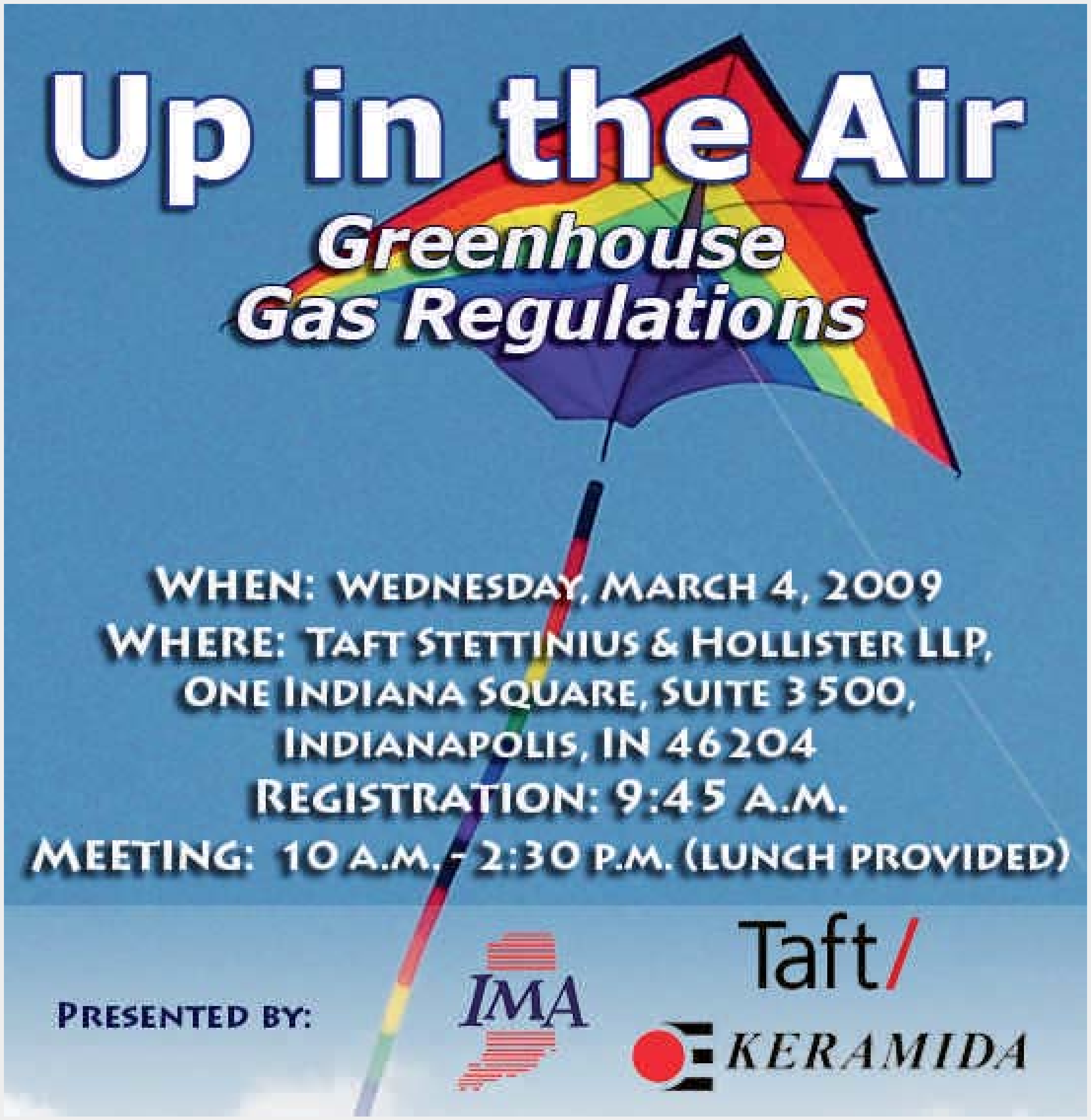
Up in the Air
Greenhouse Gas Regulations
WHEN: WEDNESDAY, MARCH 4, 2009
WHERE: TAFT STETTINIUS & HOLLISTER LLP,
ONE INDIANA SQUARE, SUITE 3500,
INDIANAPOLIS, IN 46204
REGISTRATION: 9:45 A.M.
MEETING: 10 A.M. - 2:30 P.M. (LUNCH PROVIDED)
PRESENTED BY:
IMA
Taft/
KERAMIDA

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

Bill Wagner and Larry Vanore
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Goals of this session:

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1. Identify the problems of GHG regulation for Indiana businesses

