

Client Alert

Latham & Watkins Environment, Land &
Resources Department

American Clean Energy and Security Act of 2009: Update on the Waxman-Markey Climate Change and Clean Energy Legislation

Introduction

On May 21, 2009, the US House of Representatives Committee on Energy and Commerce approved H.R. 2454, the "American Clean Energy and Security Act of 2009," by a vote of 33 to 25. This *Client Alert* updates the progress of the legislation since Rep. Henry Waxman (D-CA) and Rep. Edward Markey (D-MA) released their initial Discussion Draft on March 31, 2009.¹

H.R. 2454 (Waxman-Markey) sets forth both an economy-wide cap-and-trade program to regulate greenhouse gas (GHG) emissions as well as multiple other clean energy-related programs, including a federal combined efficiency and renewable electricity standard (CERES). Significant developments since the Discussion Draft include specific details on how emission allowances would be distributed, as well as changes to the design and requirements of the renewable electricity standard. This *Client Alert* addresses the key provisions of Waxman-Markey that will be of interest to electric generators and large industrial sources covered by the cap-and-trade program, as well as to entities involved in the development of renewable energy resources, offset projects, carbon capture and sequestration projects and energy efficiency measures that would also be affected by the legislation. A chart

summarizing these key provisions is also attached to the *Alert* as a reference tool.

Global Warming Pollution Reduction Program

Emission Reduction Targets and Program Coverage

Waxman-Markey proposes to amend the Clean Air Act by adding "Title VII – Global Warming Pollution Reduction Program," which sets forth an economy-wide cap-and-trade program that would require aggressive GHG emission reductions using a 2005 baseline. Compliance under the program would begin in 2012 for covered sectors with a cap 3 percent below 2005 emission levels. The cap would steeply decline over time, requiring 17 percent reductions by 2020, 42 percent reductions by 2030 and 83 percent reductions by 2050.

Covered entities would include "downstream" emitters such as electric generators, large industrial stationary sources that emit more than 25,000 tons per year of carbon dioxide equivalents, industrial fossil fuel-fired combustion devices (*e.g.*, boilers), natural gas local distribution companies, and sources of nitrogen trifluoride. Covered entities would also include "upstream" entities such as fuel and industrial gas producers and importers.

"This *Client Alert* updates the progress of the legislation since Rep. Henry Waxman (D-CA) and Rep. Edward Markey (D-MA) released their initial Discussion Draft on March 31, 2009."

Disposition of Allowances

Significantly, Waxman-Markey describes in detail how emission allowances would be allocated and auctioned. In the cap-and-trade program's first year of implementation (2012), around 85 percent of the available emission allowances would be freely distributed for pre-determined purposes. That figure rises to well above 90 percent by 2016.

Under Waxman-Markey, allowances would be allocated approximately as follows: electricity consumers (~35 percent), natural gas consumers (9 percent), home heating oil and propane consumers (< 2 percent), low-income consumers (15 percent), trade-vulnerable industries (up to 15 percent), investment in carbon capture and sequestration (2-5 percent), investment in energy efficiency and renewable energy (9.5 percent), clean energy innovation centers (1 percent), clean vehicle technology (3 percent), domestic fuel production (2 percent), workers (1 percent), supplemental reductions through reduced deforestation (2-5 percent), domestic wildlife and natural resources adaptation (1-4 percent), and international adaptation (1-4 percent). For more information on the specific details of Waxman-Markey's proposed emission allowance allocation plan, please reference the chart attached at the end of this *Alert*.

Approximately 30 percent of the allowances would be provided to electric local distribution companies, whose rates are regulated by states. Electric local distribution companies would then be required to use those allowances to protect their ratepayers from electricity price increases. A summary released by the Energy and Commerce Committee claims that the allowances allocated to electric local distribution companies under the bill would represent 90 percent of current utility emissions. Additionally, approximately 5 percent of allowances would be allocated to merchant coal generators and certain generators with long-term power purchase agreements. Waxman-Markey would gradually phase out the allowances for electricity consumers between 2026 and 2030.

Each year, the US Environmental Protection Agency (EPA) would auction off the remaining, undistributed allowances via single-round, sealed-bid, uniform-price auction procedures. Entities could also request that the EPA Administrator auction their allowances for them. This provision seems unnecessary given the unrestricted ability to trade emission allowances discussed later in this *Alert*. From 2012 to 2025, proceeds from the emission allowance auctions would be deposited into the Treasury. Beginning in 2026, proceeds from the auctions would be returned to consumers on a per capita basis as a climate change rebate. The proposed timing of the implementation of this provision, which coincides with the beginning of the phase-out of many of the free allowance allocations discussed previously, seems designed to satisfy the Senate budget resolution amendments discussed in the last section of this *Client Alert*, *i.e.*, that significant revenue from the cap-and-trade program be returned to consumers.

Cap-and-Trade Program Rules

Waxman-Markey provides several cost mitigation mechanisms for compliance (in addition to an offset program, described separately later in this text). Trading of emission allowances, compensatory allowances and offset credits would be allowed and would not be restricted to covered entities. Entities could receive compensatory allowances for a number of actions, including the destruction of certain fluorinated gases that are also greenhouse gases. The program would allow unlimited banking of allowances for compliance in future years and unlimited borrowing of allowances from the following year's allocation without interest payments. Borrowing from years two to five of future compliance periods would be limited to 15 percent of an entity's compliance obligations in the current year and would require interest payments (8 percent of allowances). Additionally, under the proposed program, EPA would hold quarterly

auctions of “Strategic Reserve” emission allowances. The Strategic Reserve would be limited to 1 percent of total allowances for years 2012 through 2019, 2 percent for years 2020 through 2029 and 3 percent for years 2030 through 2050. A minimum Strategic Reserve auction price would be imposed, based upon EPA’s recommended pricing models. Waxman-Markey would also rebate sums to certain eligible industrial sectors to compensate entities in those sectors for their costs to obtain allowances to comply with the cap-and-trade program.

