

KIRKLAND ALERT

March 2009

Recent Developments in Environmental Regulation

Greenhouse Gas Reporting

This Environmental Alert focuses on recent developments in the regulation of greenhouse gas (GHG) emissions that may interest clients and friends of the Kirkland & Ellis LLP Environmental and Energy Groups. The alert focuses primarily on the U.S. Environmental Protection Agency's (EPA) recent issuance of a proposed rule requiring facilities and corporations to annually report GHG emissions.

EPA'S MARCH 10, 2009 ANNOUNCEMENT

On March 10, 2009 EPA announced that it was issuing a proposed rule requiring annual reporting of greenhouse gas emissions. This rulemaking was expected, and indeed was overdue, since Congress had mandated that the Agency begin work on such a reporting regulation in the Fiscal Year 2008 Omnibus Appropriations Bill, signed into law on December 26, 2007. Congress had mandated that a proposed rule be issued within 9 months of the enactment of the bill, with a final rule to be issued within 18 months of enactment. EPA's action is also not surprising as the two-year anniversary of *Massachusetts v. EPA*, 549 U.S. 497 (2007), approaches, because the new Administration and EPA alike perceive a need to show progress in addressing GHG emissions.

The proposed rule would require facilities and fuel producers to begin reporting their GHG emissions starting in 2011 for emissions occurring in calendar year 2010, whereas vehicle and engine manufacturers would begin reporting emissions for model year 2011.

We invite you to contact us with any questions about the matters addressed in this Alert, or for copies of any materials discussed in this Alert.

THE PROPOSED GHG REPORTING RULE

The proposed rule is applicable to facilities, fuel producers, and vehicle and engine manufacturers, emitting more than 25,000 metric tons or more of carbon dioxide (CO₂) equivalent per year. EPA defines GHG emissions for reporting purposes to include anthropogenic emissions of the six Kyoto gases—carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFC), perfluorocarbons (PFC), and sulfur hexafluoride (SF₆)—as well as other fluorinated gases (e.g., nitrogen trifluoride and hydrofluorinated ethers). The global warming potential of these gases are normalized relative to CO₂, as to produce a CO₂ equivalent metric ton (mtCO₂e) for comparison to the threshold reporting value. The threshold is roughly equivalent to annual consumption of just over 58,000 barrels of oil consumed, or 131 railcars' worth of coal.

The measurement and reporting of GHGs would use existing protocols. Thus, for example, current protocols cover coal-fired utilities currently reporting heat input and emissions under EPA's Acid Rain program, or

DOE's program for voluntary reporting of greenhouse gas (sometimes referred to as the "1605(B)" program). For manufacturers of vehicles and engines, reporting would be similar to that used during certification testing of new engines and vehicles, with emissions reported on CO₂ equivalent per mile basis. For fuel producers, the GHG emissions are estimated based on the quantity of fuel produced and the estimated CO₂ equivalent GHG emissions generated when the fuel is utilized.

There are 19 source categories for which reporting is required regardless of whether the facility's annual GHG emissions exceed 25,000 mtCO₂e. These source categories are generally composed of facilities that EPA expects would exceed the reporting threshold and where complete sector information was thought to be useful. A list of these 19 source categories is available at <http://www.epa.gov/climatechange/emissions/downloads/GeneralProvisions.pdf>.

One sector that remains relatively unregulated is agriculture. There are no proposed reporting requirements specific to agriculture other than for manure management units. EPA estimates that there are 50 or fewer such facilities that would exceed the proposed reporting threshold. Thus, GHG emissions from other sources at livestock operations — enteric fermentation from cattle, field application of manure, pasture/range manure management practices, composting, rice cultivation, and emissions from agricultural burning — are not reported. It remains an open question whether these exclusions from the reporting rule will be included in the final regulation.

GHG - A NEW EPA REGULATORY REGIME?

The proposed GHG reporting rule is an important initial step toward any eventual regulation controlling GHG emissions and thus takes several important steps toward the establishment of a traditional Clean Air Act regulatory regime, including identifying significant emitters, developing a national GHG emissions inventory, determining accepted test and measurement protocols, and instituting electronic reporting protocols. These are all necessary prerequisites for a cap and trade system of GHG emission controls, which remains the most likely

structure for regulating economy-wide GHG emissions (as contrasted with an emissions tax or fee system).

The proposed rule requires self-certification by reporting entities, and does not impose a third-party certification requirement. While self-certification saves the regulated community costs, it imposes an additional burden on EPA to ensure that submitted reports are reviewed and corrected in a timely fashion. Further, if and when GHG emission credits are utilized in a cap and trade regulatory program, the financial consequences of misreporting GHG emissions will be large. Entities that underreport emissions, and that later become the subject of enforcement scrutiny, could be subject to large civil penalties based on EPA's use of the calculated economic benefit (the value of any unreported emission credits) in developing the civil penalty. A recent example from the Acid Rain Program, involving a utility that underreported emissions for several years, resulted in an \$11.4 million penalty. See <http://www.epa.gov/compliance/resources/cases/civil/aa/eastkentuckypower-dale0907.html>.

