

# Up in the Air

## Greenhouse Gas Regulations



**WHEN: WEDNESDAY, MARCH 4, 2009**

**WHERE: TAFT STETTINIUS & HOLLISTER LLP,  
ONE INDIANA SQUARE, SUITE 3500,  
INDIANAPOLIS, IN 46204**

**REGISTRATION: 9:45 A.M.**

**MEETING: 10 A.M. - 2:30 P.M. (LUNCH PROVIDED)**

**PRESENTED BY:**



# **What Indiana Businesses Need To Know About Greenhouse Gas Regulations And What To Expect In The Future**

**Bill Wagner and Larry Vanore**

**Taft Stettinius & Hollister LLP**

**(317) 713-3500**

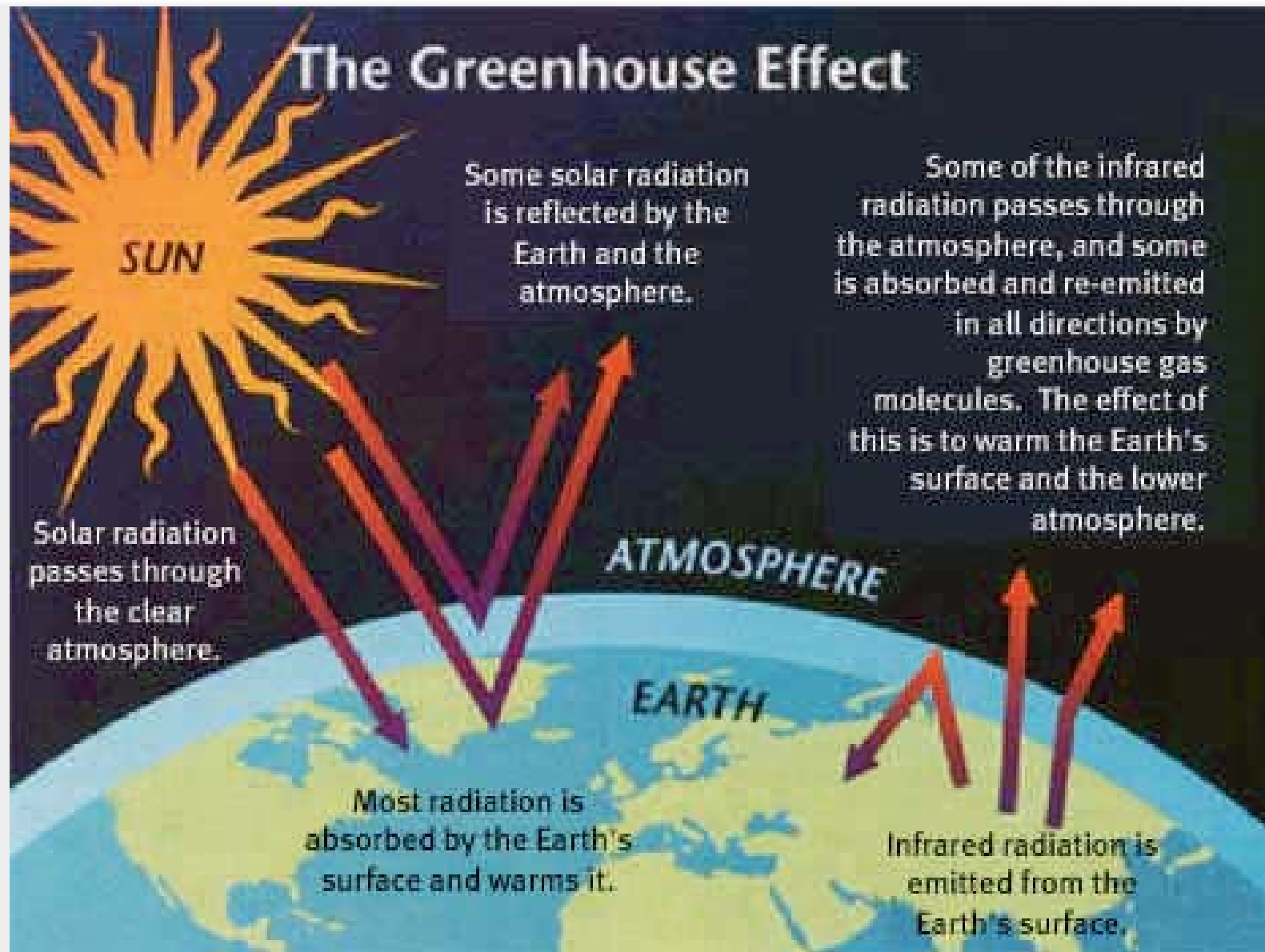
**[www.taftlaw.com](http://www.taftlaw.com)**

## Goals of this session:

1. Identify the problems of GHG regulation for Indiana businesses
2. Examine what others are doing
3. Understand carbon tax and cap and trade alternatives
4. Identify legal minefields

# 1. Introduction to GHG issues

## What are greenhouse gases?



# The Kyoto Six Greenhouse Gases:

- Carbon Dioxide (CO<sub>2</sub>)
- Methane (CH<sub>4</sub>)
- Nitrous Oxide (N<sub>2</sub>O)
- Hydrofluorocarbons (HFCs)
- Perfluorocarbons (PFCs)
- Sulfur Hexafluoride (SF<sub>6</sub>)

## Where do GHGs come from?

- Fossil fuel suppliers, oil refineries, coal power plants, natural gas mining, chemical production, aluminum smelters, and cement manufacturers
- Indiana energy sources:
  - 50% coal (although 95% of electricity coal),
  - 30% petroleum, and
  - 18% natural gas
- Coal-fired power plants account for 40% of all CO<sub>2</sub> emissions; 20% of all NO<sub>x</sub> emissions; and 70% of all SO<sub>2</sub> emissions in the United States in 2006

