

Coming Developments in Climate Change and Energy Policy

How to Prepare

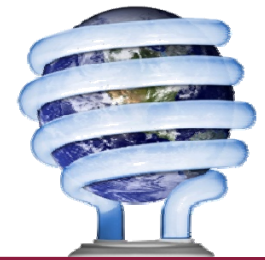
David B. Finnegan, *Senior Counsel*
(202) 263-3301
dfinnegan@mayerbrown.com

David I. Bloom, *Partner*
(202) 263-3204
dbloom@mayerbrown.com

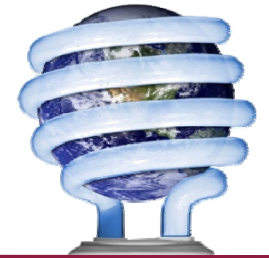


May 2009

Climate Change and Energy Policy Developments

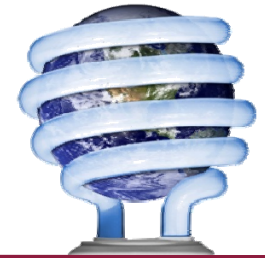


- General Comment About Future of Energy and Climate Policies
 - These Remarks Are Based On The Status Of Policies In The Executive And Legislative Branches Of Government As Of The Beginning Of May 2009
 - The Policies And Process In Both Branches Are Evolving

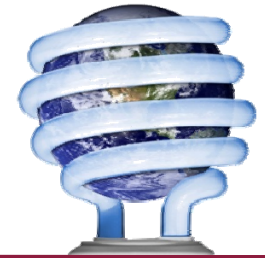


- Overview

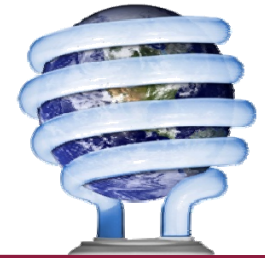
- Drivers of Climate Change and Energy Policies for the 111th Congress That Suggest Change Is Coming
 - Working Group I's Fourth Assessment Report, "The Physical Basis", of the Intergovernmental Panel on Climate Change (2007) "Warming of the climate is unequivocal" buttressed increased scientific support for actions addressing climate change on an accelerated basis.



- According to the Environmental Protection Agency's (EPA) Advanced 2008 Notice of Proposed Rulemaking under the Clean Air Act (CAA) greenhouse gases (GHGs), unlike traditional air pollutants regulated by EPA, globally mix in the atmosphere and are "everywhere".
- The 2008 spike in gasoline and diesel fuel costs and the push for a green economy with reliance on renewables.
- The patchwork GHG emission control efforts of California, the ten northeastern states, several western states, and more.

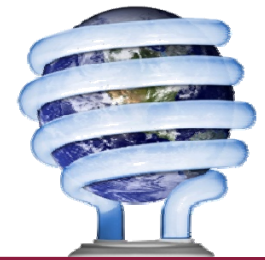


- The April 17, 2009 proposed EPA positive finding, which some call a “hammer”, under the CAA that “[i]n both magnitude and probability, climate change is a serious problem now and for future generations”, that GHGs “are responsible for it” and that GHGs “endanger public health and welfare within the meaning of the Clean Air Act”.
- The 2007 Bali Action Plan’s Kyoto Protocol and the Framework Convention on Climate Change dual negotiation tracks aimed at reaching international climate agreement in December 2009 at Copenhagen with the U.S. as a full fledged participant.

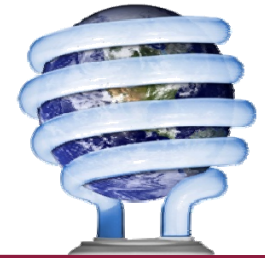


- Consensus policy recommendations of the U.S. Climate Action Partnership – a diverse group of business entities and environmental organizations – in a “Blueprint for Legislative Action” regarding “energy and climate policy”.
- President Obama’s call, in his budget plan for fiscal year 2010, to “begin a comprehensive approach to transform our energy supply and slow global warming”.