EPA REQUEST UTILIZES THE CLEAN AIR ACT INFORMATION COLLECTION AUTHORITIES

The statutory authorities cited for requiring reporting of GHG emissions are Clean Air Act sections 114 (for stationary sources) and section 208 (for mobile sources). This is consistent with the language in the FY08 Consolidated Appropriations Bill, and allows the Agency to proceed without the need for additional climate change legislation. Under the Clean Air Act, EPA has broad authority to require submission of emissions data. EPA is proposing that the enforcement of these provisions will be subject to the standard penalty provisions of the Clean Air Act. Pursuant to inflation-related provisions of law, these penalties have recently been increased to a maximum of \$37,500 per day.

When reporting emissions data to the Agency, confidentiality issues may arise. Generally, emissions data is presumed to be public information. However, for some industry sectors it is quite possible that the GHG emissions will be proportional to a facility's production output, a parameter that is frequently

sensitive for competitive reasons. It will be interesting to see whether the Agency attempts to design provisions that address this issue in the context of GHG emissions. If in doubt, it is generally advisable for a regulated entity to thoroughly document any privilege claims as well as to follow any procedures EPA has put in place for protecting confidential business information (CBI).

UNRESOLVED ISSUES REGARDING THE REPORTING PROGRAM

There are still a number of unanswered questions regarding the proposed reporting program. Among the many issues that remain unresolved are the following:

Testing and Measurement Protocols - To the extent that there are technical issues with current test and measurement protocols, these issues will be exacerbated under the proposed rule. For example, EPA proposes to require reporting from manure management facilities that exceed the reporting threshold, but it has been difficult to measure emissions from this sector. Due to the lack of data, EPA currently has underway a major national study — the National Air Emissions Monitoring Study (NAEMS) — ongoing at sites across the country, to determine the emissions from concentrated animal feeding operations (CAFOs). It is important that the EPA-mandated methodologies accurately characterize the GHG emissions from each sector under the proposed rule. Under future potential cap and trade programs, a regulated entity's emission credit requirements, and therefore costs, will be directly tied to their estimated emissions. Test methods and emission protocols that generate inaccurate emission values, especially relative to other sectors, could prove costly.

Emission Sinks - Emission sinks are not addressed. This becomes apparent in the discussion of how the proposed regulation affects producers of industrial gas and CO₂ products. A producer of dry ice (solid CO₂) would be required to report the quantity of product produced, assuming it exceeds the reporting threshold, even if all the CO₂ were to be derived from the atmosphere through condensation. Thus, even

though there is little or no net CO₂ emitted, the facility would be counted as a major source under the proposed rule. It is noteworthy that EPA's latest GHG emission inventory, which includes both GHG sources and sinks, was made available on March 10, 2009 through a notice in the Federal Register, the day of EPA's announcement of the proposed rule. *See* 74 Fed. Reg. 10,249 (March 10, 2009).

Relation to Other GHG Emission Programs - It is unclear how the proposed rule would interact with existing state, regional, federal, and international GHG inventories and registries. The proposed rule is a "bottom-up" collection of source data, and thus does not correlate with the "top-down" approach used for large international and national inventories (e.g., the GHG inventory submitted to the United Nations Framework Convention on Climate Change (UNFCCC), entitled "Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990-2006 (April 2008)"). In addition, due to the use of reporting thresholds and the exclusion of particular sectors, EPA acknowledges the emission sources in the proposed rule necessarily comprise less than a full inventory. EPA requests comment on how information in the proposed rule should be used with respect to other GHG emission programs.

GREENHOUSE GAS EMISSIONS - A NEW DIRECTION AND PACE FOR THE AGENCY

The issuance of this new proposed inventory regulation has been anticipated since the December 2007 passage of the 2008 Consolidated Appropriations Bill mandating its development. The Agency will be under pressure to issue the final rule by the June 2009 deadline. There are two public hearings scheduled for the proposed regulation; the first on April 6 and 7, 2009, at EPA Potomac Yard Conference Center, Arlington, VA; and the second on April 16, 2009, at Sacramento Convention Center, Sacramento, CA. The deadline for written comments is within 60 days of the publication of the proposed rule in the Federal Register, which would mean late May 2009. Interested parties should plan on either attending the hearings or submitting written comments.

Should you have any questions about the matters addressed in this Alert, or should you wish to add parties to our distribution list, please contact the following Kirkland & Ellis authors or the Kirkland & Ellis attorney you normally contact:

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