



REGIONAL CLIMATE CHANGE INITIATIVES: AN OVERVIEW

MAY 1, 2008

Introduction

Concerns about climate change have sparked global efforts to regulate carbon dioxide and other "greenhouse gases" (GHGs). Recent, and sometimes inconsistent, developments at various levels of government present significant business risks and opportunities. To anticipate future GHG regulation, North American companies should follow two regional regulatory initiatives: the Western Climate Initiative (WCI) and the Midwestern Regional GHG Reduction Accord (Midwestern Accord). These regional initiatives are developing market-based GHG cap and trade programs that may become models for future continent-wide regulations.

To inform you of regional developments and their implications for business, we at Perkins Coie LLP and Fasken Martineau DuMoulin LLP are working together to provide monthly updates on these GHG initiatives. We will also inform you of developments in a third regional initiative, the Northeast Regional Greenhouse Gas Initiative (RGGI)¹, where it is relevant to the WCI and Midwestern Accord.

Fasken Martineau has six offices across Canada, one in London and one in Johannesburg. Perkins Coie has 12 offices across the United States and two in Asia. Both firms are leaders in environmental and energy law. Our goal is to work together to provide you with seamless coverage of these important regional and cross-border issues.

¹ In 2005, several Northeastern U.S. states launched a process to develop and implement a mandatory CO₂ cap and trade program to limit GHG emissions from power plants in their states. The participants and key aspects of the RGGI process are described more fully in the attached table.

A Brief Summary of the WCI

Formed in February 2007, WCI is a collaboration among seven U.S. states (Arizona, California, Montana, New Mexico, Oregon, Utah and Washington) and three Canadian provinces (British Columbia, Manitoba and Quebec) whose goal is to reduce regional GHG emissions. In August 2007, WCI issued a Statement of Regional Goals that set 2020 targets for regional GHG emissions at 15% of 2005 levels. The statement calls for each state and province to undertake comprehensive and economy-wide emission reduction activities targeting all economic sectors, including stationary sources, energy supply, residential, commercial, industrial, transportation, waste management, agriculture and forestry. The activities include a regional multi-sector cap and trade program and an offset program.

What Is a Cap and Trade Program?

Cap and Trade is market based-regulation. Governments establish maximum GHG emissions, and distribute or auction emission allowances permitting emissions up to but not exceeding the cap. The allowances decrease with time to meet the government's target future emission levels. For each compliance period, regulated emitters must remit allowances equal to their actual emissions. Emitters with excess emissions or excess allowances may "trade" them with others in market transactions. Each program determines its own emission goals, regulated sectors, level and allocation of allowances, and methods to verify compliance and regulate markets.

Today, WCI is completing the design of its cap and trade and offset programs. Various WCI subcommittees recently published draft design recommendations on issues ranging from allocation of tradable allowances to which GHG offsets should

be eligible for credit. We will continue to provide WCI updates on these issues.

WCI's statement also encourages other U.S. and Mexican states, Canadian provinces and First Nations to join WCI. New entrants must undertake comparable efforts to control climate change. Fourteen states and provinces have joined WCI as observers, including Alaska, Colorado, Idaho, Kansas, Saskatchewan, Ontario, Baja California and five other Mexican states.

To date, WCI's draft recommendations contemplate the first GHG emission caps applying to (1) electricity generators; (2) large stationary combustion sources (e.g., oil refineries, and cement, pulp and paper plants); (3) process industries and waste management (e.g., aluminum smelters, iron and steel producers, agricultural chemical and plastics manufacturers, wastewater treatment facilities and landfills). Businesses with significant GHG emissions in WCI jurisdictions will be required to measure, monitor and report their GHG emissions in anticipation of mandatory GHG limits or "caps" and to offset emissions that exceed this cap with recognized allowances or eligible offsets. This could impose heavy operational costs on such businesses.

What Is an Offset?