Waxman-Markey would potentially allow the use of international emission allowances (e.g., European Union Allowances) for compliance purposes under the US system, subject to several important restrictions. The EPA Administrator must determine that the international climate change program issuing the allowances meets certain qualifications, including that the program imposes “a mandatory absolute tonnage limit” on GHG emissions and is “at least as stringent” as the US program. Furthermore, entities desiring to use international emission allowances for compliance in the US program would have to certify that those allowances had not been previously used to comply with, or retired under, the other climate change program. Waxman-Markey would also give the EPA Administrator the ability to modify, by rule, the percentage of a covered entity’s compliance obligation that could be met with international emission allowances.

The penalty for non-compliance would be twice the fair market value of emission allowances for that compliance year multiplied by the number of tons of carbon dioxide equivalent for which the covered entity failed to comply. In addition, covered entities that fail to comply would have to offset their shortfall the following year.

Offsets

The cap-and-trade program proposed under Waxman-Markey would allow covered entities to satisfy their

compliance obligations with carbon offset credits (i.e., credits from GHG-emission reducing projects at entities not covered by the cap), with several important qualifications. Up to 2 billion tons of offset credits would be available each year, split evenly between domestic and international offsets. The EPA Administrator could adjust that amount to up to 1.5 billion for international offsets, if there were insufficient domestic offsets available in a given year. The ability to use offset credits would be divided pro rata among covered entities. The percentage of a covered entity’s compliance obligation that could be met via offset credits would start at approximately 30 percent in 2012 and gradually increase as the overall cap on emissions declines. Half of that percentage may come from domestic offset credits, and the other half from international offset credits. For example, in 2012 a covered entity could satisfy up to 15 percent of its total compliance obligation with domestic offset credits, and up to 15 percent more with international offset credits. For compliance purposes, one domestic offset credit would equal one emission allowance, and one international offset credit would equal one emission allowance until 2018. Starting in 2018, 1.25 international offset credits would equal one emission allowance.

Waxman-Markey does not list specific types of eligible offset projects. Instead, the proposed legislation calls for the establishment of an independent Offsets Integrity Advisory Board to recommend offset project types for eligibility and offset methodologies for reviewing and verifying projects to ensure their environmental integrity. The EPA Administrator, rather than the Offsets Integrity Advisory Board, however, would have the ultimate responsibility for establishing and periodically revising the list of eligible offset project types and their corresponding methodologies. Persons would be able to petition to modify the eligibility list to include a particular offset project type or methodology. This proposed administrative process for establishing

an initial list of eligible project types has the potential for extensive regulatory delay. Failing to have a list of eligible project types in place when compliance under the cap-and-trade program begins would disrupt covered entities' initial compliance planning, delay their ability to use offsets for compliance and potentially slow the overall development of the carbon market.

Offsets would be subject to strict (but as yet undetermined) additionality and verification requirements according to the EPA-approved methodologies. Waxman-Markey would require the EPA Administrator to approve or reject a potential offset project only 90 days after receiving a completed approval petition. The proposed legislation is silent as to what would happen if EPA were to miss that deadline.

Early action offset projects undertaken pursuant to voluntary, state or regional GHG cap-and-trade programs would potentially be eligible for credits, subject to certain restrictions. For example, the projects would need to have been started after January 1, 2001, and whatever credits were issued for such projects must not have already been retired, cancelled or used for compliance purposes under the other cap-and-trade program. Credits would be available only for emissions reductions that occur after January 1, 2009.

International offset projects in developing countries would be eligible for credits, if a bilateral or multilateral agreement with the host country exists. The EPA Administrator would also be required, in consultation with the Secretary of State, to identify sectors in specific countries for which issuing international offset credits on sector-wide basis would be appropriate. International offset credits issued by an international body (e.g., the CDM Executive Board) would also be eligible for credits, if the EPA Administrator determines that the international body issuing those credits has requirements in place that provide "equal or greater assurance of the integrity" of the credits. As a practical matter, if EPA certifies the

CDM Executive Board, then all CDM credits should become eligible as offsets under the US cap-and-trade program. If not, however, then CDM credits may need to go through an extra layer of regulatory approval in the US.

Waxman-Markey would also provide credits for reduced deforestation projects in developing countries, subject to many restrictions. Deforestation projects in major GHG emitting nations would be limited to national-scale activities, or state-level activities in states that would be considered major emitters themselves. Smaller-scale deforestation offset projects would only be available in developing countries that generate less than 1 percent of total global GHG emissions and less than 3 percent of global forest-and-land-use-change GHG emissions. Also, developing countries would be required to establish national baselines to generate deforestation offset credits.

Preemption of State and Regional Programs for Five Years

Waxman-Markey provides that no state may implement or enforce its own GHG cap-and-trade program from 2012 to 2017. This provision is designed to give the federal cap-and-trade program sufficient time to establish itself and to provide regulatory certainty to industry. However, Waxman-Markey would allow states to continue to develop, preserve or reinstate so-called "complementary" command-and-control GHG measures, such as those currently being developed in California. State officials in California and the Northeastern states that participate in the Regional Greenhouse Gas Initiative (RGGI) cap-and-trade program have expressed concern with this state preemption provision, because of the large number of freely allocated allowances. Notwithstanding early support for the temporary preemption, recently officials from the California Air Resources Board have indicated that their state intends to move ahead with its own cap-and-trade program, in addition to its planned command-and-control GHG measures.

Importantly, Waxman-Markey would also provide for an “exchange” for GHG allowances issued before December 31, 2011 by California, RGGI or the Western Climate Initiative “in an amount that is sufficient to compensate for the cost of obtaining and holding such State allowances.” This provision is intended to ease the transition to the federal cap-and-trade program, but importantly does not provide a one-for-one allowance exchange. If the clearing price for federal allowances is \$6/ton (for example), as compared to the approximately \$3/ton RGGI allowance price, then an allowance holder would receive one federal allowance in exchange for two RGGI allowances. However, if the situation were reversed, *i.e.*, if the clearing price for federal allowances were \$3/ton and \$6/ton for RGGI allowances, then under the bill’s proposed language the allowance holder would presumably receive two federal allowances in exchange for one RGGI allowance.

