



# Energy Alert

## Recent developments in energy law

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### American Clean Energy and Security Act of 2009— House draft bill includes controversial climate change provisions

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On March 31, 2009, Henry A. Waxman, chairman of the House Energy and Commerce Committee, and Edward J. Markey, chairman of the House Energy and Environment Subcommittee, released a draft of the American Clean Energy and Security Act of 2009. The timing of the draft legislation coincides with the two-year anniversary of the U.S. Supreme Court decision designating carbon dioxide as a pollutant in *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497 (2007).

The draft bill seeks to reduce carbon emissions below 2005 levels by 20 percent in 2020 and by 83 percent in 2050, a slightly more ambitious goal than set by the Obama Administration. To meet this goal, the draft establishes a market-based cap-and-trade program on electric utilities, oil companies, large industrial sources, and other covered entities. The draft also creates two new energy portfolio performance standards: (1) a renewable energy standard that requires retail electricity suppliers to meet 25 percent of their load with electricity generated by renewable resources by 2020, including wind, biomass, solar, and geothermal; and (2) an energy efficiency resource standard that requires utilities to achieve savings of increasing percentages of electricity and natural gas by 2020.

The global warming provisions, in particular, are expected to stir a lively debate. These provisions are modeled closely on the recommendations of the U.S. Climate Action Partnership (USCAP), a coalition of electric utilities, oil companies, chemical companies, automobile manufacturers, energy companies, and environmental organizations. Yet, many important issues remain unresolved. One key issue that the draft does not address is how to allocate (e.g., free allocation versus auction) the tradable emission allowances that restrict how much a regulated source can emit. Additionally, a tug of war between the federal government and states is likely to ensue, given the potential for the federal program to preempt existing state and regional efforts to regulate carbon emissions, including the Regional Greenhouse Gas Initiative (RGGI).

A federal cap-and-trade program is expected to generate an estimated \$646 billion in revenues to the federal government over 10 years, and President Obama's budget anticipates splitting the revenues between clean energy investment, tax credits, tax cuts, and fixing the growing fiscal deficit. Nevertheless, the draft bill does not address how the money raised would be spent, and proactive states may have much to lose if their regional programs are preempted. As an example, RGGI raised more than \$117 million at its most recent auction (March 18, 2009) of more than 33 million carbon allowances; the proceeds are distributed among RGGI states, which invest the funds in energy efficiency and renewable energy technologies and programs to benefit energy consumers.

Key components of the draft legislation are summarized below:

### **Title I: Clean energy**

The "clean energy" title promotes renewable sources of energy by requiring retail electricity suppliers to provide a certain percentage of their output from renewable resources. The renewable electricity requirement begins in 2012 at 6 percent and increases gradually and annually to a rate of 25 percent in 2025. The draft bill creates a program to allow each state energy office to form a State Energy and Environment Development (SEED) Fund to receive financial assistance for clean energy and energy efficiency projects. Pursuant to the draft bill, federal agencies would also be authorized to enter into long-term contracts to purchase renewable electricity.

The draft bill also promotes the development of carbon capture and sequestration (CCS) technologies. CCS is a method of capturing carbon dioxide emitted from power plants using fossil fuels, and injecting it underground. The draft bill provides incentives for the development and implementation of CCS on a commercial scale, as well as performance standards for new coal-fired power plants.

With respect to clean fuels and vehicles, the draft bill sets a new low-carbon transportation fuel standard to promote biofuels and other clean transportation fuels. Financial support is authorized in the form of grants or loan guarantees to cities, states, or private entities for large-scale demonstrations of electric vehicles. Financial support is also authorized for automobile manufacturers to outfit their plants to build electric vehicles.

### **Title II: Energy efficiency**

Federal training and funding assistance is authorized by the draft bill to states that adopt advanced building-efficiency codes. Funds for retrofitting existing commercial and residential buildings to improve their energy efficiency are also authorized. The draft further codifies several agreements on efficiency standards for lighting and other appliances, making numerous improvements to the current process for setting energy-efficiency standards.

