



# A SIGNIFICANT STEP TOWARD COMPREHENSIVE CLIMATE CHANGE AND CLEAN ENERGY LEGISLATION: THE DRAFT AMERICAN CLEAN ENERGY AND SECURITY ACT OF 2009

Henry Waxman, Chairman of the House Committee on Energy and Commerce, and Edward Markey, Chairman of the Energy and Environment Subcommittee, have released a Discussion Draft of comprehensive energy legislation. The draft is sweeping in its coverage, detailed in its provisions, yet incomplete in important areas, including contentious issues such as the allocation of emissions allowances and new transmission siting authority for the Federal Energy Regulatory Commission (“FERC”).

The legislation has four titles: Reducing Global Warming Pollution, Clean Energy, Energy Efficiency, and Transitioning to a Clean Energy Economy. Congressmen Waxman and Markey plan to move the legislation through the full committee by Memorial Day.

The Senate Energy Committee has had trouble moving draft legislation out of committee and at this point has indicated that it intends to follow action on the

House bill. Moreover, Senate Environmental Public Works Chair, Senator Barbara Boxer, has indicated her preference to have her committee hold off introducing climate change cap-and-trade legislation this year. Although the Senate recently adopted a resolution maintaining the requirement that 60 votes, rather than a simple majority of 51, will be needed to pass climate change legislation in the Senate, majority whip Senator Durbin has conceded that he does not have the 60 votes that will be needed. It is thus difficult to predict the final form that any climate change legislation may take in Congress, including whether the draft House bill will serve as the blueprint for any eventual legislation signed into law by both chambers.

In any event, in the next few months, the key components set forth in the draft legislation and the corresponding policy choices that they implicate, which are discussed below, will certainly be the sources of heated debate.

## GLOBAL WARMING

Title III proposes to reduce greenhouse gas (“GHG”) emissions in discrete phases, using 2005 emissions as the determining baseline. The United States Environmental Protection Agency (“EPA”) is obligated to accomplish the reduction targets by developing and implementing a cap-and-trade system for affected stationary sources. Applying an ever-increasing emissions reduction—of up to 83 percent by 2050—this system would dramatically reshape the economic landscape of the United States, eliminating products and processes that emit CO<sub>2</sub> or other regulated GHGs.

**Auction or Allocation?** One key issue the draft bill does not address is how marketable emissions allowances for covered entities will be distributed. There has been vigorous debate about whether regulated entities should be issued all or a portion of the needed allowances or, instead, be required to purchase all of the allowances necessary to account for emissions.

While the Committee intends to address this issue in the final version of the bill, President Obama had expressed his preference for a 100 percent auction by proposing a budget that anticipates \$650 billion revenue over 10 years from such auctions. Recently, however, the Obama administration has signaled flexibility on its initial position for a 100 percent auction. Congressman Markey’s previous proposal, H.R. 6186 (6/4/2008), recommended auctioning 94 percent of the allowance each year between 2012 and 2020, but then auctioning all allowances beginning in 2020. This critical political question, as well as where auction proceeds will be directed, will be played out in the months to come as hearings on the legislation proceed.

**What Gases Will Be Regulated?** Like Congressman Markey’s previous proposal, and tracking the recently proposed EPA rule for the Mandatory Reporting of Greenhouse Gases, the current legislative proposal defines seven substances as GHGs—CO<sub>2</sub>, CH<sub>4</sub>, N<sub>2</sub>O, SF<sub>6</sub>, HFCs, PFCs, and NF<sub>3</sub>—and authorizes EPA to designate other gases as a GHG in the future.

**What Is a Covered Entity?** The draft legislation addresses large and small stationary sources of GHGs in two different ways. First, it creates a market-based cap-and-trade program for electricity sources, fuel importers, and other large

stationary sources that are collectively responsible for 85 percent of U.S. GHG emissions. Second, it requires EPA to develop emission standards for smaller sources that are not covered by the allowance system, but whose uncapped GHG emissions are greater than 10,000 tons per year (“TPY”) and in the aggregate were responsible for emitting at least 20 percent of the uncapped GHG emissions in 2005.

