

Climate Change and Environmental Update

In This Issue

- EPA Delineates Regulation of Greenhouse Gas Emissions from Stationary Sources
- Kerry-Lieberman Climate Change Bill Unveiled
- Significant Developments in Climate Change Nuisance Lawsuits

EPA Delineates Regulation of Greenhouse Gas Emissions from Stationary Sources

The U.S. Environmental Protection Agency (“EPA”) is now regulating greenhouse gas (“GHG”) emissions from motor vehicles under the federal Clean Air Act (“CAA”).¹ Under existing EPA policy, once GHGs from any source become subject to actual control under the CAA, any stationary sources that exceed the low emission thresholds established by the CAA also become subject to certain air permitting requirements.

- **The Problem:** Too many sources will be regulated at too great a cost and with too little benefit to the environment.

If all stationary sources of GHGs exceeding the CAA’s low thresholds are regulated, millions of sources would be affected because GHGs—particularly carbon dioxide—are more ubiquitous and emitted in much larger amounts than pollutants traditionally regulated under the CAA. The vast majority of these sources currently are subject to no or only minimal air regulations. Companies would need to spend significant sums applying for permits and complying with other regulatory requirements, even if their GHG emissions are extremely low. And the EPA and state agencies that oversee permitting programs would be overwhelmed and unable to properly focus on the major emitters.

- **EPA’s Solution:** Tailor the regulations so as to only affect the largest emitters.

The EPA has now finalized a rule determining that regulation of many smaller sources of GHGs is currently infeasible. This “Tailoring Rule” was issued in final form on May 13, 2010. It establishes when permits governing GHG emissions are required under two CAA programs: Prevention of Significant Deterioration (“PSD”) and Title V. Regulation of GHGs from stationary sources will be phased in as follows:

Larger Sources:

- Beginning January 2, 2011, GHG permits will be required only for stationary sources already subject to the PSD or Title V programs due to their emission of non-GHG air pollutants. As a result, during this first phase, no sources will be made subject to federal air permitting programs solely as a result of their GHG emissions.
 - In the case of the PSD program (which requires permits prior to constructing or modifying a stationary source under certain circumstances), PSD permits must

¹ Click [here](#) for a copy of our memorandum discussing the EPA’s regulation of GHG emissions from motor vehicles.

incorporate GHG emission requirements—most notably, the implementation of “best available control technology” (“BACT”) for GHGs—for construction or modification projects that increase GHG emissions by 75,000 tons per year or more.

- In the case of the Title V program (which requires certain stationary sources that have the potential to exceed regulatory emission thresholds to obtain operating permits), Title V permits will now incorporate GHG monitoring, recordkeeping and other procedural requirements when they are issued, renewed or revised. However, Title V permits, without more, will not impose actual GHG emission limitations, such as BACT requirements.
- Beginning on July 1, 2011, large GHG emitters will become subject to the PSD and Title V programs based solely on their GHG emissions, regardless of their emissions of other air pollutants.
 - All sources with the potential to emit at least 100,000 tons per year of GHGs will be subject to the PSD program.
 - Any modifications of facilities with emissions (of GHGs or other air pollutants) over prescribed thresholds that increase GHG emissions by at least 75,000 tons per year will be subject to the PSD program.
 - All sources that emit at least 100,000 tons per year of GHGs will be required to obtain Title V permits. This rule will subject a number of sources, primarily solid waste landfills and industrial manufacturers, to the Title V program for the first time.

Smaller Sources:

- The EPA will solicit comments during 2011 and 2012 on phasing in permitting requirements for GHG sources not already covered and to determine whether certain smaller sources should be permanently excluded from these GHG permitting requirements. This third phase of permitting is expected to begin in 2013.
- The EPA will also complete a study by the end of April 2015 of whether smaller sources not covered by any of the first three phases should be regulated. Based on the results of this study, the EPA will consider promulgating a rule by April 30, 2016 that could cover such additional sources.
- The EPA has indicated that sources with GHG emissions under 50,000 tons per year will not be subject to federal GHG permitting prior to April 30, 2016.
- **Reactions:** The Tailoring Rule (and the EPA policies that underlie it) continue to face opposition on several fronts.

