite litigation challenging the validity of the auction mechanism – companies are participating and taking the program seriously.

Moving Ahead with Linking to Other Cap-and-Trade Programs

Another indication that California's cap-and-trade program is being taken seriously is the fact other jurisdictions are engaging in discussions with California about linking cap-and-trade programs. California's program was designed to be linked to other trading programs and permits covered entities to use instruments issued by other CARB-approved greenhouse gas emission trading systems to meet their obligations.[19] Québec, a fellow member of the Western Climate Initiative,[20] is the first trading system with which California has proposed linking. CARB released its proposed regulations to link the programs last May and Québec finalized its harmonizing regulations in December.

Following CARB's release of the linking regulations, however, the California State Assembly passed a budget plan, which included a provision aimed at delaying CARB's efforts to link with Québec.[21] Prior to adopting any regulations that would link California's cap-and-trade program to that of another jurisdiction, CARB must notify the governor of its intent to link with another system and gives the governor 45 days to make the following four findings: (1) the linking jurisdiction has adopted program requirements that are equivalent to or stricter than California's; (2) California will retain the ability to enforce AB 32 against participants in its trading system; (3) the linking jurisdiction has the authority to enforce program requirements that are equivalent to or stricter than California's; and (4) the proposed link does not impose "any significant liability" on the state or any agency of the state for any failure associated with the linkage.[22] On February 22, CARB sent a letter to Governor Edmund Brown providing notice and requesting that the governor make such findings.[23]

While reports indicate that both programs had hoped to be ready to hold a joint auction this August, the likelihood of that happening diminishes as each day passes. In CARB's letter to the governor, CARB indicated that it is scheduled to consider the linking regulations at its March 21, 2013, hearing; however, CARB cannot adopt the regulations until the governor has made its findings. CARB's next scheduled meeting is April 25 through April 26.

Another complicating factor is the California Administrative Procedure Act requirement that a rulemaking must be completed within one year of the notice of proposed rulemaking.[24] This means that CARB must act quickly. If the linking regulations have not been finalized and submitted to the state Office of Administrative Law (which has 30 business days to review them) within the next two months, the entire rulemaking process restarts.[25]

Even if CARB manages to complete the rulemaking process in time, the hurdle of actually implementing the linkage and being sufficiently prepared to hold a joint auction remains. Success linking with Québec could generate momentum for linking with other jurisdictions and demonstrate that it is feasible to implement measures to reduce greenhouse gas emissions in the absence of a unified federal scheme. California emits nearly 450 million metric tons of carbon dioxide per year and is the world's ninth largest economy. On the other hand, failure to link with Québec could have a chilling effect on other jurisdictions' willingness to devote time and resources to linking with California's cap-and-trade program. To date, CARB has managed to push forward its strategies for implementing AB 32 - despite legal and political obstacles - so it will be interesting to watch the outcome of this one.

1 For more information on the EPA's regulation of climate change, see http://www.weil.com/files/Publication/4773db35-ea12-4d8f-802b-bee609f9cb51/Presentation/PublicationAttachment/8a7c9e50-5a48-4f44-b543-c2cd8f1c8fa6/Climate_Change_Update_June_2010.pdf.

2 The coalition consists of the European Institutional Investors Group on Climate Change, the North American Investor Network on Climate Risk, the Australia/New Zealand Investor Group on Climate Change, and the Asia Investor Group on Climate Change.

3 Letter from Global Investor Networks to the Governments of the World's Largest Economies (Nov. 20, 2012), *available at* http://www.ceres.org/incr/files/investor-files/2012-global-policy-letter.

4 *Id*.

5 *Id*.

6 Avery Fellow, Investors Demand Climate-Risk Disclosure in 2013 Proxies, Bloomberg, Feb. 25, 2013, *available at* http://www.bloomberg.com/news/2013-02-25/investors-demand-climate-risk-disclosure-in-2013-proxies.html.

7 PNC Financial Services Group, Inc., SEC No-Action Letter, Feb. 13, 2013, *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/bostoncommon021313-14a8.pdf.

8 *Id*.

9 17 CFR Parts 211, 231 and 214; Commission Guidance Regarding Disclosure Related to Climate Change, SEC Release No. 33-9103, *available at* http://www.sec.gov/rules/interp/2010/33-9106.pdf.

10 *SEC Says Scope of Climate Risk Decision Involving PNC Financial Is Limited*, Daily Environment Report (BNA), Feb. 21, 2013.

11 Coal and Carbon - Stranded Assets: Assessing the Risk, HSBC (Jun. 21, 2012);Oil and Carbon Revisited – Value at risk from 'unburnable' reserves, HSBC (Jan. 25, 2013).

12 California Assembly Bill 32 (2006), at §§ 38550, 38570(a), *available at* http://www.arb.ca.gov/cc/docs/ab32text.pdf.

13 CARB, October 2011 Final Regulation Order, Article 5: California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Oct. 2011) [hereinafter CARB Program], *available at* http://www.arb.ca.gov/cc/capandtrade/finalregorder.pdf.

14 CARB Program § 95870.

15 See CARB Quarterly Auction 1, *available at* http://www.arb.ca.gov/cc/capandtrade/auction/november_2012/auction1_results_2012q4nov.pdf.

16 *See id*.

17 Chamber of Commerce v. California Air Resources Board, Case No. 34-2012-80001313 (Cal. Super. Ct., Sacramento County) (Petition for Writ of Mandate, Nov. 13, 2012; Answer to Petition, Jan. 14, 2013; Complaint in Intervention of the Nat'l Ass'n of Mfr., Feb. 15, 2013, *available at* https://services.saccourt.ca.gov/publicdms/Search.aspx.).

18 See CARB Quarterly Auction 2, *available at* http://www.arb.ca.gov/cc/capandtrade/auction/february_2013/auction2_feb2013_summary_results_report.pdf.

19 CARB Program §§ 95940-42.

20 The Western Climate Initiative is a partnership among jurisdictions committed to taking cooperative action to address climate change and reduce greenhouse gas emissions. At this time, the Western Climate Initiative includes California and Canadian provinces British Columbia, Manitoba, Ontario and Québec. For more information about the Western Climate Initiative, *see* http://www.westernclimateinitiative.org.

21 *See* CAL. GOV. CODE § 12894(f)(1)-(4).

22 *See id*.

23 Letter from James N. Goldstene, CARB Executive Officer, to Governor Edmund G. Brown Jr. (Feb. 22, 2013), *available at* http://www.arb.ca.gov/cc/capandtrade/linkage/go-findings-request.pdf.

24 CAL. GOV. CODE § 11346.4(b).

25 *See id*.

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