While both the draft legislation and EPA’s proposed Reporting Rule encompass upstream suppliers of fossil fuels as well as downstream facilities that emit GHGs, the legislative proposal does not classify mobile source manufacturers as covered entities in the cap-and-trade program. The draft bill, however, broadly includes *any* electricity source, geologic sequestration site, and certain listed industrial sectors—nitric acid production, petroleum refining, and phosphoric acid production, for example—without the requirement that they emit 25,000 TPY of GHGs. After 2020, EPA is to review the emission thresholds for each category of covered sources and may by rule lower any or all thresholds to as little as 10,000 TPY.

Compliance dates begin in 2013 for electricity sources, fuel producers, geological sequestration sites, and most industrial sources, with some phase-in compliance requirements beginning in 2014.

**GHG Emission Targets.** Within two years of adoption, EPA is to draft regulations to implement the GHG cap-and-trade program. The draft legislation charts an aggressive course for GHG emission reductions, requiring EPA to reduce emissions by 3 percent below 2005 levels in 2012, by 20 percent in 2020, by 42 percent in 2030, and by 83 percent in 2050.

**Offsets.** The draft allows covered entities to increase their emissions above allowance levels if they obtain offsetting reductions from approved offset projects. The total quantity of offsets allowed in any year cannot exceed two billion tons and covered entities using offsets must submit five tons of offset credits for every four tons of emissions being offset. Offset credits may be sold, traded, or transferred.

**Carbon Market.** Under the draft bill, lawful holders of emissions allowances, who need not be covered entities, may sell, exchange, transfer, hold, or retire allowances. The draft requires EPA to create a trading system to issue, record, and

track allowances and credits. The draft provides for oversight and regulation of the new markets for carbon allowances and offsets by FERC. FERC and EPA are to coordinate regulations for the establishment, operation, and oversight of the allowance market within 18 months of enactment.

Allowances will not expire and may be used in subsequent years. A covered entity may also satisfy up to 15 percent of its compliance obligations by holding emissions allowances with vintages one to five years later than the current calendar year. No individual market participant may control more than 10 percent of any class of regulated allowances or allowance derivatives.

**Relationship With Other Provisions in the Clean Air Act.** EPA is to establish New Source Performance Standards for stationary sources that will not be subject to the cap and that emit GHGs above certain levels (10,000 TPY CO<sub>2</sub> equivalent and collectively > 20 percent of uncapped GHG emissions). Standards for natural gas extraction are to be promulgated under this section within three years of enactment, while standards for other listed small source categories are to be finalized within five and ten years after enactment.

The draft also amends Title VI of the Clean Air Act to require reduction of production and consumption of HFCs. Consumption allowances to implement such caps are to be issued, with ever-increasing percentages of allowances to be auctioned, up to 100 percent by 2019.

**Exemptions.** The difficulty in regulating GHGs under the current Clean Air Act remains a contentious issue. In an apparent attempt to resolve these difficulties, the draft legislation would exempt GHGs from being listed as criteria pollutants or, unless they independently satisfy listing criteria, as hazardous air pollutants. Significantly, the legislation prevents application of the new source review program to GHG emissions solely on the basis of their regulation under this new title of the Clean Air Act. Whether this provision is intended to provide a blanket exemption of GHG emissions from new source review is unclear. GHG emissions are also not to be considered in determining whether a Title V Operating Permit is required for an emitting source.

**The Role of Science.** The stated purpose of Title III of the Energy and Security Act is to prevent, reduce, mitigate, and remedy global warming and its adverse effects. According to the drafters, scientific uncertainty about the effects of global warming does not negate the harm that people suffer from actions that increase the likelihood of future impacts. EPA is instructed, however, to contract with the National Academy of Sciences to provide reports to Congress every four years about the status of scientific information and data relevant to global climate change. The President is then required to direct federal agencies to take appropriate actions identified by the Academy in such report.

**Citizen Enforcement.** The Act is to be implemented and enforced in an expeditious manner, with the help of citizens, states, and all levels of government. The draft provides that any person who has suffered, or reasonably expects to suffer, a harm attributable to the violation of an emission standard or limitation imposed by the Act may commence a civil action against the agency or the alleged violator. "Harm" includes any effect of air pollution occurring, or at risk of occurring, as well as the incremental exacerbation of any effect or risk associated with a small incremental emission of any air pollutant. A court may award costs to the prevailing plaintiff.