Carbon Market Oversight

Waxman-Markey provides that the Federal Energy Regulatory Commission (FERC) would regulate both the emission allowance and offset markets. Furthermore, pursuant to an adopted amendment, FERC would have authority to issue cease-and-desist orders for market manipulation. Oversight of these carbon markets will be a tremendous responsibility, and some commentators have questioned whether FERC is the proper agency for the task. Even FERC Commissioner Suedeen Kelly has publicly stated that regulating the carbon markets would dwarf the mission of whatever existing federal agency receives that assignment. Commissioner Kelly therefore called for the creation of a new entity to handle carbon markets oversight. Additionally, under Waxman-Markey, the President would delegate responsibility for carbon derivatives markets to an “appropriate” agency. Most stakeholders expect that the Commodity Futures Trading Commission (CFTC) would regulate carbon futures and the allowance derivatives markets.

Waxman-Markey would also amend the Commodity Exchange Act to provide CFTC greater oversight over energy commodities and credit default swaps.

Exemptions From Other Clean Air Act Provisions

Waxman-Markey provides several exemptions for greenhouse gases from regulation under other provisions of the Clean Air Act. Greenhouse gases may not be listed as either criteria air pollutants, which would require the promulgation of new National Ambient Air Quality Standards (NAAQS), or hazardous air pollutants (HAPs). A stationary source’s emissions of greenhouse gases also would not affect its obligations under the New Source Review (NSR) program or the determination of whether operating the source requires a Title V operating permit. Additionally, the bill specifies that it would not affect existing administrative proceedings or litigation initiated under the Clean Air Act prior to the date of enactment, *i.e.*, the proposed legislation would not interfere with or determine the outcome of ongoing permit appeals. This exclusion would not apply, however, to new coal-fired plants subject to the performance standards described later in this *Alert*.

Additional GHG Standards and HFC Cap-and-Trade Program

In addition to the cap-and-trade program described previously, Waxman-Markey would require the EPA Administrator to use existing authority under Section 111 of the Clean Air Act to set GHG emission standards for certain uncapped stationary sources of GHG emissions, including those that emit more than 10,000 tons per year of carbon dioxide equivalent. On the other hand, Waxman-Markey would also prohibit the EPA Administrator from using Section 111 authority to issue performance standards for GHG emissions from capped sources, unless it were necessary for reasons other than the impacts of climate change.

Waxman-Markey would also regulate the production and consumption of

hydrofluorocarbons (HFCs), many of which are potent GHGs themselves, under a separate cap-and-trade program. This program is designed to address a gap in coverage of the Montréal Protocol on Substances that Deplete the Ozone Layer. Allowances would be distributed through a combination of annual auctions and non-auction sales based on the auction price. This cap-and-trade program would require 85 percent reductions of HFC consumption by 2032. Offset credits to be used for compliance under this program could be obtained through the destruction of chlorofluorocarbons (CFCs).

Performance Standards for New Coal-Fired Power Plants

Under Waxman-Markey, new coal-fired power plants receiving their initial Title V operating permits under the Clean Air Act on or after January 1, 2020 would be required to achieve a 65 percent reduction in their annual carbon dioxide emissions. New coal-fired plants permitted after January 1, 2009 and before January 1, 2020 would be required to achieve a 50 percent reduction in their annual carbon dioxide emissions. Enforcement of the latter standard would begin at a later compliance date depending on the commercial availability of CCS technology, but no later than January 1, 2025.

Federal Renewable Electricity Standard

Waxman-Markey would revise Title VI of the Public Utility Regulatory Policies Act of 1978 to establish a federal combined efficiency and renewable electricity standard (CERES) for retail electric suppliers. Retail electric suppliers would include electric utilities that sold more than 4 million MWh of electricity to consumers for purposes other than resale during the previous year. In 2012, the CERES target for retail electric suppliers would be 6 percent. That percentage would rise gradually to 20 percent by 2020. Retail electric

suppliers would be required to demonstrate their compliance with at least three quarters of the target (*i.e.*, 15 percent in 2020) by submitting “Federal Renewable Electricity Credits” (RECs), each of which would represent one megawatt hour of renewable electricity. To meet the remaining portion of the target, a retail electric supplier would be required to submit a report verified by a third party that demonstrates its total annual electricity savings (*i.e.*, its reduced electricity usage). State governors, however, could petition to allow retail electric suppliers in their states to satisfy up to two-fifths of the target via efficiency savings (*i.e.*, in 2020, for states that select this option, the 20 percent target would be comprised of 8 percent efficiency savings and a 12 percent renewable electricity requirement).

Under Waxman-Markey, the CERES program rules would afford retail electric suppliers a considerable amount of flexibility for compliance planning purposes. Federal RECs would be fungible, regardless of where they were generated in the US. Retail electric suppliers would be able to trade RECs or bank them for future compliance. Demonstrated electricity savings could also be transferred between parties. As an alternative compliance method, retail electric suppliers would be allowed to pay \$25 per megawatt hour in lieu of submitting RECs or demonstrated electricity savings. FERC would use these proceeds to support state energy efficiency programs and renewable electricity development.

There are several other notable features of the CERES under Waxman-Markey. Significantly, retail electric suppliers’ baseline amount of electric energy for compliance measurement purposes would not include the following sources of generation: (i) hydropower, other than qualified hydropower; (ii) nuclear generation placed in service after the enactment date for the program; and (iii) fossil-fuel generation to the extent that the GHG emissions are captured and sequestered. Distributed generation (*e.g.*, rooftop solar) would receive

three RECs for each megawatt hour of renewable electricity generated. If a power purchase agreement for a qualifying renewable electricity project does not specify what party receives the environmental attributes from the project, then the federal RECs would be allocated to the retail electric supplier, rather than the generator. Finally, Waxman-Markey provides that the federal RES would not preempt state renewable portfolio standard programs that may require higher percentages of renewable electricity or proceed on shorter timeframes.

Carbon Capture and Sequestration

Waxman-Markey directs EPA, in consultation with the Department of Energy (DOE) and other agencies, to submit a report to Congress within one year of enactment of the bill setting forth the strategy to address legal and regulatory barriers to the commercial scale deployment of carbon capture and sequestration (CCS). The bill further directs EPA to promulgate regulations for the certification and permitting of geologic sequestration sites, for maintaining evidence of financial responsibility for geological sequestration wells, and for the distribution of emission allowances to support commercial deployment of CCS technologies in electric power generation and industrial operations.