## **New coal burning generation station power plants coming online**

- U.S.            16 GW by 2015
- Europe        33 GW by 2015
- India           67 GW by 2013
- China          216 GW by 2013



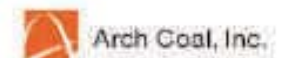
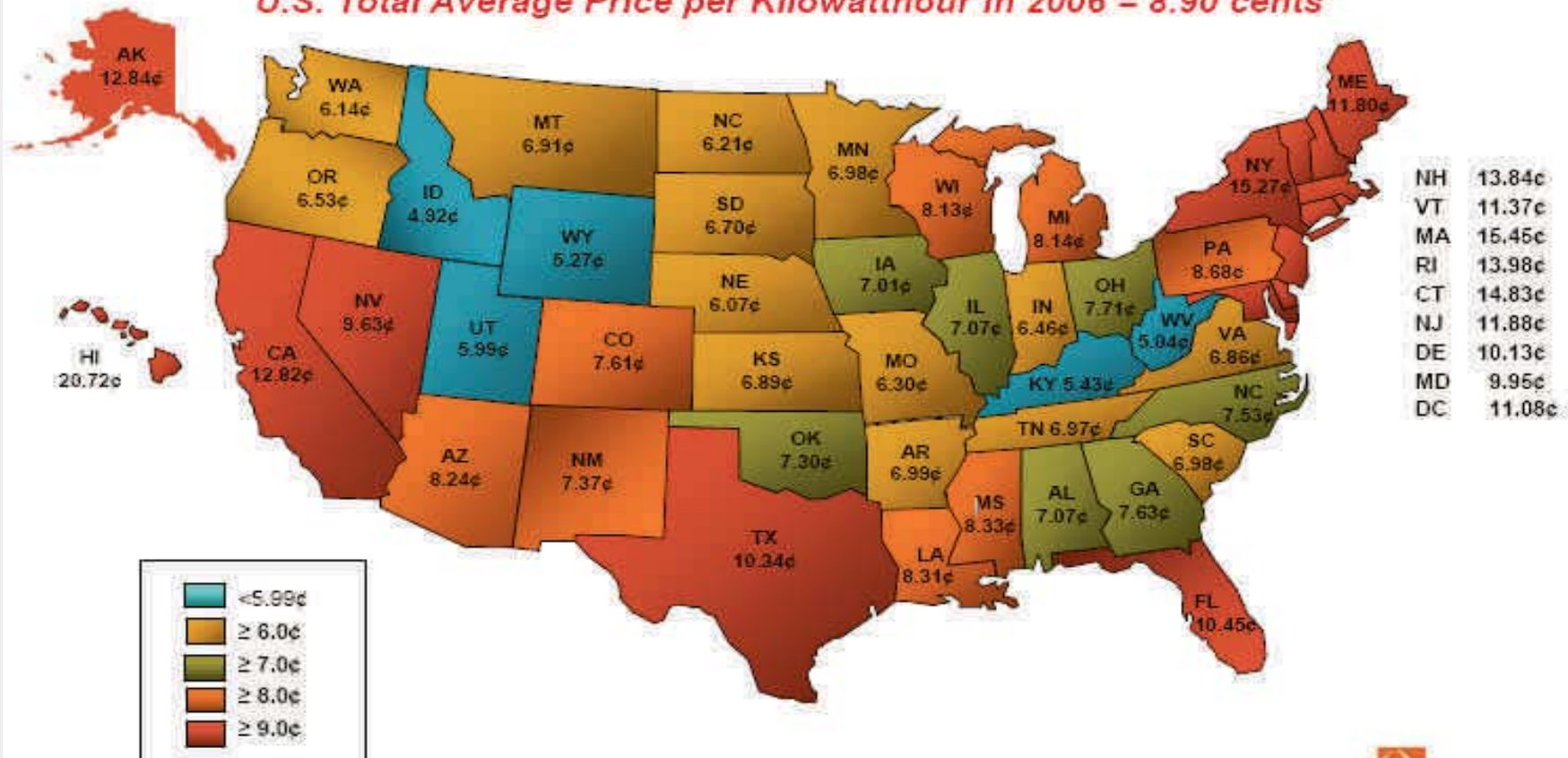
# Indiana electricity costs 6.46 cents per kilowatt hour **Taft/**

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## Low-cost electricity enhances America's standard of living and global competitiveness

*U.S. Total Average Price per Kilowatthour in 2006 = 8.90 cents*



# Low cost coal-produced electricity makes Indiana competitive

## Low-cost electricity allows countries to compete on a global scale

**International Power Costs**  
(U.S. cents per kilowatthour)



## **2. What are others doing about GHG emissions?**

## In the absence of a national policy, regional initiatives take place

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- Regional Greenhouse Gas Initiative
- The Western Climate Initiative
- **The Midwestern Greenhouse Gas Accord**
- The Southwest Climate Change Initiative of 2006
- The West Coast Governor's Global Warming Initiative of 2003
- The Western Renewable Energy Generation Information System
- Powering the Plains



# RGGI – Cap and Trade

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## Regional Greenhouse Gas Initiative

an initiative of the Northeast and Mid-Atlantic States of the U.S.

RGGI Inc | Participating States | About RGGI | Emissions and Allowance Tracking | CO<sub>2</sub> Auctions | Offsets | News

[RGGI Inc](#)

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### RGGI Inc

The Regional Greenhouse Gas Initiative, Inc. (RGGI, Inc.) is a non-profit corporation created to support development and implementation of the ten participating states' CO<sub>2</sub> Budget Trading Programs.

