

Lieberman-Warner Climate Change Cap-and-Trade Bill Seen as Framework for Senate Climate Debate

On October 18, Senators Joseph Lieberman (I-CT) and John Warner (R-VA) introduced climate change cap-and-trade legislation. The bill, titled America's Climate Security Act (ACSA), comes after an August 2, 2007 outline the Senators released to generate discussion and feedback, and contains some key differences from the August white paper.

REGULATED ENTITIES

The bill's greenhouse gas (GHG) emissions cap would apply to the electric power, industrial, and transportation sectors, reaching 75 percent of total US GHG emissions. Facilities are regulated depending on their emissions of "carbon dioxide equivalents" or CO₂e, which is defined as the quantity of each GHG that EPA determines makes the same contribution to climate change as 1 metric ton of CO₂. Fossil fuel-fired electricity generating units and industrial facilities that emit more than 10,000 CO₂e would be required to submit allowances to cover their annual GHG emissions. The transportation sector would be regulated "upstream" – regulating any entity that has annual production or imports of petroleum- or coal-based transportation fuel, the use of which would result in emissions of more than 10,000 CO₂e per year. These entities would be required to submit allowances based on the carbon content of the fuel. The bill also would regulate any entity that has annual production or imports of non-fuel chemicals that will emit more than 10,000 CO₂e. In addition to the cap-and-trade program, the bill would establish strengthened efficiency standards to reach commercial buildings and residential sources of emissions not covered by the cap.

EMISSION TARGETS AND TIMETABLES

The legislation would cap emissions from covered facilities at 2005 levels in 2012. The cap would decline to 15% below 2005 levels by 2020 and to 70% below 2005 levels by 2050. The bill will would achieve these emissions milestones by lowering each year the total emissions cap by 96 million tons (which amounts to a 1.8% annual reduction of the initial 2012 cap of 5.2 billion tons).

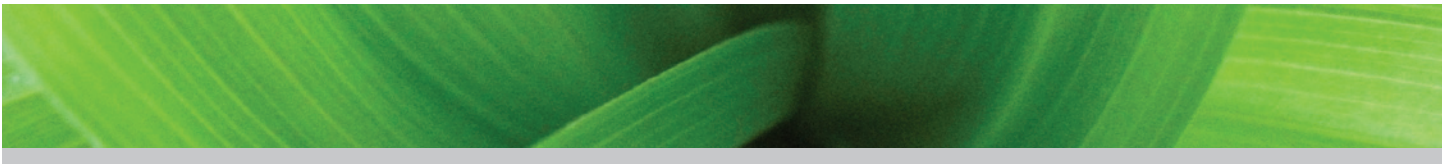
ALLOWANCE ALLOCATION PROVISIONS

EPA would be responsible for allocating emission allowances through several different means. For 2012, the first year of the program, 76% of the 5.2 billion allowances for the year would be allocated at no cost and 24% would be auctioned. By 2036, 27% of the nearly 2.9 billion allowances for that year would be allocated at no cost and the remaining 73% would be auctioned.

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Allocations to Covered Electric Power and Industrial Facilities

From 2012 to 2016, 20% of the year's allowances would be allocated, free of charge, to covered facilities in each of the electric power and industrial sectors. Allowances would be distributed within each sector to facilities on the basis of their historic emissions. The initial 20% level would decline by one percent per year, until it reaches zero in 2036.

Load-Serving Entities

Each year, 10% of the allowances would be allocated to load-serving entities (*i.e.*, electric distribution utilities), with the exact amount of allocations for each entity based on the amount of electricity sold to consumers. The entities receiving allowances would be required to pass through the value of the allowances to rate-payers. Specifically, the bill would require all proceeds from the sale of these allowances to be used to mitigate economic impacts on low- and middle-income energy consumers and promote end-use energy efficiency.

Annual Auctions

In 2012, 18% of the allowances would be auctioned under the annual auction program. The percentage of allocations that is auctioned would increase annually, as the amount of allocated allowances decreases, until it reaches 73% in 2036 and then remains at this level. The bill further provides an "early auction" provision under which an additional 6% of the 2012 allowances would be auctioned within 180 days of enactment of the bill. A substantial portion of auction proceeds would go to a fund for development of clean energy technologies.

Early Action Awards

In 2012, 5% of allowances would be awarded to covered facilities for actions taken since 1994 to reduce GHG emissions. The number of allowances available for this purpose would decline by 1% per year. EPA would be required to issue regulations setting procedures and criteria for distributing these early action awards.

States

A minimum of 5% of each year's allowances would be allocated to state governments, with an additional 1-4% available depending on various actions taken by the state, including establishment of "de-coupling" policies for electric and natural gas utilities.

Other Uses of Allowances

Remaining allowances would be allocated for carbon capture and sequestration, domestic agriculture and forestry, and international forest protection.