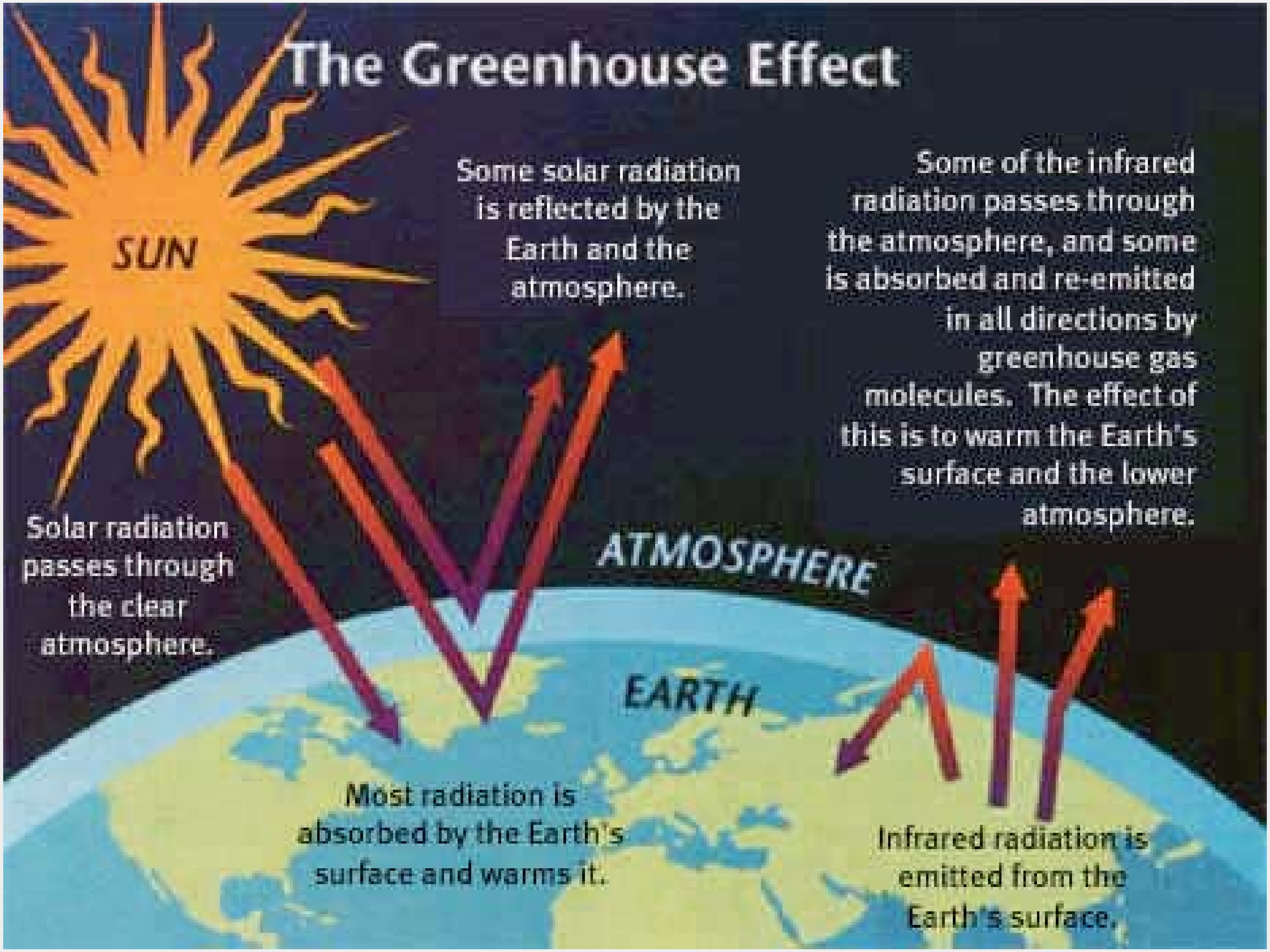
2. Examine what others are doing

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_2)
- Methane (CH_4)
- Nitrous Oxide (N_2O)
- Hydrofluorocarbons (HFCs)
- Perfluorocarbons (PFCs)
- Sulfur Hexafluoride (SF_6)

Where do GHGs come from?

- Fossil fuel suppliers, oil refineries, coal power plants, natural gas mining, chemical production, aluminum smelters, and cement manufacturers