RGGI, Inc. will provide technical and support services for key elements of the states' CO<sub>2</sub> Budget Trading programs, including:

- Development and maintenance of a system to report data from emissions sources subject to RGGI, and to track CO<sub>2</sub> allowances
- Implementation of a platform to auction CO<sub>2</sub> allowances
- Monitoring the market related to the auction and trading of CO<sub>2</sub> allowances
- Providing technical assistance to the participating states in reviewing applications for emissions offset projects
- Providing technical assistance to the participating states to evaluate proposed changes to the states' RGGI programs

# Midwest GHG Reduction Accord

## Midwestern Greenhouse Gas Reduction Accord

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"I am very pleased Democratic and Republican Midwest Governors, along with Premier Doer of Manitoba, were able to come together to support such a worthy goal. The threat of global warming is real and it is our responsibility to take steps to reduce greenhouse gasses."

Gov. Chet Culver – Iowa



### New direction, new energy, new jobs and a cleaner world.

Nine Midwestern governors and two Canadian premiers have signed on to participate or observe in the *Midwestern Greenhouse Gas Reduction Accord (Accord)*, as first agreed to in November 2007 in Milwaukee, Wisconsin. Realizing the unique and major impact that the Midwestern states play in the emissions of carbon, these governors wanted to institute Midwestern practicality in the debate on global warming.

While the Midwest has intensive manufacturing and agriculture sectors, making it the most coal-dependent region in North America, it also has world-class renewable energy resources and opportunities to allow it to take a lead role in solving the effects of climate change. The geographical location and ideological-centered beliefs of the Midwestern region provide its leaders with an ability to push the federal policy debate in a productive direction. Through the Accord, these governors agreed to establish a Midwestern greenhouse gas reduction program to reduce greenhouse gas emissions in their states, as well as a working group to provide recommendations regarding the implementation of the Accord.

### Midwestern Greenhouse Gas Reduction Accord

#### Members

Iowa  
Illinois  
Kansas  
Manitoba  
Michigan  
Minnesota  
Wisconsin

#### Observers

Indiana  
Ohio



# The Climate Registry

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## The Climate Registry North America's Leaders Solving Climate Change Together

THE CLIMATE REGISTRY is a nonprofit collaboration among North American states, provinces, territories and Native Sovereign Nations that sets consistent and transparent standards to calculate, verify and publicly report greenhouse gas emissions into a single registry.

[LEARN MORE](#)

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### spotlight

#### CLIMATE POLICY SERIES

Registration is now open for two forums! Seating is limited.

Feb 26 - [Denver, CO](#)

Mar 11 - [Columbus, OH](#)

