

Climate Change Advisory

June 30, 2009

House of Representatives Passes Groundbreaking Climate and Energy Bill -- The American Clean Energy and Security Act (ACESA) Now Heads to the Senate for Debate

On June 26, the House of Representatives narrowly approved game-changing climate change legislation, the American Clean Energy and Security Act (ACESA), also called Waxman-Markey (HR 2454), the first major environmental legislation to be approved by either the House or the Senate in almost twenty years. Much has already been said about ACES that industry may find confusing, and this alert sorts out what the bill does -- and doesn't -- do and identifies the key issues you will need to address as the debate moves to the Senate.

The come-from-behind 219-212 vote took place amidst defections by supporters in industry and environmental organizations alike, with even the White House expressing concern about global trade impacts as the vote approached. The passage of ACESA may have been a near thing, but it still would be hard to exaggerate the turning-point the House vote represents. Its commitment for a 17 percent cut in CO₂ emissions from 2005 levels by 2020, a 42 percent cut by 2030, and a huge 83 percent cut by mid-century would:

- Transform the US economy and in particular the energy sector;
- Create a multi-billion dollar new market in valuable rights to emit greenhouse gases;
- Provide a terrific boost to the "green economy" that the federal stimulus jump-started;
- Enhance prospects for a bi-lateral agreement with China;
- Virtually assure a new international climate deal in Copenhagen this December; and
- Lay a foundation on which subsequent congresses can build (many scientists say that even these emissions cuts are not nearly enough to get the job done).

The ACESA legislative runs well over a thousand pages, but its basic theory is not hard to understand. The regulatory reality for US industry is in the details of this extremely complex bill.

Regulating Greenhouse Gas Emissions

ACESA prohibits most industrial greenhouse gas releases into the atmosphere, sets an adjustable limit, or "cap," on total releases, and requires major emitters to obtain tradable emissions allowances that have been limited so that the cap will not be exceeded. Initially, the supply of marketable carbon dioxide equivalents allowed under the cap will about equal demand, but as the supply is ratcheted down, over time, supply will not nearly meet demand, and the price of allowances will go up steeply. Candidate Obama wanted the billions of dollars of emissions allowances to be auctioned off to the highest bidders, but as President he went along with the House's decision to allocate most of the valuable "pie" of allowances free by economic sector. This will set the stage for an enormous debate in the Senate over which industrial sectors will receive the many billions of dollars in allowances and economic incentives related to this allocation.

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ACESA Highlights

- Prohibits most industrial greenhouse gas releases into the atmosphere
- Sets adjustable limit ("cap") on total releases and requires major emitters to obtain tradable emissions allowances to stay under the cap
- Makes allowances available by government allocation, purchase at auction, or open market trading among holders
- Authorizes the EPA to implement and enforce cap-and-trade and numerous other complex regulatory provisions
- Requires some sources to meet specific technology-based emissions limitations and efficiency requirements
- Creates a new national renewable energy portfolio standard (RPS) that would start in 2012 at six percent and would ratchet up to a 20 percent requirement by 2021
- Provides economic incentives (e.g. subsidies, grants, waivers, etc.) to relieve hardship and promote a more rapid transition to a "low-carbon" economy
- Sets the stage for an enormous debate in the Senate over which industrial sectors will receive many billions of dollars in allowances and economic incentives

Allowances will be available by government allocation, purchase at auction, or open market trading among holders, with surrender to the government when covered emissions occur. Eventually, up to 85 percent of allowances will be auctioned. Trading will include banking, averaging, and borrowing against future allocations, in addition to market instruments not specifically mentioned in the bill. The Federal Energy Regulatory Commission and the Commodity Futures Trading Commission rather than the Environmental Protection Agency (EPA) would regulate allowances, offset credits, and renewable energy credits. Reflecting recent turmoil on Wall Street, the House voted to bar over-the-counter carbon derivatives trading. In short, the now relatively unregulated markets for trading of newly created carbon and renewable energy credits, futures, and derivatives would come under federal supervision.

The "cap-and-trade" provisions would be implemented and enforced by the EPA under the federal Clean Air Act. The cap-and-trade system would preempt existing state and regional climate change management schemes, **but states would be free to enact new, more stringent greenhouse standards.** State efficiency codes for buildings would not be preempted despite federal preemption of state appliance standards.