Waxman-Markey would allocate emission allowances for deployment of CCS technology at 2 percent of all allowances starting in 2014 through 2017, and 5 percent from 2018 through 2050. The EPA Administrator would distribute emission allowances to electric generating units (EGUs) that implement CCS technology in two phases, the first of which would cover the initial 6 gigawatts of eligible EGUs and the second of which would require EPA to promulgate additional regulations governing the method of distribution. EGUs would use the allowances to recover the costs of their CCS investments. EGUs that capture

and sequester a certain amount of their carbon dioxide emissions would receive a bonus allowance value (up to \$90 a ton). Emission allowances would also be distributed to industrial sources that implement CCS technology to recover their costs. Such distributions would be limited to no more than 15 percent of the allowances allocated for deployment of CCS technology under the bill.

Waxman-Markey also calls for the creation of an independent "Carbon Storage Research Corporation," whose members would consist of investor-owned utilities, state or municipality-owned utilities, rural electric cooperatives, fossil fuel producers, non-profit environmental organizations, independent power producers and consumer groups. The Corporation would issue competitively awarded grants, contracts and other financial assistance to support commercial-scale deployment of CCS and would seek to support at least five commercial-scale demonstration projects integrating CCS or conversion technologies. The Corporation would obtain its funding for these awards via assessments on distribution utilities for all fossil fuel-based electricity delivered directly to retail consumers on a kilowatt-hour basis and would adjust the level of those assessments so as to collect between \$1.0 and \$1.1 billion annually.

Other Energy Efficiency And Clean Energy Provisions

Clean Energy Deployment Administration

On May 19, 2009, the House Energy and Commerce Committee approved an amendment to Waxman-Markey by a vote of 51-6 that would create an autonomous Clean Energy Deployment Administration (CEDA) within the DOE and make reforms to that agency's loan guarantee program for low-emission projects.

CEDA would be authorized to provide a suite of financing options, including direct loans, letters of credit, loan

guarantees, insurance products and others. The program would fund emerging technologies and would aim to solve the common financing dilemma that can prevent promising technologies from moving from the lab into commercial demonstrations and markets for lack of private-sector lending. The program could fund projects for energy production, transmission, storage and other areas that could reduce greenhouse gases, diversify energy supplies and save energy.

The amendment does not specify eligible technologies, but supporters stated advanced nuclear and renewable energy projects, as well as carbon capture and storage, would qualify. The amendment does specify, however, that CEDA must adopt a "portfolio investment approach" to ensure no particular technology receives more than 30 percent of the total funding available.

The amendment also makes changes to the DOE loan guarantee program, including subjecting nuclear-power projects that may receive guarantees to Davis-Bacon prevailing wage requirements.

Clean Transportation and Greenhouse Gas Emission Standards for Mobile Sources

Waxman-Markey is expected to have a significant effect on the transportation sector, but the approved bill was stripped of two high-profile provisions present in the Discussion Draft. The first provision required the harmonization of federal motor vehicle standards with the level of emissions reductions that could be achieved by implementation of the California law AB 1493, if enforced not only in California but also in other states that had adopted the California standards. This provision was removed because of the proposed rulemaking announced by President Obama on May 19, 2009 that will accelerate increases in fuel economy under the corporate average fuel economy (CAFE) program to approximately the same extent as AB 1493 and impose national GHG emissions standards

on cars and trucks.² The proposed joint rulemaking by EPA and the Department of Transportation (DOT) is not expected to affect California's efforts to enforce the AB 1493 standards directly; however, if EPA ultimately grants California the necessary Clean Air Act waiver, California has agreed to defer to the national standards through 2016. The second provision directed EPA to implement a low carbon fuel standard (LCFS) that would have reduced the average lifecycle GHG emissions of transportation fuels in phases through 2030. Pursuant to the Energy Independence and Security Act of 2007, EPA has recently proposed a Renewable Fuels Standard which would require a minimum of 36 billion gallons of renewable fuels by 2022, and would limit eligibility to those renewable fuels that reduce lifecycle GHG emissions by specified amounts. Latham & Watkins is preparing a separate *Client Alert* on EPA's renewable fuels proposal.

Waxman-Markey also includes a number of provisions aimed at electrifying the nation's transportation system. Waxman-Markey would require electric utilities to develop plans to support plug-in electric drive vehicles, including deployment of Smart Grid-compatible charging stations. The approved bill would require the Secretary of Energy to establish a program to deploy and integrate plug-in electric drive vehicles into the electricity grid, including the disbursement of financial assistance. The bill also would require the Secretary of Energy to establish a program to provide financial assistance to automobile companies to facilitate the domestic development and manufacture of plug-in electric drive vehicles.

The approved bill added an Open Fuels Standard that would authorize regulations to require automakers to produce more cars capable of running on blends of alternative fuels if DOE and EPA determine such a requirement is a cost-effective way to achieve the nation's energy independence and environmental objectives. Waxman-

Markey also would establish a temporary "Cash for Clunkers" program that would provide vouchers of \$3,500 to \$4,500 to consumers that trade-in older, inefficient vehicles for new, fuel-efficient vehicles.

Waxman-Markey further directs EPA to promulgate GHG emission standards for: (1) new heavy-duty vehicles and engines by the end of 2010; (2) new non-road engines and vehicles by the end of 2012; and (3) new aircraft and aircraft engines by the end of 2012. Waxman-Markey also acknowledges the causal relationship between land-use planning and transportation related GHG emissions. The approved bill would require states and metropolitan planning organizations with populations exceeding 200,000 to submit goals and comprehensive transportation plans to achieve GHG emissions reductions through transportation efficiency and improved land use policies.

Energy Efficiency Programs

Waxman-Markey contains multiple other provisions to promote energy efficiency in commercial and residential buildings, as well as lighting and consumer appliances. For example, the bill directs the DOE to establish "Retrofit for Energy and Environmental Performance" (REEP) programs, which would be delegated to the states, to retrofit existing residential and commercial buildings across the country to improve their energy efficiency. The broad scope of the REEP program would be extremely ambitious, potentially affecting every home and commercial building in the nation. Waxman-Markey would also require greater efficiency in building codes.

Smart Grid Advancement

Waxman-Markey incorporates the concept of Smart Grid capability into the existing Energy Star program for consumer appliances and makes funds available for rebates to consumers who buy such appliances. Manufacturers of Smart Grid-capable products would then be able to use the Energy Star label.