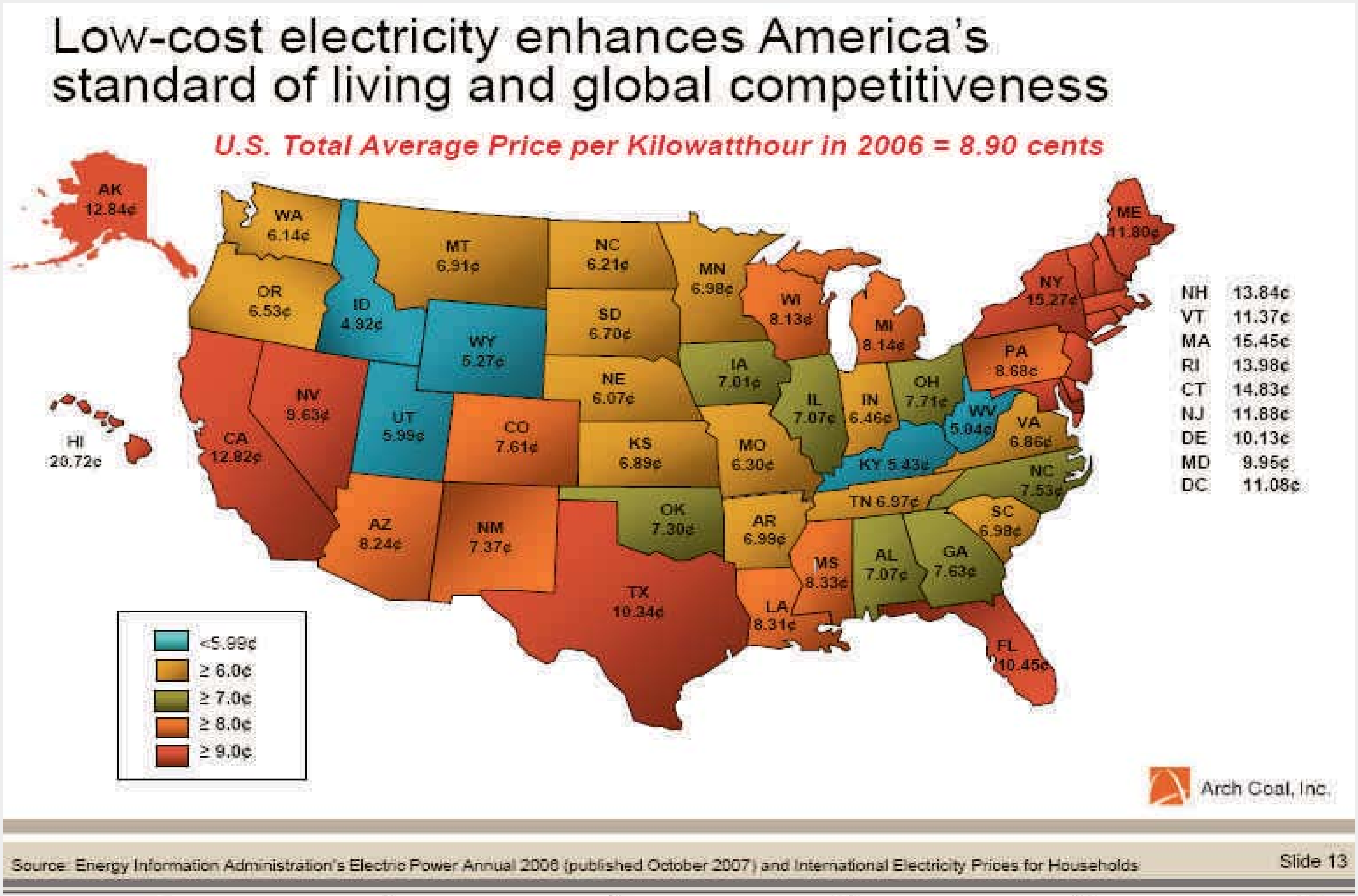
- Indiana energy sources:
  - 50% coal (although 95% of electricity coal),
  - 30% petroleum, and
  - 18% natural gas

- Coal-fired power plants account for 40% of all CO_2 emissions; 20% of all NO_x emissions; and 70% of all SO_2 emissions in the United States in 2006

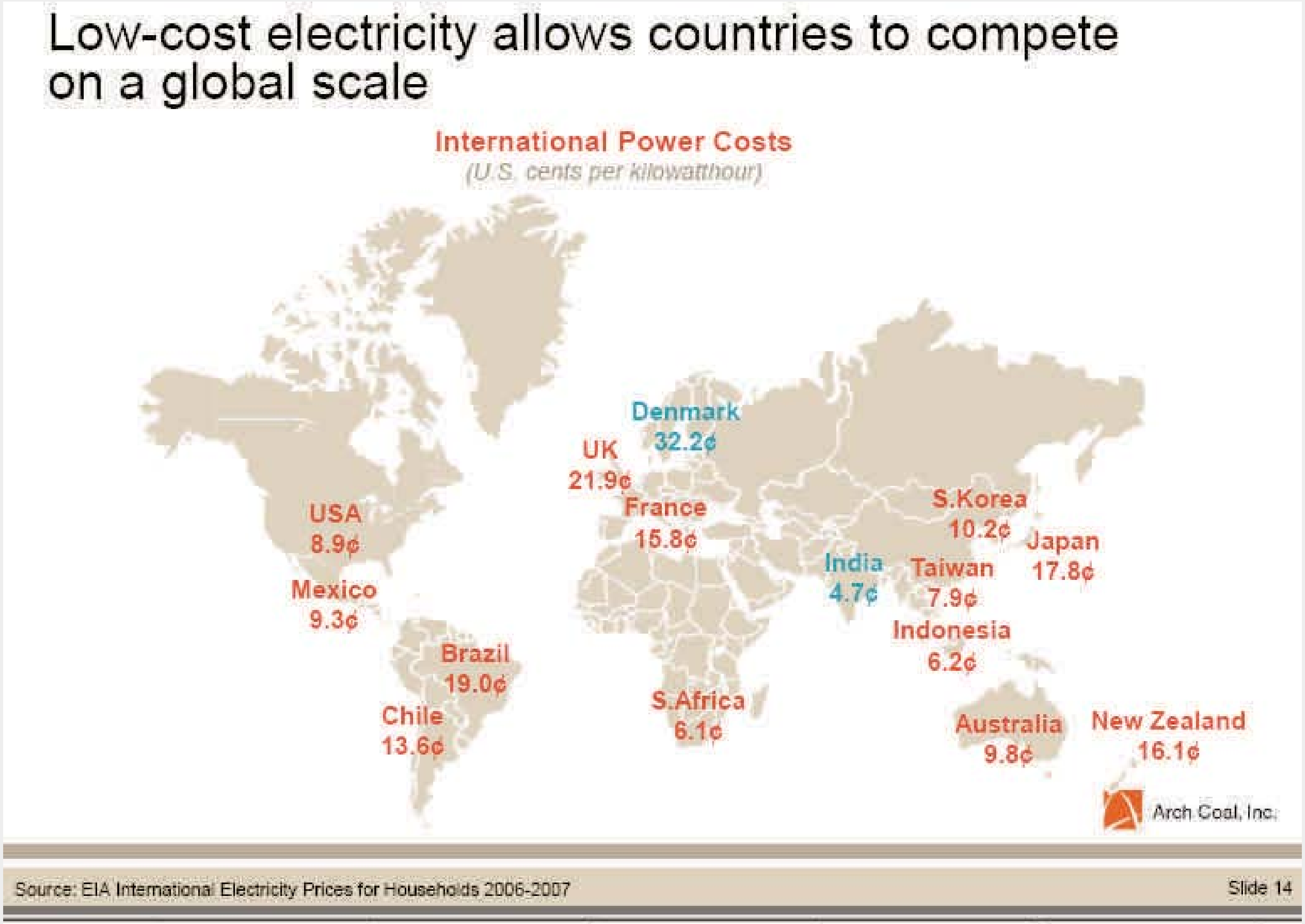
New coal burning generation station power plants coming online