Cap-and-trade would be phased in by regulating greenhouse emissions from electrical plant smokestacks in 2012, industrial sources in 2014, and natural gas and fossil-fuel distribution in 2016. The last phase is important: to handle the tens of millions of small emitters not caught up in this scheme, fuel distributors, e. g., for space heating and gasoline and diesel for vehicles, would have to obtain allowances to cover their customers' emissions, other than the utility and industrial sources already covered by cap-and-trade.

The bill authorizes a limited number of allowances to be created by "offsetting" unregulated greenhouse emissions, including by sequestration that permanently captures carbon in soils and forests. Under the bill, offsets can also be generated by projects that destroy potent greenhouse chlorofluorocarbons, if authorized in advance by the EPA Administrator. Regulations for quantifying and monitoring these offsets have to be written and are bound to become controversial. Again, the devil is in the details of this complex bill.

Emissions Limitations and Efficiency Requirements

Additional specific emissions limitations and efficiency requirements also apply, regardless of allowance allocations. The EPA would use the existing Clean Air Act to develop technology-based standards limiting emissions from some sources not covered by cap-and-trade. These highly specific requirements reflect a bargaining process that will continue in the Senate. Also, the bill would create a new national renewable portfolio standard (RPS) that would require utilities by 2012 to generate six percent of their electricity from energy efficiency measures or from renewable energy sources like wind and solar. The RPS would increase by roughly three percent each year until 2021, when it would top out at 20 percent. The RPS standard would not preempt more stringent state RPS standards, and states would be permitted to require utilities to retire federal renewable energy credits received in excess of the federal standard. The bill also calls for state planning programs to reduce emissions from transportation and for land use and other state and federal plans to foster adaptation to climate changes that already appear almost certain to occur.

Economic Incentives

Economic incentives (subsidies, grants, waivers, etc.) are provided to relieve hardship and promote a more rapid transition to the "low carbon" economy the bill contemplates. These provisions likewise provide important political bargaining opportunities, alongside the initial allocation of allowances, and together these will be a major focus in the Senate. The welter of provisions includes tax and funding incentives for renewable energy, energy efficiency, smart grid improvements, transportation programs, fuel-switching from coal to natural gas, and programs to capture and sequester greenhouse gas emissions. For example, ACESA directs many billions of dollars to the evolving technology of coal-fired electrical generation with carbon capture and store (CCS).

Representatives from states with large agriculture or forestry markets secured provisions to grandfather biodiesel facilities from the low carbon requirements of the 2007 energy law and broaden the definition of renewable biomass to gain additional credit under the RPS and the existing renewable fuels standard. The bill addresses the harvest of biomass from dead or damaged trees or "late successional" stands and clarifies that the agricultural and forestry sectors are exempt from the bill's emissions cap. Eleventh-hour agreements to address the concerns of farm-state lawmakers secured an additional billion dollars for agriculture producers who engage (or engaged prior to 2001) in conservation and stewardship practices that reduce or sequester greenhouse gas emissions but would not otherwise qualify under the offsets section of the bill. Additional allowances for rural electric cooperatives, and language blocking EPA from going forward with methods for calculating international indirect emissions from land-use changes from biofuels production as part of a final renewable fuel standard (RFS) expected this summer, were also obtained. Finally, the bill also would launch a major global effort to stop deforestation that would add yet more CO₂ savings in 2020 equal to 10 percent of current US emissions.

Conclusion

Some have called the passing of ACES "a stunning achievement, a rare alignment of the stars," and "the single most important vote a member will ever cast," yet others, including some environmental organizations, have called it a massive give-away of billions of dollars of newly valuable emissions rights. However it may have been characterized, ACESA is a milestone in the lengthy US process of coming to terms with climate change. Whether it will be as epochal an achievement as some commentators have said will play out in the Senate, to which all eyes now turn. Regarding economic impact, the Congressional Budget Office found that the cost of ACESA to the average American household in 2020 would be, in the words of a prominent former Energy Department official, about the cost of "a postage stamp a day" so that ACESA would basically "pay for itself." A prominent economist added that his figures show that more than 80 percent of the value of the billions in allowances will go back to consumers and to public purposes, leaving about 20 percent of the value of allowances for industry. These assertions will be tested and the debate on the issue will be joined by many others as the focus now shifts to the Senate.

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