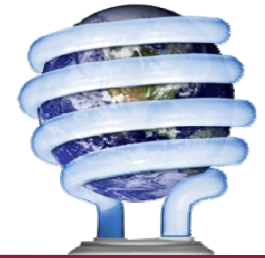
Congressional Activities on Energy-Climate Policies in the 111th Congress



- Principle Congressional Committees on Energy and Climate Change Policy
 - Senate:
 - In the Senate, energy legislation is within the jurisdiction of Energy and Natural Resources Committee while climate jurisdiction, based on 110th Congress, appears to be in the Environment and Public Works Committee, although the Energy Committee also has a jurisdictional claim over climate matters.
 - In addition, the Senate Finance Committee has jurisdiction over raising revenues through taxes and other means, which could include revenues from the cap-and-trade of allowances, as well as addressing trade matters.

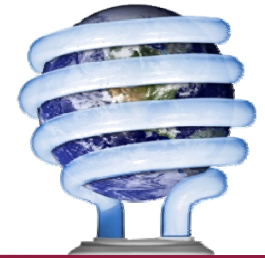


- In the Senate, resolution of jurisdictional issues is largely resolved by Majority leader with advice of the Parliamentarian
- House of Representatives:
 - In the House, energy and climate legislation issues are within jurisdiction of the Energy and Commerce Committee
 - The Ways and means Committee also raises taxes and other revenues, which could include cap and trade revenues and the Committee has jurisdiction over trade matters
 - In the House, jurisdictional disputes among Committees are settled by the Rules Committee and the Speaker, also with input by the Parliamentarian

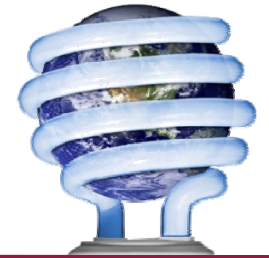


– Status of Energy and Climate Legislation in 111th Congress

- Enacted the “American Recovery and Reinvestment Act”, which, among others, provided \$16.8 billion for energy efficiency and renewable energy and \$4.5 billion for electricity delivery and energy reliability activities aimed at modernizing the electricity grid

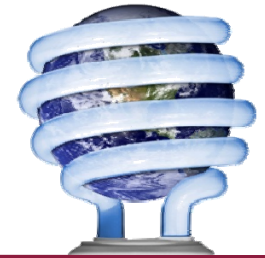


- Congress adopted in April a non-binding Concurrent Resolution for Fiscal Year 2010 Budget that includes a reserve fund to accommodate clean energy and climate change and provides \$500 million for energy in fiscal year 2010 aimed at, among other matters, reducing dependence on imported energy, produce green jobs, improve electricity transmission, encourage conservation and efficiency, decrease GHG emissions, protect consumers, and create new jobs in clean technology.

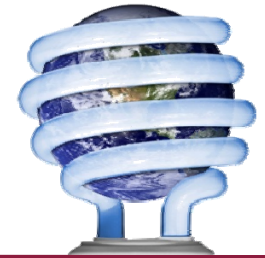


- Senate

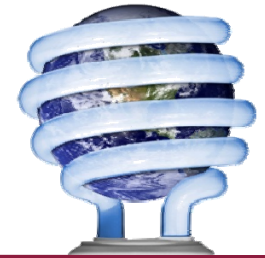
- Initial focus is on energy legislation by the Energy Committee covering such issues as: improving appliance energy efficiency standards and industrial energy efficiency, as well as a renewable energy standard, nuclear energy waste, transmission, oil and gas, and water use in energy production.