An offset is an emission reduction from a source not capped by a cap and trade program. Permitting offsets encourages reductions beyond the scope of a cap and trade program, often in sectors where emissions are more difficult to track and report (for example, mobile sources). To provide the necessary market to encourage offset development, regulated emitters in the cap and trade program can use offsets for compliance, in the same way they use allowances. The introduction of offsets into the cap and trade program provides an additional source of compliance units that may, in certain cases, be less costly than those available to capped emitters otherwise restricted to reducing their own emissions.

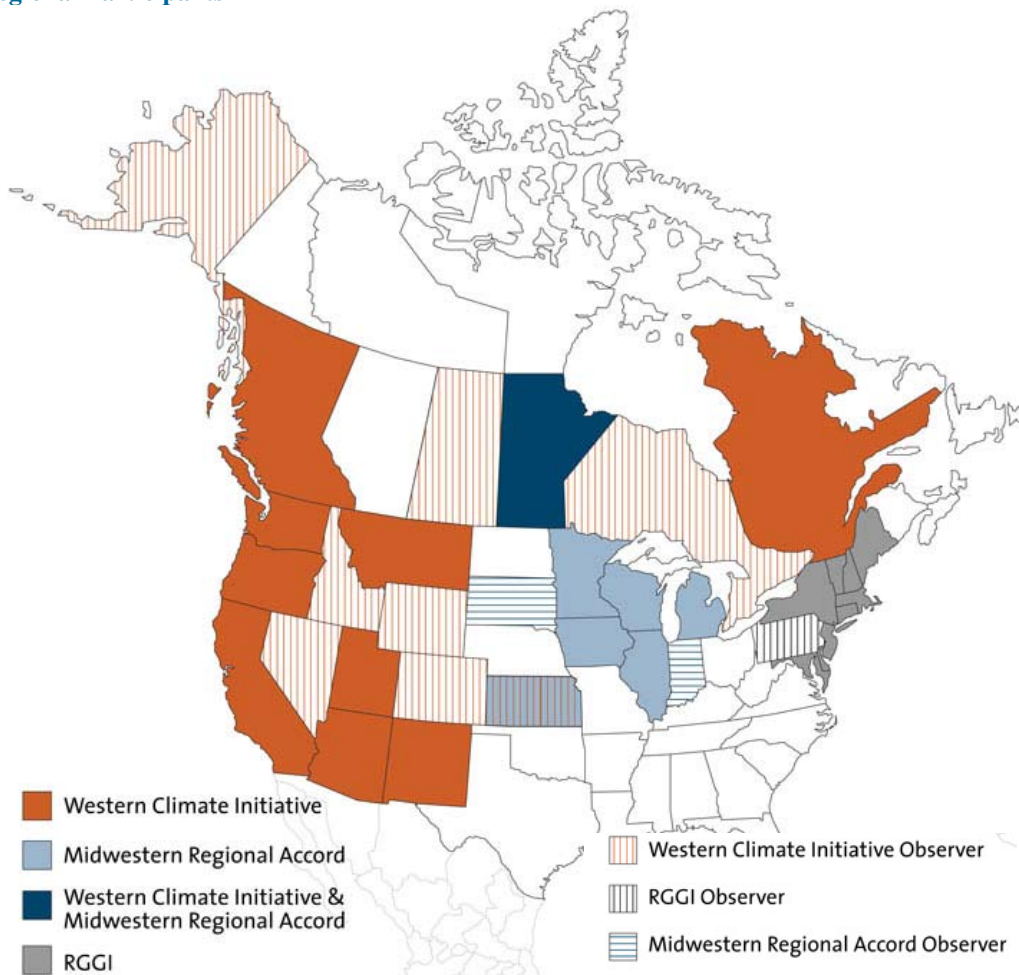
Brief Summary of the Midwestern Accord

Formed in November 2007, the Midwestern Accord involves U.S. states (Illinois, Iowa, Kansas, Michigan, Minnesota and Wisconsin) and one Canadian province (Manitoba) in a regional program to reduce Midwestern GHG emissions. Indiana, Ohio and South Dakota participate as "observers." The Midwestern Accord will establish its regional reduction targets by July 2008 and plans to establish its multi-sector cap and trade program by November 2008.