• 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



Low cost coal-produced electricity makes Indiana competitive



2. What are others doing about GHG emissions?

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

- 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_2 Auctions | Offsets | News

RGGI Inc

- About RGGI Inc
- Board of Directors
- Legal Documents
- Contact
- Jobs at RGGI Inc.

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_2 Budget Trading Programs.

RGGI, Inc. will provide technical and support services for key elements of the states' CO_2 Budget Trading programs, including:

- Development and maintenance of a system to report data from emissions sources subject to RGGI, and to track CO_2 allowances
- Implementation of a platform to auction CO_2 allowances
- Monitoring the market related to the auction and trading of CO_2 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

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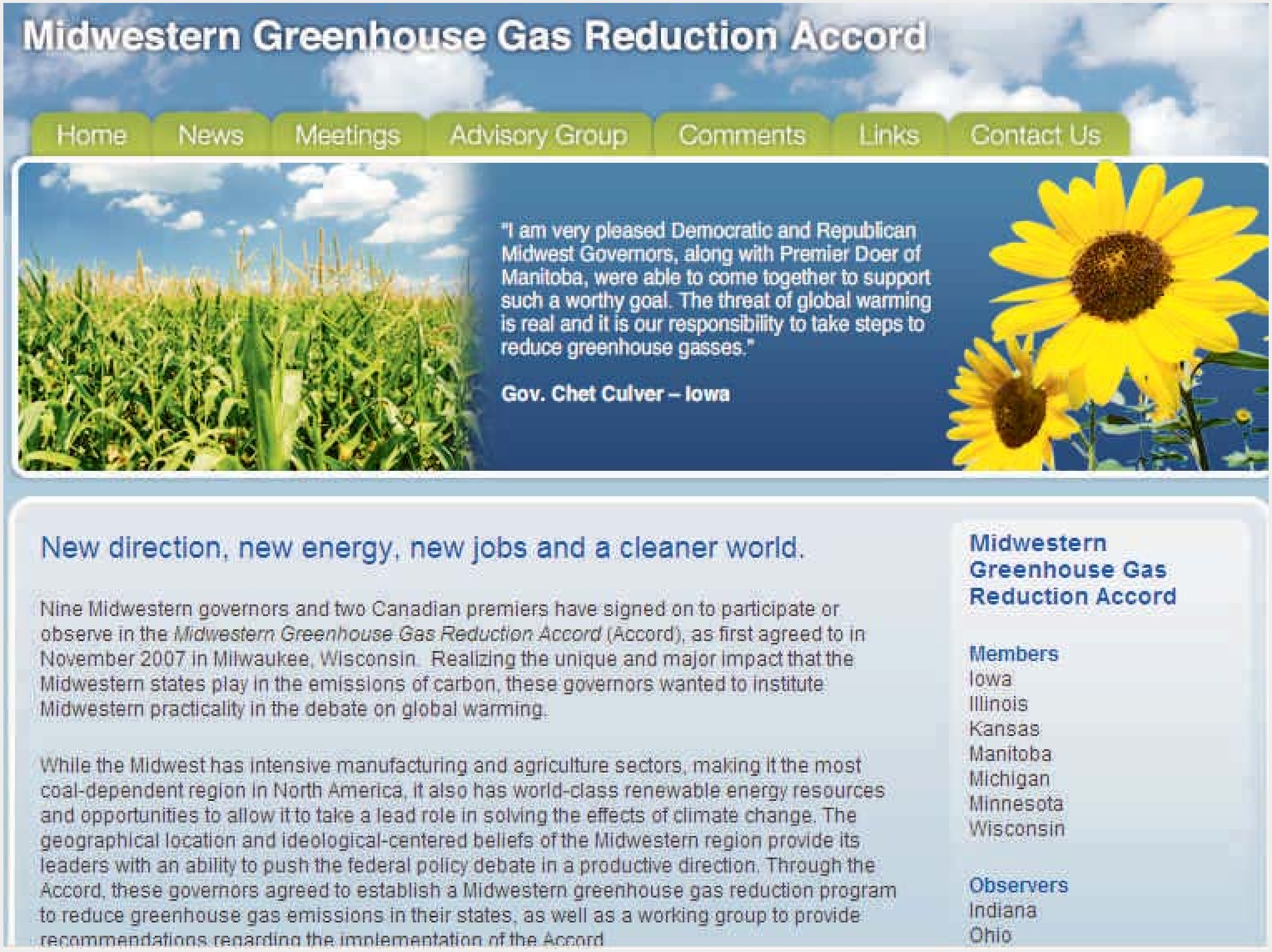