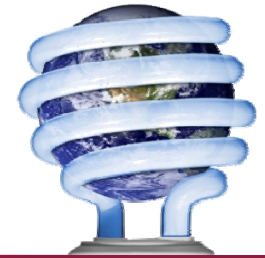
- In the Energy Committee, some moderate Democrats are concerned that a renewable energy standard will lead to cost increases for consumers, while others think a 20 percent standard is too low. One Member who is said to “probably” oppose such a standard is reported as saying “Ideally, our energy sources will be renewable, but ‘renewable’ cannot be our only goal ... it is crucial that any new energy source be both affordable and domestically available.”
- In the 110th Congress the Senate Environment Committee moved climate legislation, known as the Lieberman/Warner bill, quickly out of Committee, but it languished for months in the full Senate, and when finally considered last June fell significantly short of the 60 votes needed to cut off debate.



-
- In the 111th Congress, Environment Committee Chair Boxer's staff is quoted as saying "there is a very good chance the Senate will need to see progress over on the House side" before the Senate acts. A Committee aide said "The debate among those who already support climate legislation focuses on questions of how the legislation should be designed. But my counsel ... is to be mindful of the fact that, at least in the Senate, we have not surpassed the threshold commitment to do climate legislation".



- The Obama Administration calls for “comprehensive” energy and climate change legislation, but is apparently not going to offer its own legislative proposal even though Rep. Dingell urged that the Obama Administration send legislation to Congress, saying that Congress needs the “proper tools and proper guidance” or “we’ll be having another “discussion” in two years wondering why ... we didn’t do this thing”.
- President Obama has called for an economy-wide cap-and-trade system aimed at cutting emissions 14 percent from 2005 levels by 2020, over 80 percent by 2050 and 100 percent auction of allowances beginning in 2012, saying on

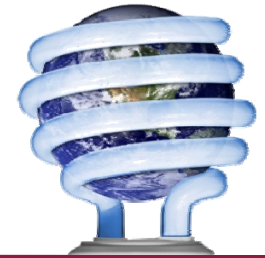


April 14 at Georgetown University that “a gradual, market-based cap on carbon pollution” is the only way to refocus the U.S. energy supply on renewables. “If businesses and entrepreneurs know today that we are closing the carbon pollution loophole, they will start investing in clean energy now.”

- But because of the potential impact on coal-fired utilities and manufacturing and jobs in the middle of the country, a bipartisan group of over a dozen Senators, informally called the “gang of 16”, have expressed concerns.

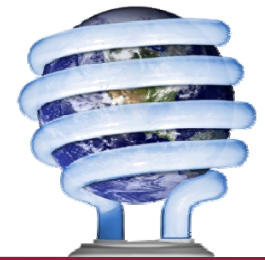


- During Senate debate on the budget resolution, an amendment was adopted by a wide margin calling for a decrease of GHGs “without increasing electricity or gasoline prices”, which is inconsistent with the goal of cap-and-trade.



- House

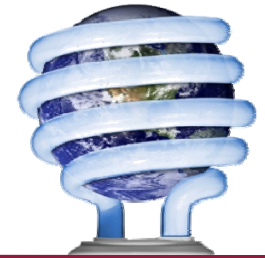
- House leaders have been calling for a climate bill, either alone or with energy, in 2009.
- The House Blue Dog Coalition of Members recently released a set of “energy principles” that, among other things, state that “long term U.S. energy independence will come from conservation, energy efficiency, and domestic energy sources; ... In the meantime, our energy needs depend upon coal, nuclear power, and oil and gas ... and long term solution [to climate change] is the best approach ... climate change solutions should not export jobs overseas”.



- Energy Committee and Subcommittee Chairs, Waxman/Markey, on March 31 released a 649-page combined energy/climate “discussion draft” covering renewable electricity standard, low carbon fuel standard, energy efficiency, clean transportation, transmission planning, a cap-and-trade program with auctions, offsets, carbon capture and sequestration, carbon market controls, preservation of domestic competitiveness and more.
- House Majority Leader Hoyer in March said that House passage of a combined bill may be “a heavy lift”. While he thinks “the Committee chairman [Waxman] believes – I don’t think he’s correct on that personally – that passing a single bill will be easier than breaking it up into parts”.