Waxman-Markey would also require electric load serving entities to develop peak demand reduction plans.

Transmission Planning

Waxman-Markey would require FERC to adopt national electricity grid planning principles to promote the development of renewable and other zero-carbon energy sources, taking into account all significant demand-side and supply-side options, and coordinate regional transmission planning efforts to coincide with those principles.

Prospects for Passage

Most commentators see US House of Representatives' passage of H.R. 2454 as reasonably achievable. House Speaker Nancy Pelosi (D-CA) has vowed to bring the legislation to the floor this summer. The bill has been referred to eight other House committees for their review: Ways and Means, Foreign Affairs, Financial Services, Education and Labor, Science and Technology, Transportation and Infrastructure, Natural Resources, and Agriculture. These committees will only take up sections of the bill under their jurisdiction. House Speaker Pelosi has given these committees a soft deadline of June 19, 2009 to complete their markups.

Approval by the US Senate may prove more difficult. On the same day that the Waxman-Markey Discussion Draft was released, the Senate approved a pair of competing amendments to the fiscal 2010 budget resolution that seek to place parameters on the looming climate change debate. Sen. John Thune (R-SD) sponsored an amendment which stated that any climate change bill approved by Congress later this year must not raise either electricity or gasoline prices for consumers. The Thune amendment passed by a vote of 89 to 8.³ In response, Sen. Barbara Boxer (D-CA) sponsored another amendment stating that federal revenue collected from the implementation of a federal cap-and-trade program should be used to help alleviate the associated cost increases

for consumers. The Senate approved the Boxer amendment by a vote of 54 to 43.⁴ The Thune amendment showcases the difficulty the Senate will face in passing expensive climate legislation during a serious recession, while the vote count on the Boxer amendment suggests that the Senate may still lack the 60 votes necessary to bring debate to a close and to pass its own climate bill. Interestingly, Sen. Boxer, Chairwoman of the Senate Committee on Environment & Public Works, has raised the possibility of going to a House-Senate conference without a Senate-passed climate bill so as to permit consideration of the House version.

As noted in other recent Latham & Watkins *Client Alerts*, significantly, EPA is now poised to move ahead with a national greenhouse gas regulatory program of its own, as it prepares to make an endangerment finding and initiate regulatory actions. While President Obama has signaled a preference for comprehensive national climate legislation, if faced with inaction in the Senate, he should be expected to authorize EPA to propose mobile source and large stationary source regulation under the Clean Air Act. Doing so would exert pressure on Congress to act while signaling to our international partners that the US is serious about addressing climate change.

Endnotes

- ¹ *Client Alert* 855 addresses the key provisions of the Discussion Draft: http://www.lw.com/upload/pubContent/_pdf/pub2603_1.pdf
- ² Note that CAFE standards use an attribute-based, fleet-average system that tends to benefit domestic automakers because their product mix includes larger trucks and SUVs. The California standards instead distinguish between truck and car classes.
- ³ S.A. 731 to S. Res. 13, 111th Cong. (2009) (enacted).
- ⁴ S.A. 749 to S. Res. 13, 111th Cong. (2009) (enacted).

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

Robert A. Wyman, Jr.
+1.213.891.8346
robert.wyman@lw.com
Los Angeles

Claudia M. O'Brien
+1.202.637.2181
claudia.o'brien@lw.com
Washington, D.C.

George (Chip) D. Cannon, Jr.
+1.202.637.2217
chip.cannon@lw.com
Washington, D.C.

Joshua T. Bledsoe
+1.714.755.8049
joshua.bledsoe@lw.com
Orange County

B. Grant Dickson
+1.202.637.3309
grant.dickson@lw.com
Washington, D.C.

John C. Heintz
+1.213.891.7395
john.heintz@lw.com
Los Angeles

Winston P. Stromberg
+1.213.891.8983
winston.stromberg@lw.com
Los Angeles

Topic	Section(s)	Description
I. GHG CAP-AND-TRADE PROGRAM	<ul style="list-style-type: none"> Title III – Reducing Global Warming Pollution 	
A. GHG Emission Reduction Targets	<ul style="list-style-type: none"> Sec. 702-703 	<ul style="list-style-type: none"> 3% reduction by 2012 17% reduction by 2020 42% reduction by 2030 83% reduction by 2050
B. Covered Sectors	<ul style="list-style-type: none"> Sec. 700(13)—definition of “covered entity” Sec. 722 	<ul style="list-style-type: none"> Electricity sources Fuel producers and importers Industrial gas producers and importers Geological sequestration sites Industrial stationary sources—starting in 2014 Industrial fossil fuel-fired combustion devices (e.g., boilers)—starting in 2014 Natural gas local distribution companies—starting in 2016 Sources of nitrogen trifluoride
C. Disposition of Allowances	<ul style="list-style-type: none"> Sec. 781-793 	<p>Allocation to Achieve Supplemental Reductions from Reduced Deforestation:</p> <ul style="list-style-type: none"> 5% for 2012-2025 3% for 2026-2030 2% for 2031-2050 <p>Electricity Consumers:</p> <ul style="list-style-type: none"> 43.75% for 2012-2013 38.89% for 2014-2015 35% for 2016-2025 Phased out by 2030 Allowances in this category would be allocated between (i) electric local distribution companies, (ii) merchant coal generators and (iii) certain other generators with long-term power purchase agreements. Electric local distribution companies would receive the majority of these allowances according to a formula that takes into account their historic emissions and retail electricity deliveries. Electric local distribution companies MUST use the allowances they would receive to protect their ratepayers from electricity price increases. <p>Natural Gas Consumers:</p> <ul style="list-style-type: none"> 9% for 2016-2025 Phased out by 2030 Natural gas local distribution companies MUST use the allowances they would receive to protect their ratepayers from gas price increases. <p>Home Heating Oil and Propane Consumers:</p> <ul style="list-style-type: none"> 1.875% for 2012-2013 1.67% for 2014-2015 1.5% for 2016-2025 Phased out by 2030 Allowances would be allocated to states for programs to benefit users of home heating oil and propane. <p>Low Income Consumers:</p> <ul style="list-style-type: none"> 15% each year EPA Administrator would auction 15% of allowances each year, with the proceeds to be used for programs that benefit low income consumers. <p>Trade-Vulnerable Industries:</p> <ul style="list-style-type: none"> Up to 2% for 2012-2013 Up to 15% for 2014 Percentage declines in proportion to the decrease in overall allowances for 2015-2025. Percentage declines according to a more accelerated formula for 2026-2050.