The Senate is expected to vote on June 10 on a resolution disapproving the EPA’s finding that GHG emissions endanger public health and welfare. This “endangerment finding” is the legal basis for EPA’s regulation of GHGs from motor vehicles, which in turn triggered GHG requirements for stationary sources and necessitated the Tailoring Rule. Even if the resolution is not passed, Senator Jay Rockefeller (D-WV) and three Congressmen have introduced bills in the Senate and House of Representatives that aim to prevent the EPA from regulating GHGs from stationary sources for two years. In addition, lawsuits challenging the EPA’s endangerment finding and other legal precursors to the Tailoring Rule have already been filed, and at least two lawsuits challenging the Tailoring Rule itself are currently pending.

- ▶ [See an EPA fact sheet on the Tailoring Rule](#)
- ▶ [See the full text of the Tailoring Rule](#)

Kerry-Lieberman Climate Change Bill Unveiled

Senators John Kerry (D-MA) and Joseph Lieberman (I-CT) unveiled a “discussion draft” of their climate change bill, called the American Power Act (the “Kerry-Lieberman Bill”) on May 12, 2010. Whether the Kerry-Lieberman Bill will be passed, or even make it to the Senate floor, is highly uncertain at this point, given election year politics and concerns over the Deepwater Horizon spill in the Gulf of Mexico.

The 987-page bill tackles a wide range of climate change and energy issues. The following is a description of its key features:

Cap-and-Trade. The Kerry-Lieberman Bill aims to reduce greenhouse gas (“GHG”) emissions by 17% from 2005 levels by 2020 and by 83% from 2005 levels by 2050. To achieve these goals, the Kerry-Lieberman Bill would establish a cap-and-trade program. Sources subject to the program would be required to have emissions allowances for each ton of GHGs they emit and for each ton of GHGs that would be emitted from the combustion of their products (in the case of providers of refined petroleum products and natural gas distributors). As discussed in further detail below, some of the allowances would be distributed for free, while the remainder would be sold at auction. Electric utilities and providers of refined petroleum products would become subject to the program beginning in 2013; most other large industrial sources (those emitting more than 25,000 tons of GHGs per year) and natural gas distributors would be subject to the program starting in 2016.

The Kerry-Lieberman Bill includes a number of provisions meant to address concerns about the costs and other potential negative impacts of the program:

- **Free Allowances:** More generous allocations of free allowances are included in the Kerry-Lieberman Bill compared to the bill passed by the House of Representatives last year.
 - Until 2030, utilities, natural gas distributors, energy-intensive industries vulnerable to competition in countries without GHG regulations and domestic refineries, among others, would receive specified percentages of the total number of allowances for free.
 - Allowances distributed to utilities and natural gas distributors would be used to blunt the impact of the program on consumers.
- **Price Collar:** Allowances would be subject to a price collar, starting with a \$12 floor and \$25 ceiling, that would increase annually at the rate of inflation plus 3% and 5%, respectively.
- **Special Provisions for Providers of Refined Petroleum Products:** Providers of refined petroleum products would purchase allowances directly from the U.S. Environmental Protection Agency (“EPA”) at a fixed price based on allowance auctions in the previous quarter, and they would not be permitted to trade or bank these allowances. These provisions would ensure that the price of carbon is constant across the industry in any given quarter.

Limits on State and EPA Regulation. The Kerry-Lieberman Bill would prohibit states from implementing their own GHG cap-and-trade programs. It would also prevent the EPA from regulating GHGs under certain sections of the federal Clean Air Act, including those air permitting programs contemplated by the Tailoring Rule discussed above.

