Comprehensive Energy and Climate Bill Discussion Draft Released

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On March 31, 2009, Representatives Henry Waxman (D-CA) and Edward Markey D-(MA), chairmen of the House Energy and Commerce Committee and the Subcommittee on Energy and Environment, respectively, released a discussion draft of a comprehensive energy and climate bill titled the "American Clean Energy and Security Act of 2009." The Waxman-Markey draft includes both an economy-wide cap and trade regime as well as clean energy and efficiency measures that have previously been left to independent legislative vehicles. Like the discussion draft released last fall by former Chairmen Dingell and Boucher, it is intended to act as a template for a future bill and is likely to be significantly revised in the coming months. The 648-page draft contains numerous provisions, the most relevant of which are outlined below.

Cap and Trade

Covered Sources

The discussion draft calls for a cap and trade program that would reduce greenhouse gas (GHG) emissions 83 percent from 2005 levels by 2050, more aggressive than the 80 percent reduction proposed in Dingell-Boucher draft and the 70 percent reduction in the Lieberman-Warner Climate Security Act, which failed in the Senate in June 2008. Waxman-Markey also calls for more aggressive near-term reductions of 3 percent in 2012 and 20 percent by 2020, compared to 2020 targets of 6 percent in Dingell-Boucher and 15 percent in Lieberman-Warner.

Beginning in 2012, covered sources, which will by full program phase-in in 2016 comprise 85 percent of U.S. GHG emissions, must submit allowances for each metric ton of CO_2 equivalent (CO_2e) emitted, produced, or imported. Consistent with previous legislative proposals, the program would regulate electricity generators and stationary sources at the point of emission ("downstream"). Fossil-based liquid fuels and industrial gases would be regulated at the point of production or import. In addition, local natural gas distribution companies would be responsible for submitting allowances for emissions from customers that are not already covered under the program. Generally, the program would cover sources above a threshold of 25,000 metric tons of CO_2e. Notably, EPA's recently proposed GHG reporting rule also utilizes a 25,000-metric ton threshold, which EPA estimated would cover roughly 13,000 sources. Thus, this proposal would likely regulate a similar number of sources.

The draft also provides EPA authority to regulate uncapped sources under the Clean Air Act (CAA). EPA is instructed to set performance standards for uncapped sources under CAA section 111. EPA would be required to list categories of stationary sources that individually have emissions above

10,000 CO_2e and that, in the aggregate, are responsible for at least 20 percent of uncapped emissions. In addition, the draft provides for the phase down of hydrofluorocarbons (HFCs) and directs EPA to use existing CAA authority to reduce emissions of black carbon, or soot.

For capped sources, the discussion draft precludes further regulation under any provision of the CAA. It provides that GHGs may not be regulated as either a criteria pollutant or a hazardous air pollutant and that New Source Review provisions do not apply to GHGs. The draft would also preempt state cap and trade programs for the 2012-2017 period.

Allowance Allocation

With the exception of allocating five percent of allowances to support efforts to reduce international deforestation, the draft does not address the percentage of allowances that will be allocated and/or auctioned and defers the issue for later resolution. While President Obama campaigned for a 100 percent auction of allowances, it is likely that a final proposal, like previous congressional proposals, will contain a mix of auction and allocation and that allocations will slowly be phased out in favor of auctions.

Cost Containment

The discussion draft includes numerous measures intended to mitigate the costs of a cap and trade program. Regulated entities will be permitted to "bank" allowances for use in a later compliance year without restriction. The draft also includes a rolling two-year compliance period, allowing "borrowing" of future allowances up to one year in advance without penalty. In addition, the draft allows limited borrowing up to five years in advance with interest.

The draft allows offsets up to 2.0 billion tons per year, split evenly between domestic and international sources, although international offsets could only be obtained from developing countries that have entered into a bilateral or multilateral agreement with the United States. The total allowable offsets represent a significant portion of the initial cap of 4.77 billion tons. However, in order to address the uncertainty of reductions from offsets, the draft requires five offset credits for every four tons of emission allowances that would otherwise be due. The draft does not enumerate specific types of acceptable offset projects, but rather directs EPA to determine eligible project types through rulemaking.

The draft also provides for a strategic reserve of 2.5 billion allowances that would be auctioned to reduce short-term price volatility. Unlike under a safety-valve mechanism, which would provide unlimited allowances for purchase above certain price thresholds, the strategic reserve allowance provides environmental certainty by borrowing allowances from future years and requiring their ultimate replacement.