OFFSETS AND COST CONTAINMENT MECHANISMS

Regulated facilities would be able to meet up to 15% of their compliance obligation in any given year with allowances generated through domestic offset projects. The bill includes procedures and standards that EPA must use to certify such projects. Facilities also would be able to meet up to 15% of their compliance obligation for a given year with credits purchased from an international emission trading market, as long as the credits were "issued by a



foreign country pursuant to a governmental program that imposes mandatory absolute tonnage limits [on GHG emissions from that country], or 1 or more industry sectors in that country.”

Covered facilities would be able to borrow from future years up to 15% of the allowances necessary to meet their compliance obligations in any given year. Such borrowing would be subject to a 10% annual interest rate and have a five-year limit.

The bill also would create a Carbon Market Efficiency Board, modeled after the Federal Reserve, to oversee the allowance market. Under certain economic circumstances, the Board would be authorized to relax the limits on use of domestic offsets and international offsets credits, and to expand the ability to borrow allowances. Significantly, the Board also could increase the emission cap for any given year by up to 5%, provided that equivalent reductions are made to the cap in future years.

MEASURES TO ADDRESS IMPACTS ON TRADE AND COMPETITIVENESS

ACSA would direct the President to encourage efforts of other nations to lower their GHG emissions. To mitigate trade impacts from countries that are not taking comparable action to the United States to lower GHG emissions, the legislation would authorize the President to require importers of “GHG-intensive manufactured products from that nation to submit emissions allowances of a value equivalent to that of the allowances that the U.S. system effectively requires of domestic manufacturers.” The allowance requirement would apply to covered imports starting in 2020.

CARBON SEQUESTRATION DEVELOPMENT

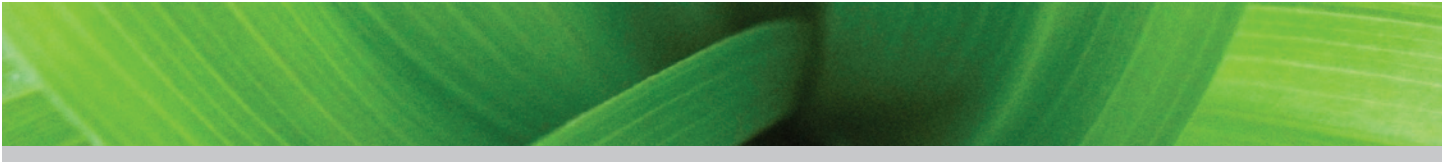
The Lieberman-Warner bill would direct the EPA to establish an advisory committee to develop regulations for the permitting of commercial-scale CO₂ injection and storage sites. In addition, a private task force would be formed to consider a legal framework for the Federal assumption of liability with respect to closed geologic storage sites.

KEY DIFFERENCES FROM EARLIER WHITE PAPER

ACSA differs in several important respects from the detailed proposal released by Senators Lieberman and Warner on August 2, 2007. First, ACSA includes a more aggressive emissions reduction target – the August outline proposed a 10% reduction from 2005 levels by 2020, whereas ACSA contains a 15% reduction by 2020.

Second, the bill’s program for allowance allocation and auction differs somewhat from the earlier draft. The number of allowances allocated free of charge to covered facilities in 2012 was decreased, and such allowances now would be eliminated by 2036. The number of allowances to be auctioned was increased by a corresponding amount. Furthermore, ACSA changes several of the allowance allocation percentages from the August proposal. For example, the allowance allocation for refineries was eliminated, while the allowances allocated to the states were increased.

ACSA also contains two additional provisions that were not in the August proposal – a distribution of 20% of the auction proceeds to low- and moderate-income consumers, and new energy efficiency standards for residential heating and commercial and residential buildings.



IMPLICATIONS

Sen. Barbara Boxer (D-CA), Chairman of the Senate Environment and Public Works Committee, has pledged to move a climate change bill through her committee this year and said that the Lieberman-Warner draft would be the “starting point” for deliberations. The Committee’s Subcommittee on Private Sector and Consumer Solutions to Global Warming and Wildlife Protection, chaired by Sen. Lieberman, has scheduled a hearing on the measure for October 24, with a mark-up immediately to follow during the week of October 29. This Subcommittee includes some Senators who have publicly advocated for aggressive GHG emission reductions, which could be part of the reason why ACSA proposes a somewhat more stringent program than the August outline.

FOR ADDITIONAL INFORMATION

Van Ness Feldman has an experienced climate change and emissions trading team that assists a wide range of clients on policy, transactional, strategic and advocacy issues. The firm has been actively involved for clients in the development of climate change legislation. We are in a strong position to provide expert analysis and advice on the bills emerging in Congress, the surrounding policy and political debate, and the implications for your organization. If you would like more information, please contact Kyle Danish, Doug Smith, Stephen Fotis, or any member of the firm’s Climate Change and Emissions Trading Practice group at (202) 298-1800.

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