Topic	Section(s)	Description
<p>C. Disposition of Allowances (cont'd)</p>	<ul style="list-style-type: none"> • Sec. 781-793 (cont'd) 	<p>Deployment of Carbon Capture and Sequestration Technology:</p> <ul style="list-style-type: none"> • 2% for 2014-2017 • 5% for 2018-2050 • Allowances would be allocated to eligible electric generating units (EGUs) and industrial operations that implement CCS technology to recover the costs of their investment. See Sec. 115. • See also Sec. 115(c)(3)—EGUs that capture and sequester higher percentages of CO2 would be eligible for “Bonus Allowance Value” funds. <p>Investment in Energy Efficiency and Renewable Energy:</p> <ul style="list-style-type: none"> • 9.5% for 2012-2015 • 7.0% for 2016-2017 • 6.0% for 2018-2021 • 1.5% + for 2022-2025 • 4.5% for 2026-2050 • Allowances would be allocated to states for renewable energy and energy efficiency programs. See Sec. 131-132. <p>Clean Energy Innovation Centers:</p> <ul style="list-style-type: none"> • 1% from 2012-2050 • Allowances would be allocated to Centers via a competitive process. See Sec. 172. • Centers must use allowances to fund awards for clean energy projects. See <i>id.</i> <p>Investment in Clean Vehicle Technology:</p> <ul style="list-style-type: none"> • 3% for 2012-2017 • 1% for 2018-2025 • Allowances would be allocated to applicants for plug-in electric vehicle manufacturing and deployment programs. See Sec. 124. <p>Domestic Fuel Production (i.e. refineries):</p> <ul style="list-style-type: none"> • 2% for 2014-2026 <p>Investment in Workers:</p> <ul style="list-style-type: none"> • 0.5% for 2012-2021 • 1.0% for 2022-2050 • EPA Administrator would auction these percentages of allowances each year, with the proceeds to be used for programs that benefit workers. <p>Domestic Adaptation:</p> <ul style="list-style-type: none"> • 0.9% for 2012-2021 • 1.9% for 2022-2026 • 3.9% for 2027-2050 • Allowances would be allocated to states for programs to build resilience to climate change impacts. See Sec. 453. • EPA Administrator would auction 0.1% of allowances each year, with the proceeds to be deposited in the Climate Change Health Protection and Promotion Fund. See Sec. 467. <p>Wildlife and Natural Resource Adaptation:</p> <ul style="list-style-type: none"> • 1% for 2012-2021 • 2% for 2022-2026 • 4% for 2027-2050 • EPA Administrator would auction these percentages of allowances each year, with the proceeds to be deposited in the Natural Resources Climate Change Adaptation Fund. See Sec. 480. <p>International Adaptation:</p> <ul style="list-style-type: none"> • 1% for 2012-2021 • 2% for 2022-2026 • 4% for 2027-2050 • Allowances would be allocated to a designated account for eventual distribution to aid international adaptation to climate change. See Sec. 492-495.

Topic	Section(s)	Description
<p>C. Disposition of Allowances (cont'd)</p>	<ul style="list-style-type: none"> • Sec. 781-793 (cont'd) 	<p>International Clean Technology Deployment:</p> <ul style="list-style-type: none"> • 1% for 2012-2021 • 2% for 2022-2026 • 4% for 2027-2050 • Allowances would be allocated to a designated account for eventual distribution to aid international clean technology development. See Sec. 446. <p>Release of Future Allowances:</p> <ul style="list-style-type: none"> • Sec. 782(p) directs the EPA Administrator to auction off certain amounts of allowances with future vintage years. <p>Auction Procedures:</p> <ul style="list-style-type: none"> • Single-round, sealed-bid, uniform-price auction procedures, which could be modified by the EPA Administrator. • Entities could request that the EPA Administrator auction their allowances for them. <p>Revenue from Auction of Undistributed Allowances:</p> <ul style="list-style-type: none"> • From 2012 to 2025, proceeds would be deposited into the Treasury. • Beginning in 2026, proceeds would be returned to consumers on a per capita basis as a climate change rebate.
<p>D. Program Rules</p>	<ul style="list-style-type: none"> • Sec. 721-728 	<ul style="list-style-type: none"> • Trading would not be restricted to covered entities. • Unlimited banking of allowances for compliance in future years. • Unlimited borrowing of allowances from the next year's compliance period without interest. • Covered entities could satisfy up to 15% of their compliance obligations by borrowing allowances from years two to five of future compliance periods at 8% interest. • EPA Administrator would hold quarterly auctions of "Strategic Reserve" allowances, in which only covered entities would be allowed to participate. There would be a minimum strategic reserve price based upon EPA pricing models, as well as annual limits on how many allowances should be released from the Strategic Reserve. • Emission allowances, compensatory allowances and offset credits would not constitute property rights. • Title V Clean Air Act operating permits would require covered entities to hold a sufficient number of emission allowances to cover their GHG emissions. • Use of international emission allowances (e.g., European Union Allowances) would potentially be allowed for compliance purposes with the US cap-and-trade program. • Use of compensatory allowances (e.g., for the destruction of fluorinated gases) would also be allowed for compliance purposes. • Penalty for non-compliance = twice the fair market value of emission allowances for that year multiplied by the tons of carbon dioxide equivalent for which the covered entity failed to comply. • Covered entities that fail to comply would have to offset their shortfall the following year.
<p>E. Offsets</p>	<ul style="list-style-type: none"> • Sec. 722 • Sec. 731-740, 743 	<ul style="list-style-type: none"> • Up to 2 billion tons of offset credits would be available each year, split evenly between domestic and international offsets. • EPA Administrator could adjust that amount to up to 1.5 billion for international offsets, if there were insufficient domestic offsets available in a given year. • The ability to use these offset would be divided pro rata among all covered entities. • The percentage of an entity's compliance obligation that could be met via offset credits starts at around 30% in 2012 and gradually increases. • 1 domestic offset credit = 1 emission allowance • Before 2018, 1 international offset credit = 1 emission allowance • After 2018, 1.25 international offset credits = 1 emission allowance • Offset Integrity Advisory Board would recommend offset project types for eligibility and offset methodologies for reviewing and verifying projects. • EPA Administrator would be required to establish a list of eligible offset project types within one year of enactment.