The Midwestern Accord intends its cap and trade program to enable linkage with other jurisdictions' programs. This enables a future network of regional programs that could link WCI, the Midwestern Accord and other regional efforts such as RGGI.

Partners to the Midwestern Accord agreed that their emissions reductions targets would be "consistent with each state's goals," which, when established, will likely reflect the fact that members produce approximately 14% of total GHG emissions in North America and generate approximately 60% of their electricity from coal. Members have emphasized the need for innovation and leadership in using the region's significant coal reserves while reducing GHG emissions and expanding the use of other energy sources such as wind and biofuels. The Midwestern Accord will use incentives and other funding mechanisms as policy tools to encourage energy efficiency programs, ethanol and biodiesel industries and carbon capture and storage.

Map of Regional Participants



What Drives These Initiatives?

The WCI and Midwestern Accord each reflect expectations that climate change will present economic opportunities as well as burdens. Each seeks to position its members as market leaders in new climate-related industries: producing and selling alternative fuels, recruiting "green" business, and selling GHG reduction offsets. At the same time, each realizes that climate policies can be synergistic with other state goals—for example, expanding use of mass transit will reduce GHG emissions and encourage denser urban development.

Although the initiatives differ substantially from one another in design and timetable, there are signs that members will seek to integrate them into a single North American program. Each WCI and Midwestern Accord member seeks to work in partnership to achieve substantive reductions in GHG emissions

while sustaining and enhancing regional economic development. Broad geographic partnerships can develop more comprehensive, integrated and cost-effective carbon control policies that eliminate duplication and bring uniformity and predictability to state rules and regulations. Regional leadership and expertise also earns credibility to influence development of nationally based cap and trade programs in a way that will reflect each region's unique needs and capacities.²

² Each regional initiative and its members are also members of The Climate Registry (TCR), a joint effort by most U.S. states and Canadian provinces, and two Mexican states to develop and manage a common GHG emissions reporting system.

Summary of Key Information

The following table summarizes key components of the WCI, Midwestern Accord and RGGI initiatives.

COMPARISON OF REGIONAL CLIMATE CHANGE INITIATIVES

| | WESTERN CLIMATE INITIATIVE "WCI" | MIDWESTERN ACCORD | REGIONAL GREENHOUSE GAS INITIATIVE "RGGI" |
|---------------------|--|---|---|
| Cap & trade | Yes, potential start date in 2009. | Yes, potential start date in 2009. | Yes, 1st auction 9/2008. |
| Sector | Multi-sector | Multi-sector | C & T starts 1/2009 |
| Target | 15 % below 2005 levels by 2020. | Fix goals by July 2008. | 2008: single sector (power plant CO ₂); |
| Other programs | Consider non C&T programs to meet targets. | Link to others (e.g., WCI/RGGI); develop other programs including carbon fuel standard and new funding mechanisms. | During 2009-2014 maintain CO ₂ emissions ≤2008 levels; post 2014 reduce emissions 2.5%/yr year for next four years (2015- 2018). |
| Gases targeted | CO ₂ , CH ₄ , N ₂ O, HFCs, PFCs, SF ₆ | CO ₂ , CH ₄ , N ₂ O, HFCs, PFCs, SF ₆ | Start w/CO ₂ ; expand to other GHG's |
| Sector focus | As many as possible. Start w/ electric sector and large stationary combustion sources. Expand to industrial process, waste management, fossil fuel production, transportation fuel, and other sectors. | Multi-sector, but not defined. Partners may phase in programs to be consistent with WCI. | Fossil fuel-fired electric generators ≥ 25 mw |
| Reporting | Develop GHG reporting rule based on each partner's mandatory requirement. Reporting likely required before C & T program in place. Capped sectors must report; some non-capped sectors may too. Plan to use TCR infrastructure and software if possible. | Reporting plans not defined. Partners commit to track and manage GHG emissions. May develop reporting program in addition to TCR. | Specific tracking registration system for tradable allowances will permit reporting of non power plant emissions to TCR. |
| Status/major events | Sub-committees designing program; recommendations due 8/2008. Each partner's regulators must approve. Next public meeting: May 21, Salt Lake City. | Create C&T model rule by 11/2008. Developing work plan and work groups to implement program objectives through Midwestern Governor's Assoc. | Model C&T rule adopted; individual partners seeking regulatory approval. First GHG allowance auction 9/2008; C&T in effect 1/2009. |