## CLEAN ENERGY

The Clean Energy Title contains numerous subtitles, including a Renewable Electricity Standard ("RES"), carbon capture and sequestration, a low carbon fuel standard, and electricity transmission planning by FERC.

**A National Renewable Energy Standard.** The draft amends Title VI of the Public Utility Regulatory Policies Act of 1978 to require the Secretary of Energy, in cooperation with the states, to establish a program to implement a national RES within one year of enactment. The draft program requires each retail electric supplier to meet an increasing percentage of its total electric sales with electricity generated by renewable resources, such as wind, solar, biomass, or geothermal power. The required annual percentage begins at 6 percent of the load in 2012 and increases to 25 percent by 2025.

Suppliers can meet these requirements through submitting federal renewable electricity credits. A federal renewable electricity credit represents one megawatt-hour of renewable electricity and is issued by the Secretary. If electricity is generated from mixed renewable and nonrenewable resources, credits may be issued according to the proportion of electricity attributable to renewable energy resources. A holder of federal renewable electricity credits may sell, exchange, transfer, or submit such credits for compliance. The governor of any state may choose to permit a covered supplier in its state to meet up to one-fifth of its RES requirements through adoption of energy-efficient measures.

Renewable electricity means electricity generated from wind, solar, geothermal, biomass, qualified hydropower, or marine and hydrokinetic renewable energy resources. Covered entities include retail electric suppliers that sell at least one million megawatt-hours of electric energy to electric consumers for purposes other than resale.

**Carbon Capture and Sequestration.** This subtitle develops a multipronged strategy to promote carbon capture and sequestration.

First, the draft requires EPA to:

- Promulgate regulations within two years to certify and permit geologic sequestration sites.
- Establish a task force to study existing laws applicable to geologic sequestration sites for carbon dioxide.
- Coordinate with FERC to assess the need for pipelines to be used for transportation of carbon dioxide for the purpose of sequestration.
- Promulgate regulations to establish a program to distribute funds to support the commercial deployment of carbon capture and sequestration technologies in electric power generation and appropriate industrial operations.

Second, to accelerate the commercial availability of carbon dioxide capture and storage, the draft allows qualified industry organizations—such as the Edison Electric Institute, the American Public Power Association, the National Rural Electric Cooperative Association, or any such organization

that represents at least 20 percent of the volume of fossil fuel-based electricity delivered by distribution utilities to consumers in the U.S.—to establish a Carbon Storage Research Corporation.

That Corporation will collect assessments from distribution utilities for all fossil fuel-based electricity delivered directly to retail consumers. Assessments will reflect the relative carbon dioxide emission rates of different fossil fuel-based electricity. The draft establishes assessment rates for coal, natural gas, and oil per kilowatt-hour, which will be adjusted to generate between \$1.0 billion and \$1.1 billion annually. Funds will be used to issue grants and contracts for commercial-scale demonstrations of carbon capture or storage technology projects. The Corporation is authorized to conduct operations for a 10-year period.

Third, the draft amends the Clean Air Act to establish performance standards for new coal-fired power plants. Electricity generating units (“EGU”) that derive at least 30 percent of their annual heat input from coal, petroleum coke, or any combination of these fuels, permitted after 2009, must comply with the standard. Covered EGU emissions will be capped at 1,100 pounds of carbon dioxide per megawatt-hour after 2015 and no more than 800 pounds of carbon dioxide per megawatt-hour after 2020.

**Low Carbon Fuel Standard.** This subtitle amends the Clean Air Act to promote a low carbon fuel standard that will apply to refineries, blenders, importers, and other fuel providers. The Administrator is to determine the lifecycle GHG emissions of all transportation fuels as well as the fuel emission baseline. Between 2014 and 2020, the annual average lifecycle GHG emissions per unit of energy of transportation fuel is not to exceed the baseline of 2005. After 2023, the annual average lifecycle GHG emission is to be 5 percent below the baseline and 10 percent below the baseline by 2030. Transportation fuel providers can generate credits for achieving greater reductions for the fuel produced or imported than are required by the regulations.