Topic	Section(s)	Description
E. Offsets (cont'd)	<ul style="list-style-type: none"> • Sec. 722 • Sec. 731-740, 743 (cont'd) 	<ul style="list-style-type: none"> • Offsets would be subject to additionality and verification requirements. • EPA Administrator would be required to approve or reject potential offset projects within 90 days of receiving an application. • Early action offset projects undertaken pursuant to voluntary, state or regional GHG cap-and-trade programs would potentially be eligible for credits, if: <ul style="list-style-type: none"> ◦ Started after January 1, 2001; ◦ Credits issued have not been retired, cancelled or otherwise already used for compliance; and ◦ Credits would only be available for emission reductions after January 1, 2009. • International offset projects in developing countries would be eligible for credits, if a bilateral or multilateral agreement with the host country exists. • EPA Administrator would be required to, in consultation with the Secretary of State, identify sectors in specific countries for which issuing international offset credits on sector-wide basis would be appropriate. • International offset credits issued by an international body (e.g., the CDM Executive Board) would be eligible for credits, if the EPA Administrator determines that the international body issuing those credits has requirements in place that provide "equal or greater assurance of the integrity" of the credits. • International offset credits from reduced deforestation projects in developing countries would be available subject to many restrictions, including: <ul style="list-style-type: none"> ◦ Limited to national-scale activities for major emitting nations, or state-level activities in states that would be considered major emitters themselves. ◦ Smaller-scale deforestation offset projects would only be available in developing countries that generate less than 1% of total global GHG emissions and less than 3% of global forest-and-land-use-change GHG emissions. ◦ Developing countries would be required to establish national baselines to generate credits.
F. Other Cost Mitigation	<ul style="list-style-type: none"> • Sec. 763-765 	<ul style="list-style-type: none"> • Would rebate sums to eligible industrial sectors to compensate entities for their costs under the cap-and-trade program.
G. Preemption of State and Regional Programs	<ul style="list-style-type: none"> • Sec. 790 • Sec. 861 	<ul style="list-style-type: none"> • No state would be allowed to implement or enforce its own GHG cap-and-trade program from 2012 to 2017. • Entities would be permitted to exchange emission allowances issued prior to December 31, 2011 pursuant to the California, RGGI or WCI cap-and-trade programs for federal emission allowances sufficient to cover the costs of obtaining the state allowances. • States would still have authority, however, to adopt and enforce their separate standards or limits on air pollution under the Clean Air Act, including GHG emissions.
H. Exemptions from Other Clean Air Act Provisions	<ul style="list-style-type: none"> • Sec. 831-835 	<ul style="list-style-type: none"> • <i>Criteria Air Pollutants</i>: GHGs could not be listed as criteria air pollutants. • <i>Hazardous Air Pollutants</i>: GHGs could not be listed as HAPs. • <i>New Source Review</i>: NSR would not apply to GHG emissions. • <i>Title V Permits</i>: Emissions of GHGs could not be considered when determining whether a stationary source is required to operate pursuant to a Title V Permit. • <i>Existing Proceedings</i>: Waxman-Markey would not affect existing administrative proceedings or litigation initiated under the Clean Air Act prior to the date of enactment, <i>i.e.</i>, this legislation would not interfere with or determine the outcome of ongoing permit appeals.
I. Carbon Market Oversight	<ul style="list-style-type: none"> • Sec. 341 • Sec. 351-358 	<ul style="list-style-type: none"> • FERC would regulate the allowance and offset markets, with authority to issue cease-and-desist orders for market manipulation. • President would delegate oversight of carbon derivatives markets to an "appropriate" agency. • Would provide CFTC greater oversight over energy commodities and credit default swaps.

Topic	Section(s)	Description
II. RENEWABLE ELECTRICITY STANDARD	<ul style="list-style-type: none"> • Sec. 101 	<ul style="list-style-type: none"> • Combined efficiency and renewable electricity standard (25/75 split) for retail electric suppliers.
A. Targets		<ul style="list-style-type: none"> • 6% in 2012 (1.5% efficiency savings – 4.5% renewable electricity). • Percentage rises gradually to 20% in 2020 (5% efficiency savings – 15% renewable electricity). • State governors could petition to satisfy up to 40% of the target via efficiency savings (<i>i.e.</i>, in 2020, the targets would be 8% efficiency savings and 12% renewable electricity). • Sunset provision—program would expire at end of 2040.
B. Who Must Comply?		<ul style="list-style-type: none"> • Retail electric suppliers = electric utilities that sell > 4 million MWh of electricity to consumers for purposes other than resale. <ul style="list-style-type: none"> ◦ Power sales from an affiliate to consumers would count ◦ Power sales to certain affiliates would not count
C. Compliance Methods		<ul style="list-style-type: none"> • Retail electric suppliers would be required to submit <ul style="list-style-type: none"> ◦ Federal Renewable Electricity Credits (RECs), which represent 1 MWh of renewable electricity, to demonstrate the percentage of their electricity that comes from renewable resources, and ◦ A report verified by a third party to demonstrate their total annual electricity savings (<i>i.e.</i>, reduced electricity usage). • In the alternative, retail electric suppliers could submit \$25 per MWh in lieu of RECs or demonstrated electricity savings. <ul style="list-style-type: none"> ◦ Proceeds would go to state funds to develop renewables or energy efficiency programs.
D. Qualifying Renewable Resources		<ul style="list-style-type: none"> • Qualifying renewable resources would include: <ul style="list-style-type: none"> ◦ Wind ◦ Solar ◦ Geothermal ◦ Renewable biomass ◦ Biogas derived from renewable biomass ◦ Qualified hydropower ◦ Marine and hydrokinetic renewables ◦ Landfill gas ◦ Wastewater treatment gas ◦ Coal mine methane used to generate electricity at or near the mine mouth ◦ Qualified waste-to-energy
E. Program Rules		<ul style="list-style-type: none"> • Trading RECs would be allowed. • Demonstrated electricity savings could also be transferred. • Unlimited banking of RECs for future compliance years would be allowed. • Distributed generation (<i>e.g.</i>, rooftop solar) would receive 3 RECs for each 1 MWh of renewable electricity generated. • If not specified in a power purchase agreement, the retail electric supplier would receive the RECs. • Penalty for non-compliance would be \$50 per REC or electricity savings that the entity failed to submit.
F. Baseline		<ul style="list-style-type: none"> • Baseline electricity amount for retail electric suppliers would exclude the following generation sources: <ul style="list-style-type: none"> ◦ Hydropower, other than qualified hydropower; ◦ Nuclear generation placed in service after enactment; ◦ Fossil-fuel generation to the extent that GHG emissions are captured and sequestered.
G. Preemption of State Programs		<ul style="list-style-type: none"> • States would still be allowed to adopt and enforce more stringent renewable electricity and energy efficiency standards.