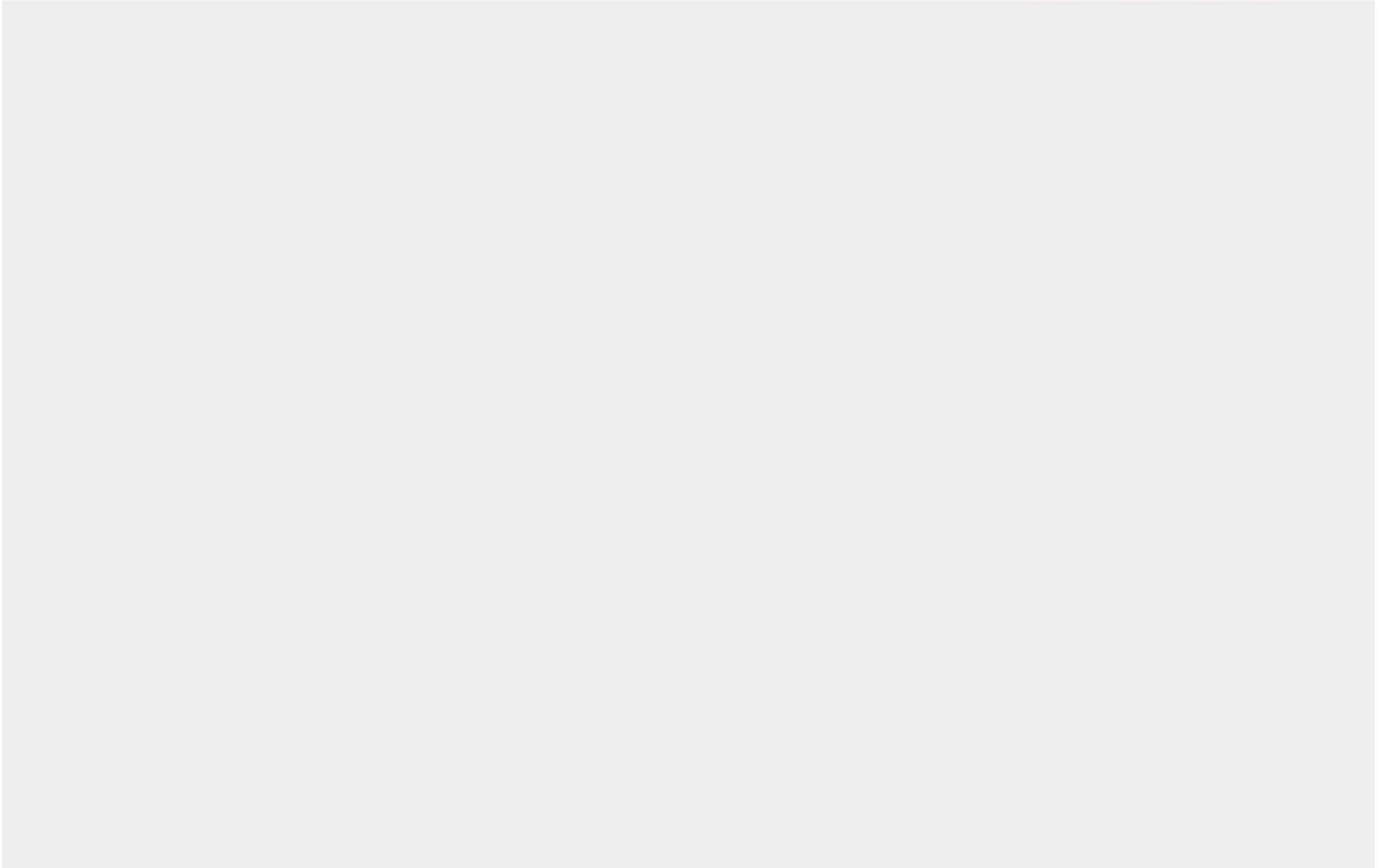


# The Climate Registry

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# Chicago Climate Futures Exchange

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**CCX Chicago Climate Exchange**

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Market Info / CCX CFI 2003 \$2.00

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**Affiliated Exchanges:**

- ▶ [European Climate Exchange \(EEX\)](#)
- ▶ [Insurance Futures Exchange \(IFE\)](#)
- ▶ [Montréal Climate Exchange \(MCE\)](#)
- ▶ [Tianjin Climate Exchange \(TCX\)](#)

The World's First and North America's Only  
Greenhouse Gas Emissions Registry,  
Reduction, & Trading System

**Exchange Overview**

Welcome to CCX: We are a financial institution whose objectives are to apply financial innovation and incentives to advance social, environmental and economic goals through the following platforms:

[Chicago Climate Exchange \(CCX\)](#) is North America's only cap and trade system for all six greenhouse gases, with global affiliates and projects worldwide. [\(learn more\)](#)

[Chicago Climate Futures Exchange \(CCFE\)](#) is a landmark derivatives exchange that currently offers standardized and cleared futures and options contracts on emission allowances and other environmental products. CCFE is a wholly owned subsidiary of CCX. [\(Visit CCFE's website\)](#)

**Market Overview**

CCX | **CCFE** | ECX

February 20, 2009 Updated end of day

Total Daily Electronic Volume: 249,600 mt CO<sub>2</sub>

CCX CFI	CLOSE	CHANGE
CFI 2003	\$2.00	\$0.00
CFI 2008	\$2.00	\$0.00
CFI 2010	\$2.00	\$0.00

To view all listed contracts click [here](#).

CCX CFI Vintage 2008 (Quoted in mt CO<sub>2</sub>)

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# Carbon Capture & Sequestration

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- 30 large scale projects in U.S., Europe, Canada, and Australia at \$20 Billion; 110 projects in 18 countries
- \$3.4 Billion carbon-related research and demonstration programs
- CCS to scale by 2016

# Midwest Regional Carbon Sequestration Partnership



**MRCSP**  
MIDWEST REGIONAL  
CARBON SEQUESTRATION  
PARTNERSHIP

The MRCSP is one of seven regional partnerships established by the U.S. Department of Energy's National Energy Technology Laboratory (DOE/NETL) to study carbon sequestration as one option for mitigating climate change. We invite you to learn more by exploring this website.

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## Managing Climate Change and Securing a Future for the Midwest's Industrial Base



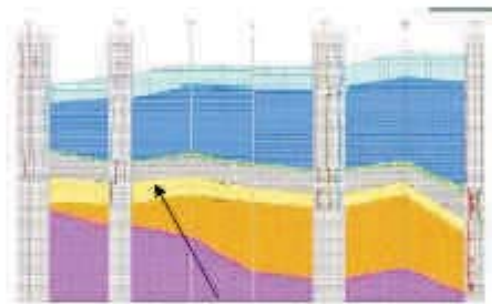
### WHAT'S NEW

**[Battelle researchers working on the MRCSP prepared comments on the USEPA Proposed Rule](#)** (January 27, 2009)

Battelle researchers working on the Midwest Regional Carbon Sequestration Partnership (MRCSP) prepared comments on the USEPA Proposed Rule - Federal Requirements under UIC Program for CO2 ...



## East Bend Station (Duke Energy)



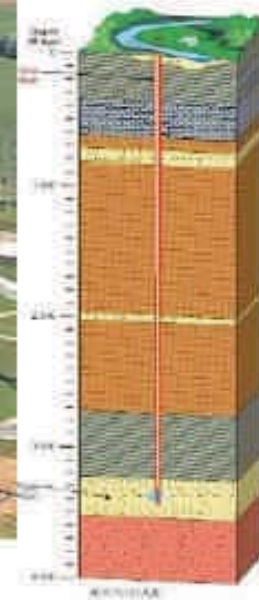
Injection Target,  
Mt. Simon Formation



Seismic Survey  
October, 2006



East Bend Station



Test Well Design

## MRCSP Phase III proposed sites



### Primary site

- Host: TAME, a joint venture of The Andersons and Marathon Petroleum
- Plant operational: February 2008.
- Injection start: FY2010
- Scale: 1 million tonnes of CO<sub>2</sub> over a four-year period
- Target: Mt. Simon at ~3500 ft.