There are additional provisions to encourage the development of electric vehicles.

**Transmission Planning.** The draft amends the Federal Power Act by directing FERC to adopt a national policy that regional electric grid planning should facilitate the deployment of renewable and other zero-carbon energy sources for generating electricity to reduce GHG emissions. The draft bill stops short, however, of granting FERC any new authority to site transmission lines that enable renewable energy resources to reach the market. In contrast, both Senator Bingaman and Senator Reid recently introduced bills that would, under certain circumstances, give FERC the power to override state and regional transmission planning authorities.

FERC is to adopt national electricity grid planning principles derived from the policy and to harmonize regional electric grid planning efforts. Regional planning entities will be required to submit regional electric grid plans to FERC for review and recommendations.

## ENERGY EFFICIENCY

**Transportation Efficiency.** The draft requires the President to harmonize motor vehicle standards already set by the National Highway Traffic Safety Administration, EPA, and the state of California, with direction to achieve at least as much emissions reductions as would be achieved by the implementation of California's law for the regulation of GHGs from passenger vehicles and light-duty trucks (AB 1493).

Additionally, EPA is to promulgate standards that will achieve the greatest degree of GHG emissions reduction achievable, based on the application of technology that the Administrator determines will be available when the standards take effect, for:

- new heavy-duty vehicles and engines;
- new marine vessels and locomotives, and other non-road vehicles, as appropriate; and
- aircraft and aircraft engines.

EPA may provide for averaging, banking, and trading of GHG emissions credits within or across classes or categories of motor vehicles, non-road vehicles, and aircraft.

Each state and large metropolitan area is to submit plans and goals for reducing GHG emissions. EPA is to establish standardized models and methodologies to develop state and regional plans and goals. Ten- and 20-year plans will establish targets to reduce mobile source GHG emissions and will utilize strategies that consider transportation and land use planning regulation.

**Utility Efficiency.** The federal energy efficiency resource standard will set a nationwide minimum level of electricity and natural gas savings to be achieved through utility efficiency programs, building energy codes, appliance standards, and related efficiency measures.

The Secretary of Energy is to establish a program to implement and enforce cumulative electricity and natural gas savings (to be annually reported by retail electricity and natural gas distributors). The 2012 standard requires 1 percent and .75 percent, respectively, for electricity and natural gas cumulative savings, increasing to 15 percent and 10 percent by 2020. The Secretary may delegate enforcement of this program to the states.

"Savings" are reductions in consumption, through measures implemented through customer facilities, the distribution system, the adoption of new or revised appliance and equipment efficiency standards, and systems that use the same energy source for heat and power. There is no market established for the sale and purchase of savings, but retail distributors may use savings purchased pursuant to a bilateral contract from another retail distributor, state, or third party.

## TRANSITIONING TO A CLEAN ENERGY ECONOMY

The draft authorizes companies in certain industrial sectors to receive rebates to compensate for additional costs incurred under GHG programs. Sectors that use large amounts of energy and that produce commodities traded globally would be eligible for the rebates. Eligible industrial sectors might include steel and cement manufacturing. Rebates will be phased out or eliminated beginning in 2021.

## CONCLUSION

The proposed climate change legislation could fundamentally alter energy production and use in the United States. The draft legislation significantly amends the Clean Air Act and other federal laws to address GHG emissions, and it will require the almost immediate creation of an extensive new regulatory regime by EPA and other federal agencies to implement its sweeping directives. Congress will no doubt make changes to the legislation before it (or some other version of it that can gain enough votes in both chambers to become law) is adopted. Businesses across all sectors of the U.S. economy—not just those that will be directly regulated but also those whose operations will see increasing costs imposed by regulated entities—are well-advised to stay abreast and, as needed, to participate in the upcoming debates, as their economic fates are forever altered.

The draft legislation can be found at:

[http://energycommerce.house.gov/index.php?option=com\\_content&task=view&id=1560&Itemid=1](http://energycommerce.house.gov/index.php?option=com_content&task=view&id=1560&Itemid=1).

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