The Climate Registry

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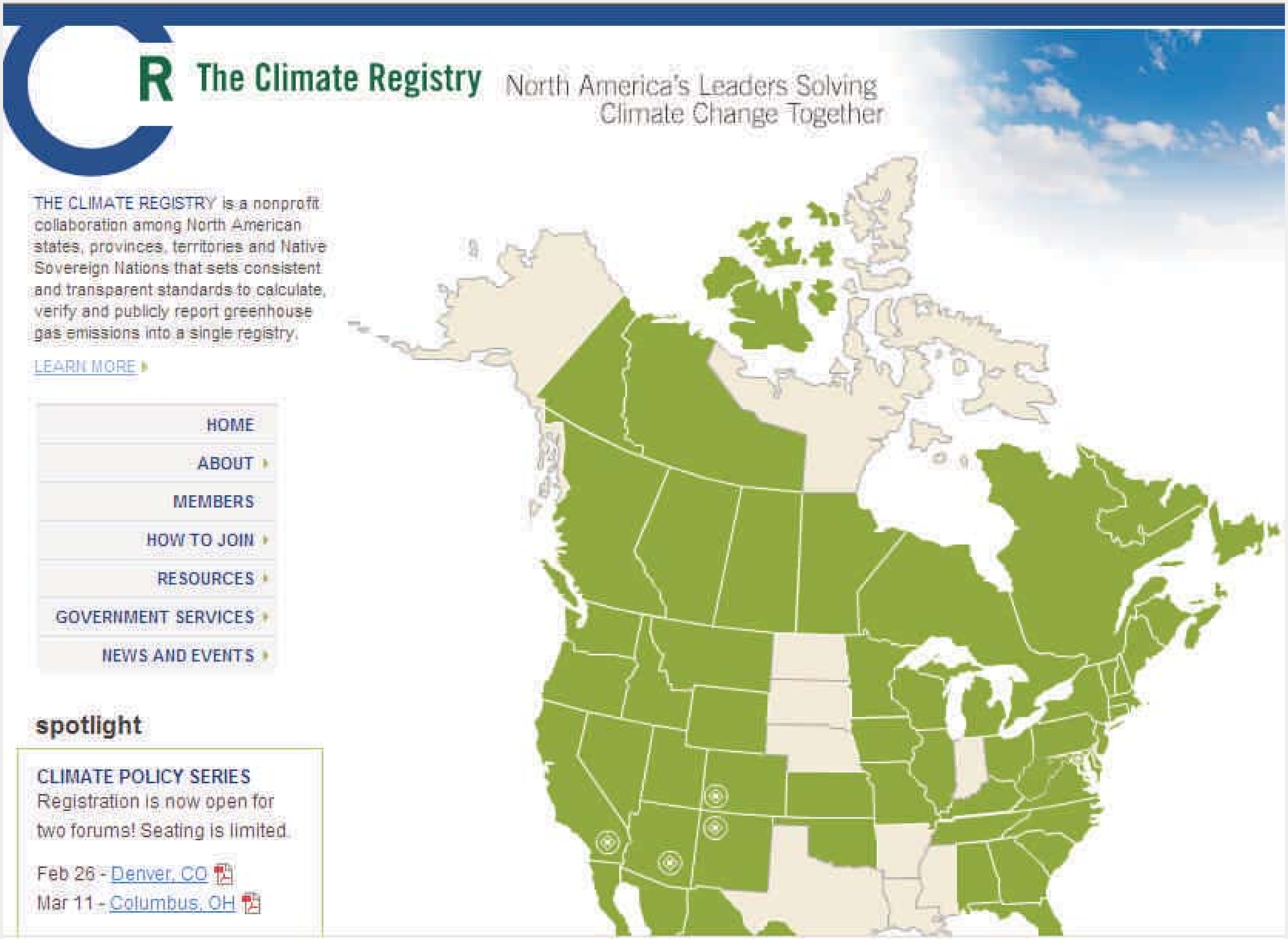