Topic	Section(s)	Description
H. Market Oversight		<ul style="list-style-type: none"> • FERC would oversee the RECs and electricity savings markets.
III. CARBON CAPTURE AND SEQUESTRATION (CCS)	<ul style="list-style-type: none"> • Sec. 111-115 	<ul style="list-style-type: none"> • Would require EPA to report to Congress within one year of enactment on the legal and regulatory barriers to CCS. • Would require EPA to promulgate regulations in the following areas: <ul style="list-style-type: none"> ◦ Certifying and permitting geologic sequestration sites ◦ Maintaining evidence of financial responsibility for geological sequestration wells ◦ Distributing emission allowances to support CCS • CCS would receive 2% of emission allowances between 2014 and 2017, and 5% between 2018 and 2050. • EPA Administrator would distribute emission allowances to EGUs in two phases to recover the costs of their CCS investment: <ul style="list-style-type: none"> ◦ Phase I: first 6 gigawatts of eligible EGUs ◦ Phase II: EPA would need to issue new regulations. • EPA Administrator would also distribute emission allowances to certain industrial sources that implement CCS as well, but only up to 15% of the allowances allocated for CCS. • Would establish the "Carbon Storage Research Corporation," which would levy assessments on distribution utilities and use those funds to award grants to CCS projects.
IV. ENERGY EFFICIENCY	<ul style="list-style-type: none"> • Title II • Sec. 201-215 	<ul style="list-style-type: none"> • Would require greater energy efficiency in building codes. • Would establish "Retrofit for Energy and Environmental Performance" (REEP) programs to retrofit existing residential and commercial buildings. • Would contain multiple other programs to promote energy efficiency in lighting and consumer appliances.
V. PERFORMANCE STANDARDS FOR NEW COAL-FIRED PLANTS	<ul style="list-style-type: none"> • Sec. 116 	<ul style="list-style-type: none"> • New coal-fired plants permitted on or after Jan. 1, 2020 would be required to achieve a 65% reduction in their annual CO₂ emissions. • New coal-fired plants permitted after Jan. 1, 2009 and before Jan. 1, 2020 would be required, by a certain date (but no later than 2025), to achieve a 50% reduction in their annual CO₂ emissions.
VI. ADDITIONAL GHG STANDARDS, INCLUDING HFC REGULATION	<ul style="list-style-type: none"> • Title VIII • Sec. 811 • Sec. 332 	<ul style="list-style-type: none"> • Would require EPA Administrator to use existing authority under Sec. 111 of the CAA to set GHG emission standards for certain uncapped sources. • Would establish a separate, distinct cap-and-trade program to regulate the production and consumption of hydrofluorocarbons (HFCs). <ul style="list-style-type: none"> ◦ 85% reductions by 2032 ◦ Offset credits available for destruction of CFCs
VII. CLEAN ENERGY DEPLOYMENT ADMINISTRATION (CEDA)	<ul style="list-style-type: none"> • Dingell amendment 	<ul style="list-style-type: none"> • Would establish an autonomous Clean Energy Development Administration (CEDA) within DOE to fund emerging clean technologies. • Would also make reforms to DOE's loan guarantee program.

Topic	Section(s)	Description
VIII. CLEAN TRANSPORTATION	<ul style="list-style-type: none"> • Sec. 121-128 • Sec. 221-224 	<ul style="list-style-type: none"> • Would require electric utilities to develop plans to support plug-in electric drive vehicles. • Would require the Secretary of Energy to establish a program to deploy and integrate plug-in electric drive vehicles into the electricity grid. • Would require the Secretary of Energy to provide financial assistance to automobile companies to facilitate the domestic development and manufacture of plug-in electric drive vehicles. • Would amend the definition of renewable biomass. • Would authorize regulations to require automakers to produce more cars capable of running on blends of alternative fuels. • Would establish a temporary “Cash for Clunkers” voucher program to catalyze the retirement of older, inefficient vehicles. • Would require GHG emission standards for new heavy-duty vehicles and engines, new nonroad engines and vehicles, and new aircraft and aircraft engines. • Would require States and metropolitan planning organizations with populations > 200,000 to submit land use and transportation efficiency plans to achieve GHG emissions reductions. • Would establish a SmartWay Transport Program within EPA to quantify, demonstrate, and promote ways to reduce GHG emissions from the mobile source sector.
IX. SMART GRID	<ul style="list-style-type: none"> • Sec. 141-146 	<ul style="list-style-type: none"> • Would incorporate Smart Grid concept into Energy Star program for consumer appliances and make funds available for rebates for these products. • Would require electric load serving entities to develop peak demand reduction plans.
X. TRANSMISSION PLANNING	<ul style="list-style-type: none"> • Sec. 151 	<ul style="list-style-type: none"> • Would require FERC to adopt national electricity grid planning principles to promote development of renewable and other zero-carbon energy sources. • Would require FERC to coordinate regional transmission planning efforts to coincide with those principles.

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney whom you normally consult. A complete list of our *Client Alerts* can be found on our Web site at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, please visit www.lw.com/LathamMail.aspx to subscribe to our global client mailings program.

Abu Dhabi

Barcelona

Brussels

Chicago

Doha

Dubai

Frankfurt

Hamburg

Hong Kong

London

Los Angeles

Madrid

Milan

Moscow

Munich

New Jersey

New York

Orange County

Paris

Rome

San Diego

San Francisco

Shanghai

Silicon Valley

Singapore

Tokyo

Washington, D.C.