- A lawyer at a Washington law firm and a former Republican staffer noted when Waxman/Markey released the draft that for the “first time” in Congress “we’re going to see climate change discussed in the context of a comprehensive energy” debate, suggesting that would be welcome.
- While the Committee schedule for Waxman/Markey legislation is tight, the Committee has adopted “regular order” of hearings in April and Subcommittee/Committee mark-up in May with the aim of Committee passage by the start of the Memorial Day recess on May 22.

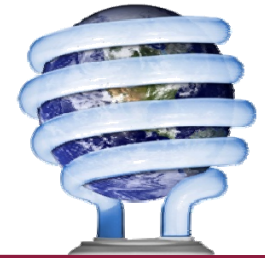


- Markey’s Subcommittee held three days of hearings on the draft during the week of April 27 with nearly 70 witnesses.
- Nevertheless, on April 20, all of the Republican Members of E&C’s Energy and the Environment Subcommittee wrote to Waxman and Markey asking for additional hearings saying:

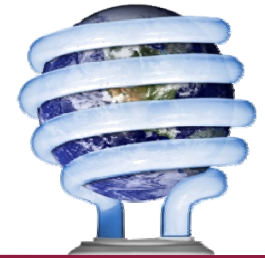
“... we would note that your discussion draft lacks any decision on permit allocations versus auctions. The manner in which you will address this issue is the cornerstone of the legislation; without it the bill is simply not finished and not ripe to be marked up on accurately discussed in the context of a hearing.



“Your ambitious schedule of nine separate panels during this week’s three days of hearings is going to touch on many important topics, including the effect of mandatory cap and trade on the domestic economy, international trade competitiveness and participation of the developing world, green jobs and job market projections, and the oversight and trading of a \$2 trillion carbon derivative market. Your discussion draft affects every element of our economy and certainly deserves greater hearing treatment than a mere three day marathon of topics. Because all of these issues will be greatly impacted by the allocation scheme you eventually propose with respect to auction versus free allocation of permits, we strongly suggest that additional hearings be held.”



- Waxman/Markey offered a hearing day of May 1, but Republicans declined because the issues of allowances allocation and disposition of revenues from auctions are unstated in the Waxman/Markey draft for the Members to consider and decide.
- House Republicans refer to Waxman/Markey draft as “a national energy tax” with Republican Leader Boehner quoted as saying it would cost American families up to \$3,100 a year in higher energy costs



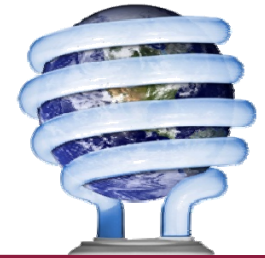
-
- In the Markey Subcommittee, while Democrats outnumber Republicans 21-13, up to 10 Democrats led by Reps. Boucher (D-VA) and Doyle (D-PA) in late April made over 30 recommendations for changes in Waxman/Markey draft including free allocation of allowances for the utility and industrial sectors, adjustment of timelines/targets to reflect need for technology development from 20 percent to 6 percent in 2020, modify offset provisions, delete proposed changes to Clean Air Act citizen suit provisions, and work with chemical industry regarding compensatory allowance language to ensure natural gas feedstock issues are resolved.



- On May 5, Committee Democrats and President Obama held “closed-door” meeting with aim to move climate bill in Congress in 2009. Reports of meeting suggest that there is pressure to finish energy/climate so as to move to health care legislation which is also in the jurisdiction of the Energy and Commerce and the Ways and Means Committees. At the end of the meeting, Chairman Waxman said his goal was still to finish legislation by May 22. He said: “If we can reach agreement with the coal sector, with the steel, with the auto sector, with the refining sector on our committee which is very representative of the Congress on the whole, then we believe that will be a template for passage in Senate as well.”