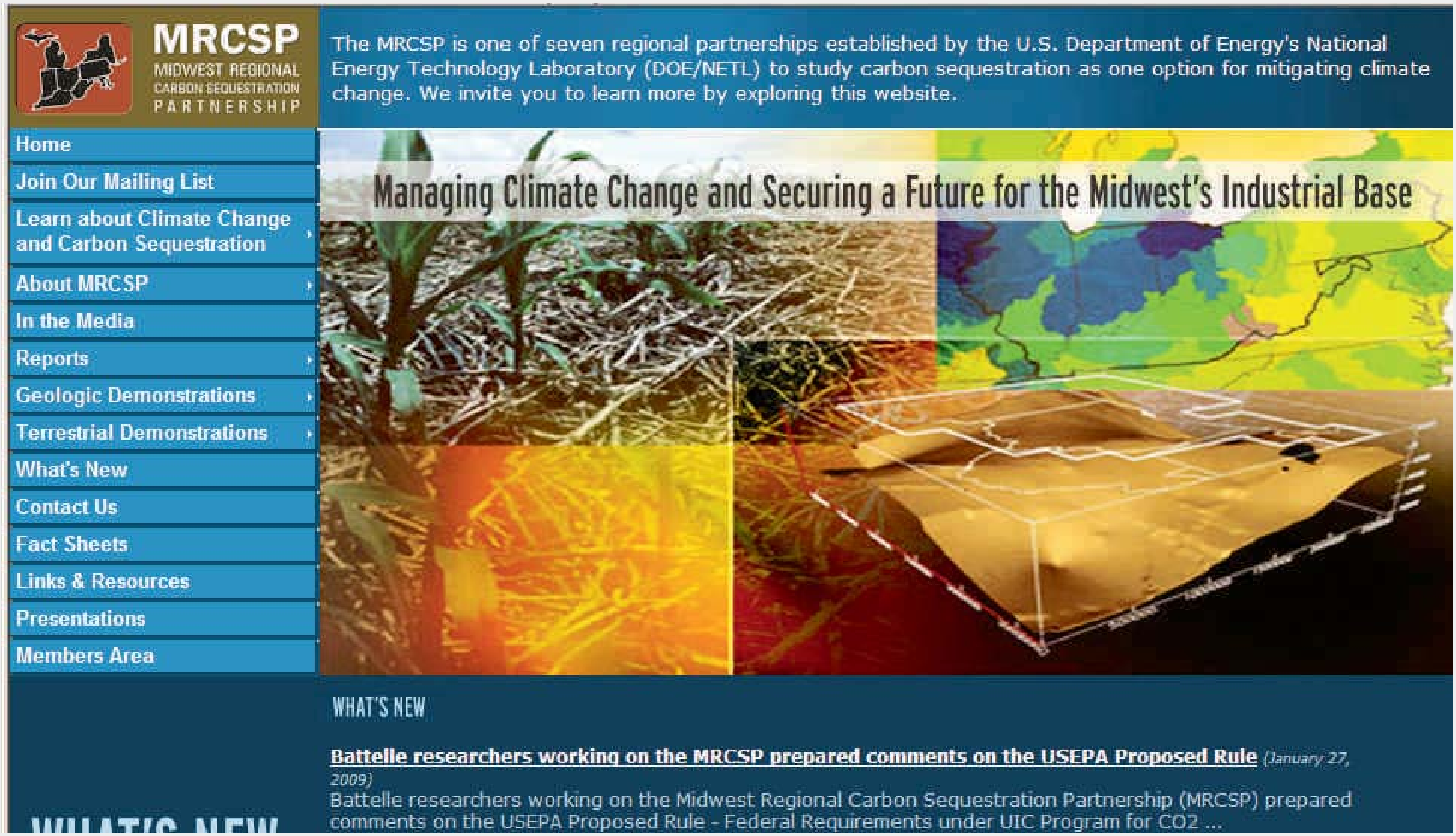
The Climate Registry

Chicago Climate Futures Exchange

Carbon Capture & Sequestration

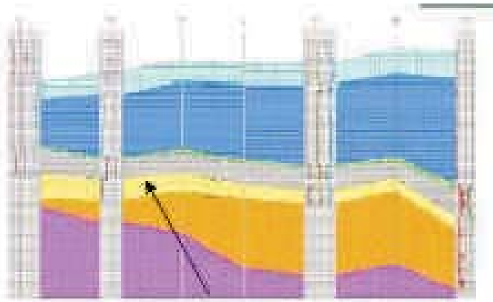
- 30 large scale projects in U.S., Europe, Canada, and Australia at $20 Billion; 110 projects in 18 countries
- $3.4 Billion carbon-related research and demonstration programs
- CCS to scale by 2016

Midwest Regional Carbon Sequestration Partnership



Battelle
The Business of Innovation

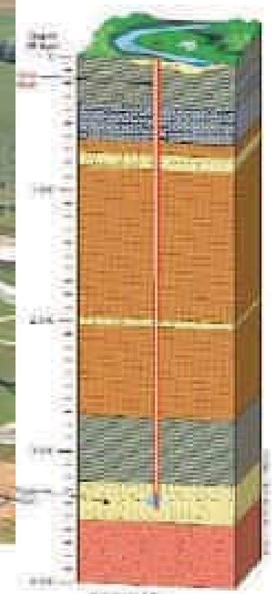
East Bend Station (Duke Energy)