### Optional site

- Host: Duke Energy
- Plant operational: FY 2012
- Possible injection start: FY 2012
- Scale: Possible 2 million tonnes over four-year injection period
- Target: Mt. Simon at ~8000 ft.
  - Multiple injection zones and caprock layers

## **3. Carbon tax versus cap and trade alternatives**

# Carbon tax versus cap and trade



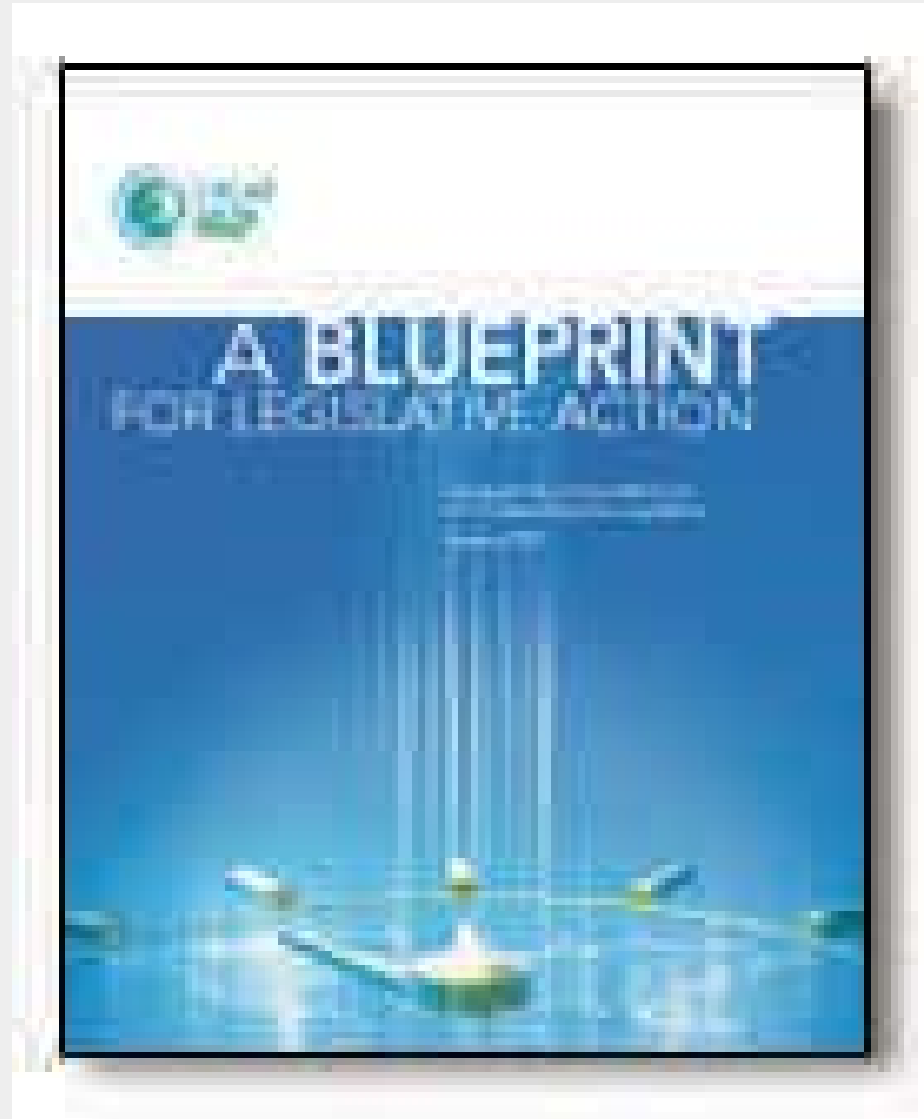
Exxon Mobile Corp.'s Chairman and CEO Rex Tillerson believes a carbon tax would provide the stability companies need to invest in renewable energy.

Pricing carbon through a direct and transparent tax could incentivize the search for lower-emission energy solutions while providing the stability and predictability industrial companies need to make long-term, capital-intensive investments in equipment and research.

# Carbon Tax



## Cap and Trade



# What are the cap and trade goals?

- Establish cap
- Sell credits or allowances
- Credits decline every year
- Trade establishes CO<sub>2</sub> market

When market works, is it cheaper to:

1. buy allowances, or
2. reduce emissions?

May be difficult for aluminum and cement manufactures

# Cap and trade issues

- Who participates?
- What is the reduction target level?
- How will the trade market work?
- How do you control leakage?
- Is there a safety valve on price?
- Can I get an offset?
- Can I get an allocation?
- Can I bank my credits?
- Can I borrow credits against the future?
- Can I get credit for early action?

# Who participates? (coverage)

- **RGGI:** fossil fuel electric generating units of 25+ MW
- **USCAP:**
  - CO<sub>2</sub> emissions of 25,000 metric tons/year existing;
  - CO<sub>2</sub> emissions of 10,000 metric tons/year new;
  - transportation fuel providers; and
  - local distribution companies (natural gas)
- **Obama Administration:** Economy-wide

# What is the targeted reduction?

- **RGGI:** 90% of 2009 levels by 2018
- **USCAP:**
  - 97-102% of 2005 levels by 2012
  - 80-86% of 2005 levels by 2020
  - 58% of 2005 levels by 2030
  - 20% of 2005 levels by 2050
- **Obama Administration:**
  - (Campaign 80% of 1990 levels by 2050)
  - Budget: 14% of 2005 levels by 2020
  - 83% of 2005 levels by 2050

# Who can trade?

- **RGGI:** 100% auction. RGGI participant state must approve auction outcome before any allowances transferred to successful bidder.
- **USCAP:** Single global market; establish a domestic market with a uniform price for carbon for all sectors and regions of the United States
- **Obama Administration:** 100% auction. Establish a trading system that includes everyone from big businesses to small farmers.