Linkages Between WCI and the Midwestern Accord and RGGI

WCI is currently considering whether to link its cap and trade programs to the Midwestern and RGGI programs and whether voluntary carbon offset credits or other emission reductions generated outside WCI's area will be eligible within WCI. We will address these ongoing issues in future bulletins.

Coordination and Conflict With National Programs and Kyoto Protocol

Unlike the United States, Canada ratified the Kyoto Protocol in December 2002. Canada's federal

government and its provinces share jurisdiction over Canada's environment. Typically, the federal government sets a baseline standard and enters into equivalency agreements with the provinces. Provided that provincial standards meet or exceed the federal standard, which is usually the case, provincial and regional programs will likely succeed without conflict or overlap with federal programs.

In contrast, the U.S. federal government has the power to pre-empt state or regional action thus creating more uncertain risks of overlap and conflict. Today, it is unclear how the regional cap and trade programs might interrelate with prospective U.S. national programs or ongoing efforts by the U.S. government to negotiate an international response to

climate change. A U.S. national cap and trade program could expressly pre-empt individual state or regional programs, or it could expressly accommodate such initiatives.

Internationally, Canada and the United States may seek to integrate transboundary regional initiatives like WCI and the Midwestern Accord into ongoing efforts for a post-Kyoto GHG reduction agreement to take effect once Kyoto expires in 2012. International negotiations on this subject have officially begun.

Conclusion

Our firms will publish these updates monthly or more often as relevant events occur. We aim to assist our clients who will be impacted by climate change regulatory developments to better understand the regional initiatives and their effect on business on both sides of the border. We will be pleased to respond to inquiries and provide further information.

For more information, please contact the Fasken Martineau or Perkins Coie lawyer with whom you regularly deal, or:

Perkins Coie

Ivan Gold
503.727.2214

igold@perkinscoie.com

Steve Higgs
503.727.2215

shiggs@perkinscoie.com

Tom Lindley
503.727.2032

tlindley@perkinscoie.com

Karen McGaffey
206.359.6368

kmcgaffey@perkinscoie.com

Robert Maynard
208.343.3434

rmaynard@perkinscoie.com

Christopher Sutton
303.291.2312

csutton@perkinscoie.com

Shane Swindle
602.351.8384

sswindle@perkinscoie.com

Kirk Dublin
415.344.7059

kdublin@perkinscoie.com

Sloane Wildman
202.434.1623

swildman@perkinscoie.com

Fasken Martineau

Kai Alderson
604.631.3222

kalderson@fasken.com

Florence Dagicour
514.397.5236

fdagicour@fasken.com

Ron Ezekiel
604.631.4708

rezekiel@fasken.com

Heidi Granger
604.631.4790

hgranger@fasken.com

Brenden Hunter
403.261.6157

bhunter@fasken.com

Pierre Meunier
514.397.4380

pmeunier@fasken.com

Andre Turmel
514.397.5141

aturmel@fasken.com

Paul Wilson
604.631.4748

pwilson@fasken.com