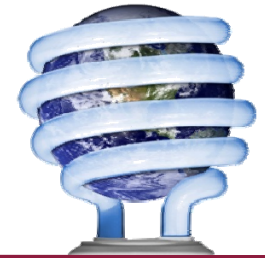
- The New York Times, in a May 8 editorial, “The Climate Debate Heats Up”, said the proposal was “stuck” in the Committee, “opposed by Republicans, feared by rust-belt Democrats who think it will harm manufacturers, regarded with suspicion by some environmentalists who think” it has too many “escape hatches”. It called the Democrat’s proposal of a 6 percent target in 2020 “a joke, not a compromise” and said the Republicans “are no help at all”.



- After the White House meeting, Waxman suggested skipping markup in Subcommittee in favor of going directly to full Committee, but later backed off the idea, apparently after resistance from Committee Members.
- The Ways and Means Committee plans to play a role in climate legislation, particularly regarding issues relating to taxes, revenue, and how to address competitiveness and tariff matters. Bills have been referred to the Committee for a carbon tax, as opposed to cap-and-trade, or hybrid tax/cap-and-trade approach. The Committee has held a number of hearing and several bills have been introduced, but no signs of mark-up.



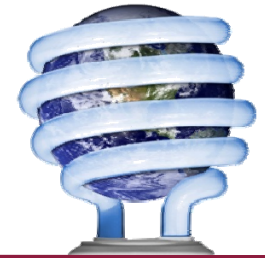
-
- Other House Committees, such as Agriculture and Labor, have indicated interest in addressing climate issues regarding offsets and “green” jobs.



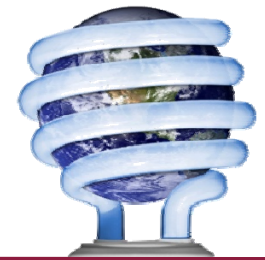
– Some Issues with Energy and Commerce Committee
March 31st Draft

- Climate

- Allocation of Allowances: left blank the most critical part of cap-and-trade: the allocation of emissions to the covered entities, including electric utility, large industrial transportation, oil company, commercial and other covered entities, for Members to decide either before or during mark-up.

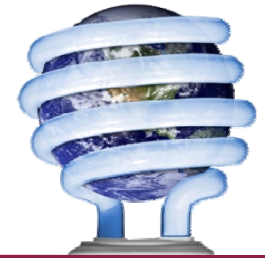


- Transition Allowances/Targets and Timetable: no apparent provisions for transition allowances as target and timetables start immediately in 2012. Waxman/Markey said provisions to reduce GHGs “modeled closely on recommendations of U.S. CAP,” but some contend that draft choose the high end of reduction ranges and target schedule offered by the coalition and particularly does not include U.S. CAP’s proposal for free allowances in the early years.



<u>Obama FY 2010 Proposal</u>	<u>U.S. CAP Proposal</u>	<u>Waxman/Markey Draft</u>
	3% below to 2% above 2005 levels by 2012	3% below 2005 levels by 2012
14% below 2005 levels by 2020	16-20% below 2005 levels by 2020	20% below 2005 levels by 2020
	42% below 2005 levels by 2030	42% below 2005 levels by 2030
83% below 2005 levels by 2050	80% below 2005 levels by 2030	83% below 2005 levels by 2050

Need to address costs in early years in advance of technology for sectors. In the case of utility plants, one Democrat from Pennsylvania said without this, "it becomes a transfer of wealth from one region to another based on where coal is."



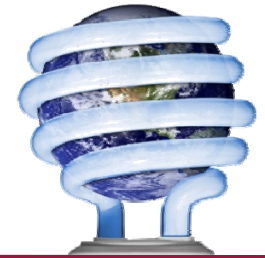
– Auctions

- Procedures for auctions included in draft, but the draft is silent on auction percentages and disposition of proceeds. In 110th Congress, Senate bill created a number of special funds for the proceeds and those proceeds were said to be in trillions of dollars over time and not subject to appropriation process. House rules would require that they be subject to appropriation.