# Offsets used to trade for credit

- **RGGI:** Can satisfy 3.3% of a source's compliance obligation, though may expand to 5-10% if price reaches certain threshold. Land fill methane capture/destruction; reduction of SF<sub>6</sub> emissions; CO<sub>2</sub> sequestration from afforestation; reduction/avoidance of CO<sub>2</sub> emissions from natural gas, oil, or propane end-use combustion due to end-use energy efficiency in the building sector; avoided methane emissions from agricultural manure management operations. Eligible offset projects in any RGGI state or any other US state or jurisdiction that executed agreement with RGGI states for oversight report.
- **USCAP:** Ample amount (2 – 3 billion MT/year); split domestic/international; unlimited banking of offsets; ratio going forward; multi-year compliance periods; must be verifiable, permanent, measurable, and enforceable; avoided tropical deforestation
- **Obama Administration:** Allow purchase of verified offsets.



# Leakage

Occurs when company moves to avoid regulation. Why international agreements are so important. Otherwise, drive away jobs and won't reduce CO<sub>2</sub> emissions.

- **RGGI:** Authorized working group to study leakage and propose mitigation mechanisms.
- **USCAP:** International commitment needed; UN Framework Convention on Climate Change
- **Obama Administration:** Wants international commitment, but willing to lead on our own.

# Safety Valve (price check) – market policy without market risk

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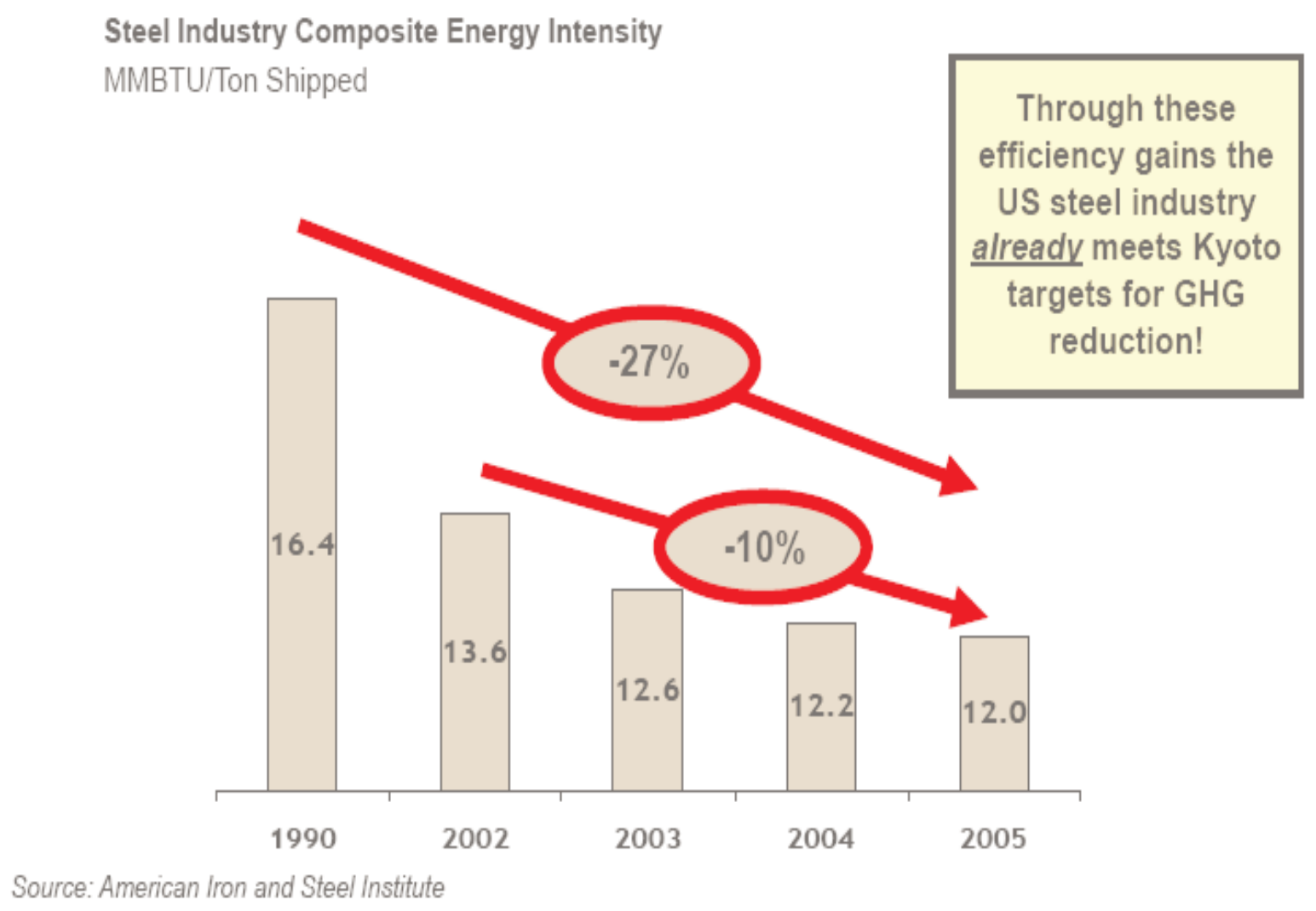
# Allocation?

- **RGGI:** 25% of allowances to support consumer benefit programs, rest are up to the state. Sell a significant portion, if not all, of the initial allowances through quarterly regional auction where costs are passed through to consumers.
- **USCAP:** A significant portion of free allowances should be initially distributed to capped entities and economic sectors particularly disadvantaged by the secondary price effects of a cap and phased out over time. Local distribution companies 40% to electricity and natural gas consumers used to combat leakage and help low income consumers.
- **Obama Administration:** Require all pollution credits to be auctioned.