Energy Focus. In addition to the cap-and-trade program, the Kerry-Lieberman Bill contains a number of other provisions aimed at spurring further development and innovation in the energy sector, including:

- Incentives for construction of nuclear power plants, including tax incentives, expansions of federal guarantee and insurance programs and streamlined licensing procedures;
- A revenue sharing plan that gives states 37.5% of any leasing and royalty payments from new offshore drilling but also allows states to veto any offshore drilling within 75 miles from their coastlines; and

- Funding and incentives for the development and deployment of carbon capture, sequestration and conversion technologies and for transportation, renewable energy and energy efficiency projects.

Senators Kerry and Lieberman are currently trying to drum up support for their bill, and in recent days President Obama has been more vocal in urging Congress to act on energy and climate legislation this year. Senate Majority Leader Harry Reid (D-NV) issued a letter on June 3, 2010 to eight Democratic committee chairmen indicating there would be an energy package debated on the floor before the August recess. While the letter focused on directing the Senators to submit recommendations aimed at dealing with the oil spill in the Gulf and did not specifically mention climate change, Senators Kerry and Lieberman clearly think it will be covered. In a joint statement also issued on June 3, they mentioned their support for Senator Reid's efforts and noted that they "look forward to working with the Leader and the White House to continue to strengthen our legislation and make this the year for Senate action."

- ▶ [See the Senators' short summary of the draft bill](#)
- ▶ [See the Senators' section-by-section summary of the draft bill](#)
- ▶ [See the full text of the draft bill](#)

Significant Developments in Climate Change Nuisance Lawsuits

- In a high-profile climate change lawsuit, a federal appellate court has thrown out a decision that was unfavorable to defendants.

In *Comer v. Murphy Oil*, a group of Gulf Coast property owners brought public nuisance claims against a group of oil, coal, energy and chemical companies, alleging that the defendants' greenhouse gas emissions contributed to global warming, which exacerbated the effects of Hurricane Katrina. The district court's decision to dismiss the lawsuit was overturned by a three-judge panel of the U.S. Court of Appeals for the Fifth Circuit in late 2009. The defendants then petitioned for an *en banc* rehearing by the full Fifth Circuit. Seven of the court's 16 active judges were recused—presumably for conflicts of interest—from voting on the defendants' petition, but in February 2010 a majority of the remaining nine judges agreed to rehear the case. By local rule, the decision to rehear the case automatically vacated the panel's decision.

The Fifth Circuit subsequently notified the parties that an additional recusal by one of the court's judges for unspecified reasons left it without a quorum to hear the case. In late May 2010, a majority of the eight remaining judges dismissed the appeal but explicitly declined to reinstate the panel's decision. As a result, the district court's decision to dismiss the lawsuit now governs. The plaintiffs' next step would be to file a petition for certiorari with the U.S. Supreme Court.

- The defendants in a separate climate change lawsuit, *Connecticut v. American Electric Power*, have not fared as well. The plaintiffs in *Connecticut* claimed that the defendants' power plants contributed to the public nuisance of global warming. As in *Comer*, the defendants were successful in having the lawsuit dismissed at the district court level, only to have it reinstated by the U.S. Court of Appeals for the Second Circuit. Unlike *Comer*, the Second Circuit denied the defendants' petition for an *en banc* rehearing in March 2010. Commentators expect the defendants to file a petition for certiorari with the Supreme Court.
- If the parties in either case do appeal to the Supreme Court, that court may also face a conflict of interest issue. A number of the justices have owned, and may still own, stock in the defendants in *Comer*, and one (Justice Sotomayor) participated in the lower court decision in *Connecticut*. It is unknown if other justices might also have conflicts relating to either of these cases. The Supreme Court cannot hear a case if four of the nine justices are unable to participate.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Gail A. Flesher	212 450 4469	gail.flesher@davispolk.com
Loyti Cheng	212 450 4022	loyti.cheng@davispolk.com
Betty Moy Huber	212 450 4764	betty.huber@davispolk.com
Hayden S. Baker	212 450 4727	hayden.baker@davispolk.com
Brianne M. Lucyk	212 450 4861	brianne.lucyk@davispolk.com