Injection Target,
Mt. Simon Formation

East Bend Station

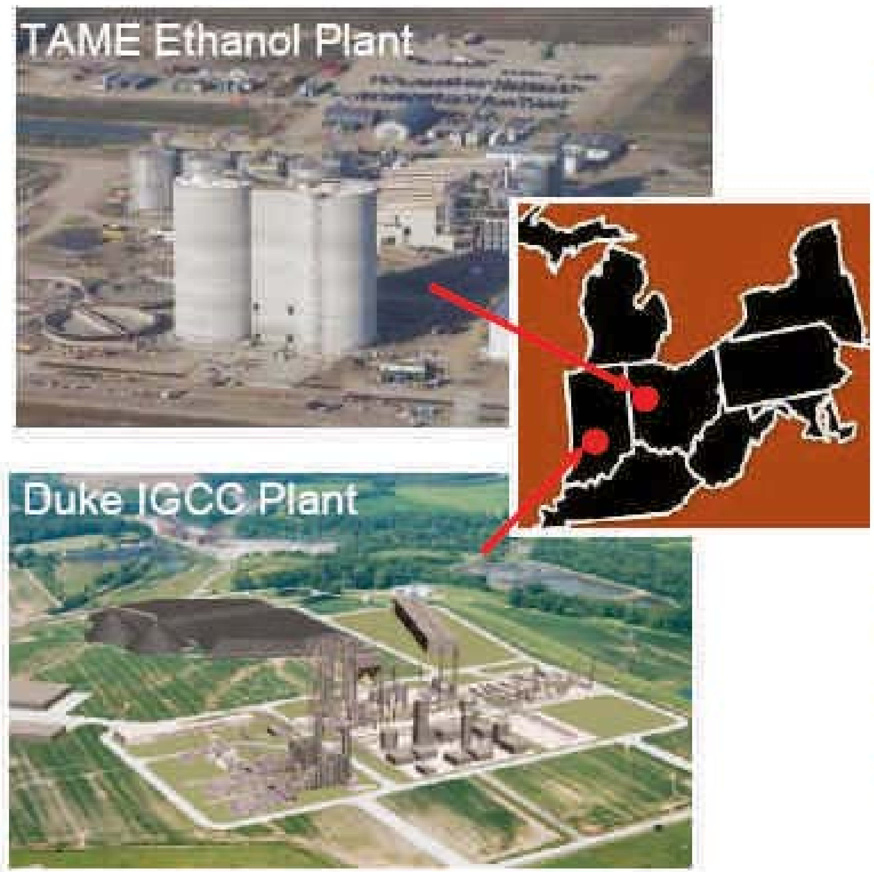
Seismic Survey
October, 2006



Test Well Design

Battelle
The Business of Innovation

MRCSP Phase III proposed sites



Primary site

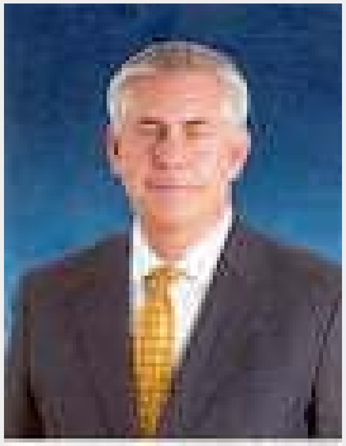
- Host: TAME, a joint venture of The Andersons and Marathon Petroleum
- Plant operational: February 2008
- Injection start: FY2010
- Scale: 1 million tonnes of CO_2 over a four-year period
- Target: Mt. Simon at ~3500 ft.

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



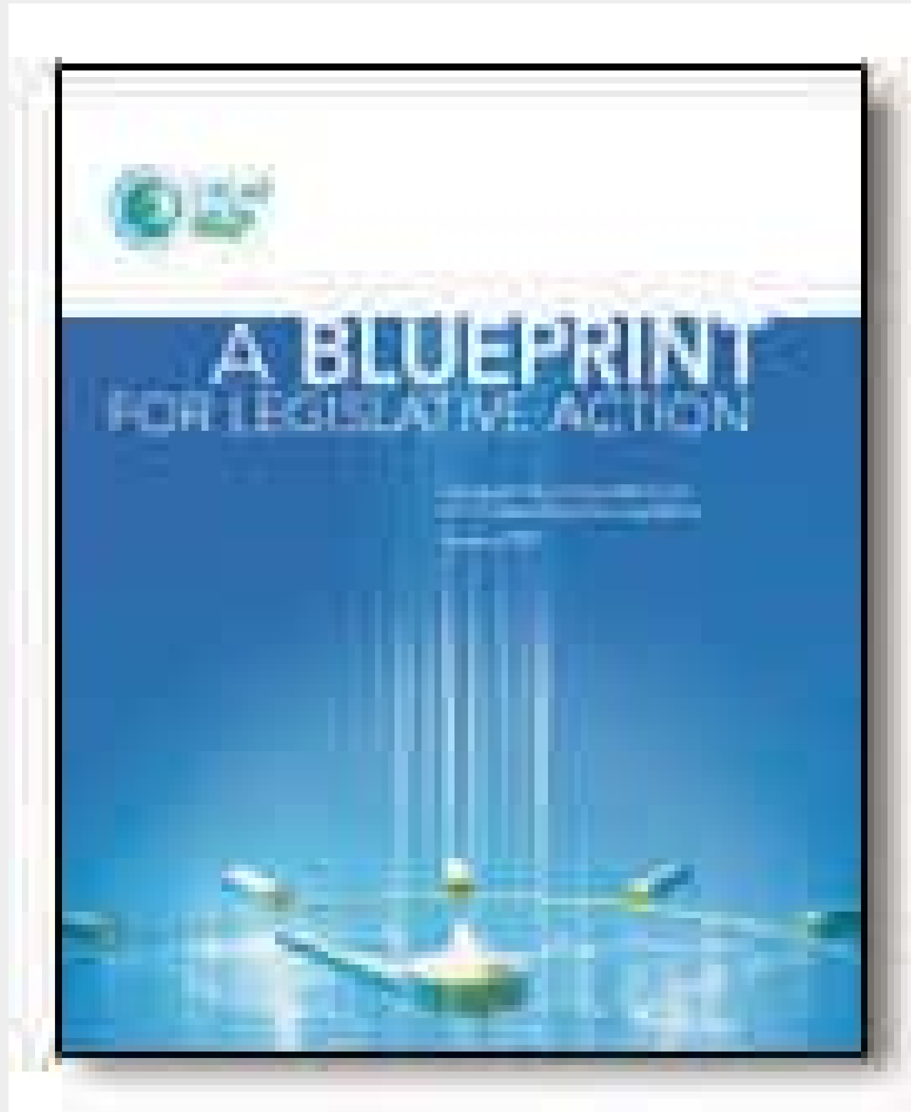
Exxon Mobile Corp.'s Chairman and CEO Rex Tillerson believes a carbon tax would provide the stability companies need to invest in renewable energy.