# Banking, borrowing, and credits?

- **RGGI:** Yes, no, yes
- **USCAP:** Full banking and allow a limited number of allowances to be borrowed from future compliance periods as a last resort. Credits for early action as of a specified date, such as no earlier than 1995.
- **Obama Administration:** Yes, no, yes

# Why credits matter...



# Cap and Trade

- RGGI – 2 auctions; next 3/31/09
- Auction #1 - 9/25/08 auction raised \$38.6M for 6 RGGI states participating (12,565,387 at \$3.07 per)
- Auction #2 - 12/17/08 auction raised \$106.5 million for 10 RGGI states (31,505,898 at \$3.38 per)
- Post-Settlement Auction Report dated 1/6/09
- 69 separate entities submitting bids to purchase 3.5 times the available supply of allowances
- 46 entities won allowances
- Bid prices ranged from \$1.86 to \$7.20

# Midwest GHG Reduction Accord Announcement 1/18/2009

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- Indiana is “observer”
- Advisory Group proposed target reductions of 15-20% below 2005 levels by 2020, and 60-80% reduction by 2050
- Cap and trade programs contemplates all 6 Kyoto GHGs
- Allowances distributed to companies and other emitters, with 3 years to have allowances equal to emissions
- Each jurisdiction will decide whether to auction or allocate

## Obama Budget Released 2-26-2008

- Assumes cap-and-trade program begins 2012
- Collect \$79 Billion annually in revenues
- Spend \$15 Billion on clean energy technologies
- Spend \$64 Billion on “Making Work Pay” payroll tax refunds of \$400 for individuals and \$800 for families
- Use payroll taxes to make it “revenue neutral”
- Raise over \$646 Billion in the next decade
  
- Eliminate \$31.5 Billion in tax preferences oil and natural gas industry



## 4. Legal Minefields

# EPA's Greenhouse Gas Reporting Rule

- Final Rule - Due June 2009
- Objective: to collect comprehensive & accurate data relevant to future climate policy decisions, including potential regulation under the Clean Air Act. (Part of FY2008 Omnibus Appropriations Act signed by President Bush on December 26, 2007.)
- EPA has discretion re:
  - (1) the threshold for reporting
  - (2) the frequency of reporting
- Will build on [www.theclimateregistry.org](http://www.theclimateregistry.org) and [www.arb.ca.gov/cc/cc.htm](http://www.arb.ca.gov/cc/cc.htm) .
- Senator Dvorak – HB 1352 will have Indiana sign the Climate Registry with ability to withdrawal – moot?

## Should Indiana act now?

Fate of federal cap and trade program could hinge on compromise under discussions in House and Senate regarding state preemption that would allow states to regulate GHG emissions, but only if their laws are in place before Congress acts. (Grandfathered in)

Under MGHGRA, allowances distributed to emitters

# Should Indiana adopt green energy tax credits?

Leakage: Tennessee has committed to cover the cost of any future carbon tax for green companies making major investments in the state. The credit helped lure \$1 Billion Wacker Chemie AG plant and \$1.2 Billion Hemlock Semiconductor Corp. plant to manufacture polysilicon, used to make solar cells for solar panels. State took carbon tax out of the investment equation.

## “Pore space” bills

- Carbonsheds: (Frio - 65%; The Mount Simon -17%)  
Mount Simon sandstone saline aquifer in Illinois / Indiana
- Pore space bills give surface owners control over the gaps within geological formations beneath their lands
- Owners of subsurface mineral rights retain right to mine oil and natural gas from pore spaces
- New Mexico developed model carbon sequestration statute to avoid conflicts over ownership/leasing rights
- Indiana considering similar measures
- Concerns whether storage of CO<sub>2</sub> will displace groundwater or dissolve groundwater, affecting water rights and groundwater quality

# Carbon Sequestration – An Uncertain Legal and Regulatory Environment

- RCRA and CERCLA potentially apply to CCS activities
- CO<sub>2</sub> capture (e.g., performance requirements under future regulation)
- CO<sub>2</sub> transportation (e.g., pipeline ownership, safety, regulation, access)
- State property law governing reservoirs, pore space, and injected CO<sub>2</sub>
- Liability for CO<sub>2</sub> leakage (regulatory liability for emissions control, and contractual liability for carbon trading)
- Liability for damage to property (induced seismicity, commingled resources)
- Liability for trespass (multiple users of reservoirs, boundary disputes)
- Liability for CCS activities after transfer of property ownership
- Health, safety, and environmental liability (groundwater contamination, NRD)
- CCS site selection, permitting, operation, closure
- Long-term monitoring, remediation, and financial responsibility for CCS sites
- Treatment and accounting for CCS as a mitigation measure

Hart, Craig A., “Advancing Carbon Sequestration Research in an Uncertain Legal and Regulatory Environment: A Study of Phase II of the DOE Regional Carbon Sequestration Partnership Program.” Discussion Paper 2009-01, Cambridge, Mass.: Belfer Center for Science and International Affairs, Jan. 2009.



## Financial Assurance

Geological sequestration sites could be subject to CERCLA or RCRA regulations and practice to meet statutory requirements for financial responsibility.

Two components:

1. Cost estimate

2. Instrument:

- Self-assurance test / corporate guarantee
- Letter of credit
- Surety bond
- Trust fund
- Insurance

Recent problems: Financial crisis and lack of EPA guidance on multi-party assurance posed problems

# Regulations Under RGGI

- Each ton of carbon emitted > cap is separate violation of regulations and state law
- May forfeit up to three times the amount of allowances in excess, be assessed fine or penalty, possibly subject to enforcement action
- Owners and operators of covered units equally exposed to liability as any liability that applies to a covered unit also applies to the owner and operator
- DEP has authority to conduct audits
- Trading program regulations provide for extensive monitoring, record keeping, and reporting requirements incorporating applicable requirements of NO<sub>x</sub> and SO<sub>2</sub> trading programs.