With regard to efficiency in the transportation industry, the draft bill directs the president to work with relevant agencies and with California to harmonize federal fuel economy standards, emissions standards promulgated by the EPA, and California's standards. The goal of the provision is to preserve the environmental benefits to be achieved by existing standards while simplifying compliance for vehicle manufacturers. The bill goes on to direct

the EPA to establish emission standards for other mobile sources of pollution, such as locomotives, marine vessels, and other non-road sources.

To enlist electricity and natural gas distribution companies in the effort of making the nation more energy-efficient, the draft bill establishes a new energy efficiency resource standard. Under this program, each distribution company must demonstrate that its customers have achieved a required level of electricity or natural gas savings.

### **Title III: Global Warming**

The draft bill establishes a Global Warming Pollution Reduction Program, which targets electric utilities, oil companies, large industrial sources, and other entities that collectively are responsible for 85 percent of the global warming emissions in the U.S. Under the program, covered entities must have federal allowances or tradable permits for each ton of greenhouse gases emitted into the atmosphere. Each year, the number of available allowances issued by the federal government will be reduced. Allowances may be banked for use during future compliance years and a rolling two-year compliance period, which allows covered entities to borrow from one year ahead without penalty, is created. Allowances from two to five years in the future can be borrowed under limited circumstances. Companies that emit less than 25,000 tons per year of CO<sub>2</sub> are not covered by the program. The draft bill directs the EPA to create a “strategic reserve” of approximately 2.5 billion allowances by setting aside a small number of allowances authorized to be issued each year, in the event allowance prices rise faster than expected. The reserve allowances would be made available through an auction if needed, and the proceeds of the auction would be used to purchase additional offsets to replenish the strategic reserve.

The draft bill allows covered entities to increase their emissions above their allowances if they can obtain offsetting reductions from other sources. The total quantity of offsets allowed in any year cannot exceed 2 billion tons, for both domestic and international offsets. Covered entities using offsets must submit five tons of offset credits for every four tons of emissions being offset. Strict oversight and regulation of the markets for carbon allowances and offsets is provided for in the draft bill. The Federal Energy Regulatory Commission is charged with regulating the cash market in emission allowances and offsets.

With respect to sources that are not covered by the allowance system, the EPA is directed to set emissions standards. Special programs to reduce emissions of two pollutants that contribute to global warming—hydrofluorocarbons (HFCs) and black carbon—are created in the draft bill. Under this program, EPA will be directed to phase out the production of HFCs. EPA is directed to use its existing authority under the Clean Air Act to reduce emissions of black carbon domestically and to study opportunities for reductions internationally.

The draft bill further provides that CO<sub>2</sub> and other greenhouse gases may not be regulated as criteria pollutants or hazardous air pollutants on the basis of their effects on global warming. The draft also clarifies that New Source Review does not apply to these global warming pollutants.

#### **Title IV: Transitioning to a clean energy economy**

To ensure that U.S. manufacturers are not at a disadvantage relative to overseas competitors, the draft bill authorizes companies in certain industrial sectors to receive “rebates” to compensate for additional costs incurred under the bill. The program may be modified at the direction of the president if the rebates do not effectively correct competitive imbalances. The draft bill also includes provisions to provide U.S. assistance to encourage widespread deployment of clean technologies to developing countries that have ratified an international treaty and have undertaken appropriate mitigation activities.

Several provisions in the draft bill promote green jobs. The Secretary of Education is authorized to award grants to universities and colleges to develop training programs to prepare students for careers in renewable energy, energy efficiency, and other forms of climate change mitigation.

#### **Next steps**

It remains to be seen whether Congress has the political will to approve comprehensive energy legislation before the global climate negotiations in Copenhagen this coming December. Proponents believe that it is critical that Congress pass such legislation if the U.S. is to have any credibility with the international community, given the prior administration’s refusal to sign the Kyoto Treaty. Hearings before the House Energy and Environment Subcommittee are expected to commence the week of April 20, 2009, and the House Energy and Commerce Committee hopes to complete its consideration of the legislation by Memorial Day. The Senate Energy and Natural Resources Committee has begun marking up its own energy legislation, but has not yet addressed a number of controversial items.

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