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

USCAP
United States Climate Action Partnership



What are the cap and trade goals?

- Establish cap
- Sell credits or allowances
- Credits decline every year
- Trade establishes CO_2 market

Trading

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_2 emissions of 25,000 metric tons/year existing;
  - CO_2 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_6 emissions; CO_2 sequestration from afforestation; reduction/avoidance of CO_2 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); spilt 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_2 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

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.

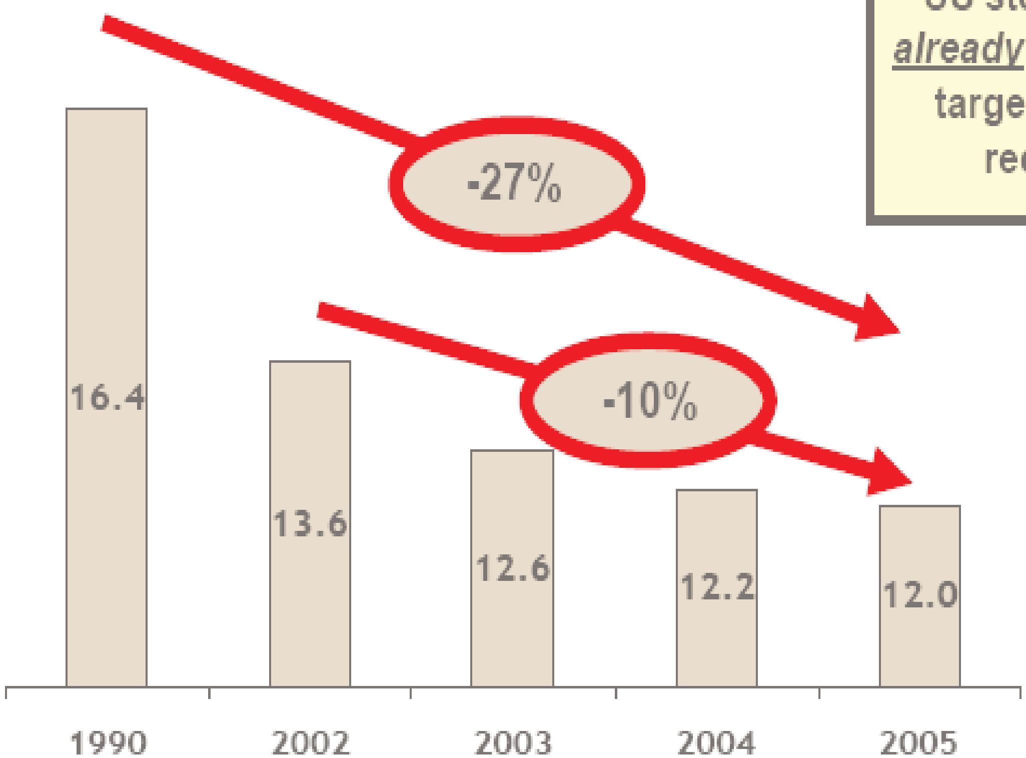
Banking, borrowing, and credits?

- **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…

Steel Industry Composite Energy Intensity

MMBTU/Ton Shipped



Through these efficiency gains the US steel industry *already* meets Kyoto targets for GHG reduction!

Source: American Iron and Steel Institute

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

- 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 and
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_2 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_2 capture (e.g., performance requirements under future regulation)
- CO_2 transportation (e.g., pipeline ownership, safety, regulation, access)
- State property law governing reservoirs, pore space, and injected CO_2
- Liability for CO_2 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 NOx and SO_2 trading programs.

Enforcement Under RGGI

- DEP can conduct audits
- Extensive monitoring
- Extensive record keeping
- Extensive reporting requirements
- Incorporates requirements of NO_x and SO_2 trading programs

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

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_2.

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_2 emissions from industrial sources. (Decision expected April 2, 2009)

10-K Disclosures
Dominion Subpoena

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"In its 2006 Form 10-K, Dominion made no disclosure of projected CO_2 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_2 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_2 emissions;
- projected increases in CO_2 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_2 a pollutant?)

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

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."

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

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

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

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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