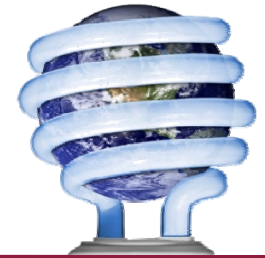


– Offsets As A Cost Containment Mechanism

- Both industry and environmentalists have concerns.
- While the Waxman/Markey draft adopts the 2-ton billion cap annually of offset credits to meet targets proposed by U.S. CAP, this amount is split 50/50 between domestic/international offset projects. However, on the international side while it appears to open up use of CDM (non-forestry) credits under the Kyoto Protocol subject to EPA screening, there are concerns from industry/business:



- The U.S. is not a Party to the Protocol, which makes use of such credits subject to a successor agreement that could take years to negotiate and enter into force.
- EPA has discretion whether to issue such credits.
- Waxman/Markey draft requires agreement with host country to ensure that international offset requirements in Waxman/Markey draft are met and EPA and State must negotiate sectoral baselines with each of the listed countries.



- All of these will limit supply of international offsets and affect their costs. Other limits on offsets/offset projects are:
 - 5 tons of offset credits needed for 4 tons of GHG emissions;
 - There may not be enough domestic offsets to achieve the 1-billion ton domestic cap;
 - There is an “additionality” test that includes the phrase “an adequate margin of safety” borrowed from the CAA, where it has always been controversial, to ensure environmental integrity;
 - Requires each project type to have an “uncertainty” methodology that is not explained as to what is intended;



- EPA, in issuing offset rules, must apply “conservative assumptions”;
 - There is no list of project types;
 - The draft makes the U.S. government a buyer of international forest carbon which will put it in unfair competition with private buyers of offsets and thus make them scarce and costly.
- In short, offset cost containment may be an illusion for industry/business, yet many in industry believe offsets are essential, particularly in early years. U.S. CAP is apparently troubled with the offset provisions of the draft.



- Some environmentalists and Republicans believe that offsets are subject to fraud and manipulation and that they do not belong in the draft.
- Two California-based environmental organizations issued an analysis of the offset provisions saying that “the climate section of the bill is seriously weakened by its heavy reliance on offsets to substitute for actual emission cuts by large polluters” and that an offset credit “is essentially a permit to pollute more than the buyer would otherwise be able to do”. The “result is that actual emissions – what impacts the atmosphere – are higher than what is accounted for.”

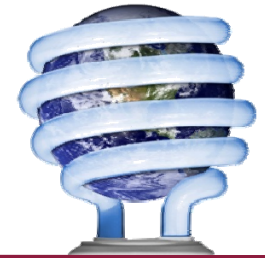


– CAA Amendments

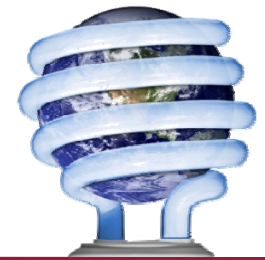
- According to one report, Carol Browner, the White House climate/energy coordinator, has said Congress is more suited to address climate change than EPA and that the Obama Administration prefers Congressional legislation over EPA regulation.
- The Waxman/Markey bill addresses climate change by amending existing title VI of the Clean Air Act on ozone depletion to address global warming potential hydrofluorocarbons and by adding two new titles VII and VIII regarding greenhouse gas emissions to the Act.



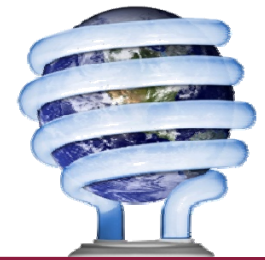
- However, the Waxman/Markey draft does not appear to squarely address the possibility of GHGs also being subject to existing provisions of the CAA, namely the term “air pollutant”, as interpreted by the Supreme Court in 2007. While the new title VIII purports to exempt GHGs from sections 108 and 112 of the Act, there is nothing in the draft making it clear that the term “air pollutant” no longer is to include GHGs. Indeed, the new title VIII directs EPA to list categories of stationary sources with “uncapped” GHG emissions under title I, section 111 of the CAA and to issue performance standards under section 111 for such sources.