Competitiveness Provisions

The draft addresses international competition and emissions leakage chiefly by adopting a rebate program recently introduced in the House by Representatives Jay Inslee (D-WA) and Mike Doyle (D-PA). The program would compensate industries that meet thresholds of energy and trade intensity for costs incurred under the cap and trade program. Rebates would be awarded on an output basis that would favor the most efficient producers within a sector or sub-sector. After 2020, the rebate program would phase down, and each sector or sub-sector would be subject to an annual review to determine if the sector or sub-sector would still be vulnerable to substantial competition from production in countries without commensurate GHG regulations.

Although allowances have not been allocated to fund this rebate program, Representative Inslee has stated that the program would set aside about 15 percent of allowances, significantly higher than the 11 percent of allowances initially set aside for energy-intensive industries under the Lieberman-Warner proposal.

If the rebate program is not effective, the proposal provides for an additional border-adjusted tax provision program as a backstop. Under this provision, importers of primary products such as iron, steel, aluminum, cement, and glass, among others, would be required to purchase and submit "international reserve allowances" along with those products.

Renewable Energy and Efficiency

The Renewable Electricity Standard (RES) would require utilities to purchase 6 percent of their electricity from renewable energy sources by 2012 and 25 percent by 2025. Renewable energy would include wind, solar, geothermal, biomass or landfill gas, incremental hydropower, and hydrokinetic renewable energy, though it would not include nuclear energy as some have advocated. The governor of any state could choose to meet up to one-fifth of the requirement from energy efficiency measures under the Federal Energy Efficiency Resource Standard (FEERS), discussed below. Unlike with the cap and trade provisions, more stringent state renewable energy programs would not be preempted, though state renewable energy credits could also be used to satisfy the federal standard.

The FEERS would require utilities to achieve efficiency savings of one percent for electricity and .75 percent for natural gas in 2012, escalating to fifteen and ten percent in 2020, respectively. The standard would allow customers, including industrial facilities, to sell demonstrated efficiency improvements to utilities as third-party efficiency providers.

The energy provisions also include a title on industrial energy efficiency that would require the establishment of industrial plant energy efficiency standards. The draft would also establish a program to provide awards for gains in electric or thermal efficiency.

Carbon Capture and Sequestration

The draft contains extensive provisions for Carbon Capture and Sequestration (CCS). An early demonstration program would be funded by assessments against fossil fuel utilities totaling at least $1.0 billion per year. Assessments would levied per kilowatt hour of fossil-based electricity delivered to customers and would differ depending on the relative carbon dioxide emission rates of different fossil fuels, with coal carrying the highest assessments and natural gas the least. The draft also calls for a commercial-scale CCS deployment program that would distribute funds for projects at electric generating units and large industrial facilities.

In addition, the draft would require new coal-fired facilities to meet declining performance standards. Plants permitted after 2015 would be required to emit no more than 1100 lbs/CO_2 per megawatt-hour, declining to 800 lbs per megawatt-hour after 2020. Plants permitted between 2009 and 2015 would be required to meet the 2015 performance standard within four years of commercial demonstration of CCS on a significant scale.

Mobile Sources

The draft would require harmonization of motor vehicle fuel emissions standards promulgated by NHTSA, future EPA standards, and California standards. The harmonized standards would be required to be at least as stringent as California standards, and California would retain authority to adopt and

enforce its own mobile source standards. In addition, EPA is directed to establish GHG emissions standards for new aircraft, heavy-duty vehicles, marine vessels, and locomotives. GHG emissions from nonroad vehicles other than marine vessels and locomotives would be regulated as the administrator deems appropriate after consideration of the relative contribution of GHG emissions and the costs of achieving reductions from each class of nonroad vehicles.

Low Carbon Fuel Standard

The draft would establish a Low Carbon Fuel Standard (LCFS) similar to the standard currently being promulgated in California. However, the LCFS would not be effective until the biofuel volume mandates under the Renewable Fuel Standard are completed in 2022. When effective, the LCFS would require lifecycle GHG reductions from the transportation fuel pool, including aircraft fuels, of 5 percent by 2023 and 10 percent by 2030. Non-transportation fuel providers could elect to be covered under the program as well. In contrast, the California LCFS does not include aircraft or non-transportation fuels and requires a 10 percent reduction by 2020.

Conclusion

The Waxman-Markey draft represents an ambitious effort to combine an economy-wide cap and trade program with comprehensive energy legislation. Much work remains, including the contentious task of allocating emissions allowances. Hearings on the bill are scheduled for the week of April 20 and a subcommittee markup is scheduled for the week of April 27. A full committee markup would follow the week of May 11, with a goal of reporting the bill out of committee by Memorial Day. We encourage clients to examine the bill for potential concerns and will be glad to assist in this regard.

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