# Enforcement Under RGGI

- DEP can conduct audits
- Extensive monitoring
- Extensive record keeping
- Extensive reporting requirements
- Incorporates requirements of NO<sub>x</sub> and SO<sub>2</sub> trading programs

# Massachusetts v. EPA, 127 S.Ct. 1438 (U.S. 2007)

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Supreme Court ordered EPA to make a finding on whether GHG emissions endanger public health and the environment. Finding of endangerment would require EPA to issue GHG emissions limits for vehicles under CAA. The vehicle rules would, in turn, lead to emissions controls for stationary sources under the Prevention of Significant Deterioration (PSD) program.

2/17/2009 – EPA granted petition for reconsideration of Bush Administration interpretive memo addressing when the Prevention of Significant Deterioration program applies to CO<sub>2</sub>.

EPA Administrator Lisa Jackson appears ready to reverse December 2008 Memorandum of former EPA Administrator Stephen Johnson outlining why regulators should not use the CAA's existing programs to control CO<sub>2</sub> emissions from industrial sources. (Decision expected April 2, 2009)

# 10-K Disclosures Dominion Subpoena

“In its 2006 Form 10-K, Dominion made no disclosure of projected CO<sub>2</sub> emissions from the proposed plants or current plants. Further, Dominion did not attempt to evaluate or quantify the possible effects of future GHG regulations, or discuss their impact on the company. Dominion also did not present any strategies to reduce CO<sub>2</sub> emissions, as new regulations would likely require. These omissions make it difficult for investors to make informed decisions.

Under federal and state laws and regulations, Dominion’s disclosures to investors must be complete and not misleading. **Selective disclosure of favorable information or omission of unfavorable information concerning climate change is misleading.** Dominion cannot excuse its failure to provide disclosure and analysis by claiming there is insufficient information concerning known climate change trends and uncertainties.”

9/14/07 Subpoena NYAG Cuomo to AES Corp., Dominion Resources, Xcel Energy, Dynegy, and Peabody Energy.

## Did your company make 10-K disclosures like those listed in the CERES Petition?

- Amount of GHG emissions
- Impacts/risks related to current or proposed GHG regulations;
- Impacts/risks related to the physical effects of climate change;
- Legal proceedings regarding GHG emissions or climate change; and
- Efforts related to reducing GHG emissions or climate change?

Petition for Interpretive Guidance on Climate Risk Disclosure – filed 9/18/2007 by Coalition for Environmentally Responsible Economies (CERES) with SEC.



# Xcel Energy Settlement

8-27-08 NYAG Cuomo announced Xcel Energy agreement to disclose financial risks that climate change poses to investors in its 10-K.

1. Present and probable future climate change regulation;
2. Climate-change related litigation; and
3. Physical impacts of climate change.

# Dynegy Settlement

10-23-2008 – NYAG Cuomo and former VP Gore announced agreement that requires Dynegy Inc. to disclose timely and relevant information to investors about climate change risks.

Same 3 as Xcel, plus:

- current CO<sub>2</sub> emissions;
- projected increases in CO<sub>2</sub> emissions from planned coal-fired power plants;
- company strategies for reducing, offsetting, limiting, or otherwise managing its global warming pollution emissions and expected global warming emissions reductions from such actions; and
- corporate governance actions related to climate change, including if environmental performance is incorporated into **officer compensation.**

## Will your insurance protect you?

Will your D&O insurance protect you class action securities lawsuits?

Common D&O claims include financial statement misrepresentations and improper forward-looking statements, such as overstatement of revenues/receivables and understatement of expenses and liabilities, and breach of fiduciary duty, such as conflict of interest/self-dealing and failure to exercise due care.

Will your CGL insurance protect you if you engage in CCS?  
(Is CO<sub>2</sub> a pollutant?)

# North Carolina v. Tennessee Valley Authority, 2009 WL 77998 (W.D.N.C. 2009)

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# North Carolina v. Tennessee Valley Authority, 2009 WL 77998 (W.D.N.C. 2009)

Preemption? No

“the CAA’s comprehensive scheme does not impair the inherent equitable powers of this Court to address NC’s concerns.” (citing N.C. v. TVA, 549 F.Supp.2d 725, 729 (2008) (discussing CAA’s savings clause, 42 U.S.C. 7604(e), which permits actions to abate air pollution pursuant to state law doctrines, such as public nuisance.”

4<sup>th</sup> Circuit affirmed Court’s order denying TVA’s motion to dismiss. N.C. ex rel. Cooper v. TVA, 515 F.3d 344 (4<sup>th</sup> Cir. 2008).

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The court finds, moreover, that it is financially feasible for TVA to bear the costs of the installation, maintenance, and year-round operation of the pollution control technology listed above and orders same.

Widows Creek, AL and Kingston, Bull Run, and John Sevier, TN plants are a public nuisance, while others are too remote.

Each party bears own attorney fees and costs.

TVA must not release more pollutants than released in prior year.

# Will your company be able to pass on the cost of a cap-and-trade program to your customers?

## Indeck Corinth v. Patterson,

filed NY state court 1/29/09

- Indeck - 128-MW natural gas-fired cogeneration plant sued to overturn state regulations implementing RGGI
- Under RGGI, Indeck can't pass cost on to ConEd because long term fixed-price contract.
- Claims RGGI unconstitutional violates Compact Clause
- Claims it is a tax implemented by governor and state agencies without statutory authority of state legislature
- How does this compare to New Jersey v. EPA, 65 ERC 1993 (D.C. Cir. 2008), holding that EPA ignored the plain text of the CAA when it created an emission trading program for mercury rather than following Section 112 of the CAA?

# Additional Issues

- Are your marketing people putting you at risk for a false advertising claim?

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