- Rep. Dingell has previously called such an approach a “glorious mess”.
- Moreover, the new title VII includes Congressional findings and purposes (section 701) that appear to establish a new “general purpose of this Act”, i.e. the Clean Air Act, which is “to help prevent, reduce the pace of, mitigate, and remedy global warming” and its adverse effects”. That has the effect of changing the existing purposes of the entire CAA to a focus on combating climate change.

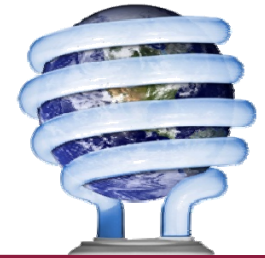


- As to transportation, the draft anticipates, in several ways, that the authority to regulate GHGs as an “air pollutant” under the CAA will continue. For example, the draft directs EPA to regulate GHGs from heavy-duty vehicles and engines, as well as marine vessels, locomotives, aircraft and their engines, and nonroad vehicles and engines all under title II of the CAA and it provides for trading and banking of GHG emissions among all of them.
- Also, the draft amends a number of the titles of the CAA relating to investigations, citizen suits, enforcement, judicial review, etc.



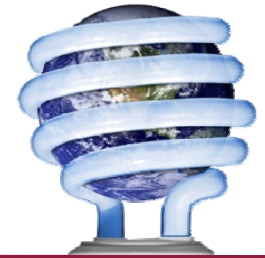
– Green Energy

- As a general comment, the Waxman/Markey draft is the third Congressional energy program for this decade, with the other two in 2005 and 2007.
- The draft includes a number of energy provisions and incidentally makes a number of technical “changes” to those two laws. For this purpose, the focus is on two:



– Renewable Electricity Standards (RES)

- Amends title VI of the Public Utility Regulatory Policies Act of 1978 to establish mandatory Federal RES that starts at 6% in 2012 and increases to 25% by 2025 for retail electricity suppliers. They, in general, include any electric utility that generated for sale at least 1 million megawatt hours (MWh) of electric energy to final customers in a calendar year. The utility industry apparently contends that 22 of 30 states and DC that now have RES could not meet 25% by 2025. In calculating a supplier's sales, there is excluded hydroelectric and municipal waste generation. Eligible renewables include wind, solar, geothermal, and biomass or landfill gas. Suppliers are not allowed to count efficiency, but the directive can be reduced up to one-fifth, if the supplier is in



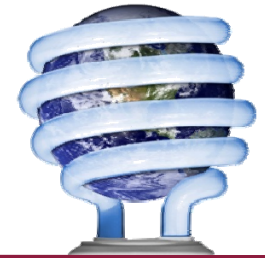
compliance with the Federal Energy Efficiency Resource Standard (EERS) also a part of Waxman/Markey. It is noted that House RES legislation in 2007 set the percentage at 15% and allowed use of up to 4% efficiency.

- For each MWh of renewable energy generated by a generator one credit is given. To be in compliance, the supplier must either submit credits or make alternative payment that start at 5 cents per kilowatt hour. In 2007, they were at 3 cents per KWh. These payments, plus civil penalties, go into a Renewable Electricity Deployment Fund at the Energy Department (DOE).



– Energy Efficiency Resource Standard (EERS)

- Applies to retail electricity and natural gas distributors. They must submit proof of savings to DOE. The requirement for electric utilities is “cumulative electricity savings starting at 1% in 2012 and growing to 15% in 2020. For gas utilities, the percentage in 2012 is 0.75 and it raises to 10% in 2020. The criterion for covered gas/electric utilities appears to exclude, from an electricity standpoint, municipal utilities and co-ops. If either type of utility fails to meet the mandate there are civil penalties.

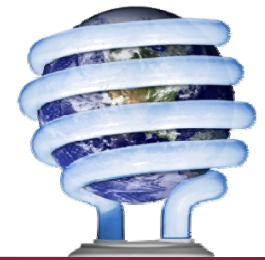


- The term “cumulative electricity savings” is not defined and a source of uncertainty. For example, does it mean incremental savings or does it require compounding?
- In the case of electricity, savings are defined as “reductions in electricity consumption relative to business-as-usual projections.” But BAU is undefined. How is it interpreted and how is it to be applied?



- Legislative Timetable

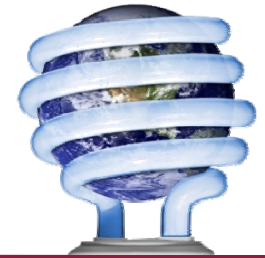
- Senator Jay Rockefeller (D-WVa) recently called legislation on climate change in 111th Congress “a given”; adding there is “tectonic shift” on Capitol Hill; “We’re going to do it. Will it be easy? No.”



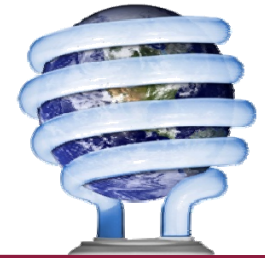
- Speaker Pelosi called the Waxman/Markey draft “a strong starting point” saying that climate change is “flagship issue” for her office and that “House leaders will work closely with the committees of jurisdiction to advance this critical legislation ... with the intention of having legislation on the House floor this year”. On May 5, Speaker again called energy bill “our highest priority”.



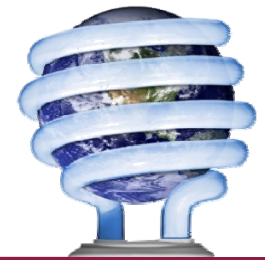
- International Climate Change Talks for Copenhagen in December 7-18, 2009
 - Deliberations resumed in Bonn, Germany in March and April. Further talks and negotiations scheduled in June and September with prospects of additional meetings in August /November timeframe.
 - While talks are described as narrowing “gaps” and positive, negotiating texts for both tracks will first be tabled in June and there is much expectation as to what the U.S. will put on the table.



- A new term was coined at Bonn for some of the developing countries. It is “advanced developing countries” apparently referencing such more economically progressive countries like China, South Korea, and Brazil. However, none of them apparently have adopted it.
- Still unaddressed is the nature of the agreement at Copenhagen.



- On May 4 the Obama Administration made submissions to FCCC process for a “Copenhagen Agreed Outcome” saying:
 - The United States supports a Copenhagen agreed outcome that recognizes the magnitude and seriousness of what science demands, reflects both common and differentiated elements, is pragmatic, and recognizes the diversity of countries’ circumstances and opportunities so as to invite a variety of approaches and encourage participation.

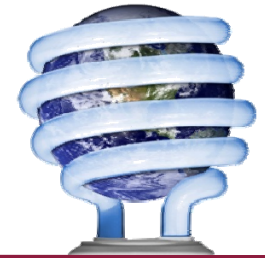


- The United States is committed to reaching a strong international agreement in Copenhagen based on both the robust targets and ambitious actions that will be embodied in U.S. domestic law and on the premise that the agreement will reflect the important national actions of all countries with significant emissions profiles to contain their respective emissions.



• Prospects for Legislation

- The climate change issue has been percolating for some time in Congress, but it is still not high in public opinion polls.
- For first time, it has a President making it a high profile policy issue for Congressional action, but President has not submitted legislation to Congress, only “principals”.
- Waxman/Markey have not yet formally introduced legislation – it is only a draft.



- Question whether sufficient majority in House (60 Senators in Senate) feel that the issue is timely and ripe for comprehensive legislation.
- While energy/climate bill likely to be introduced and reported out of House Committee in modified form in May or June, it is also likely to be revised by other Committees making House Floor consideration problematic before August recess.
- Nevertheless, prospects for House passage of bill this year reasonably good.



- Senate energy legislation also likely May or June, but may not get floor time until September or October.
- Uncertain how and when Senate may address climate issue.