

Senators Kerry and Lieberman Unveil Draft Energy and Climate Change Bill

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On May 12, 2010, Senators John Kerry (D-MA) and Joseph Lieberman (I-CT) released the initial draft of a comprehensive climate change and clean energy bill, titled the “American Power Act” (APA). The 987-page draft bill, which has not been formally introduced in the Senate, is the product of months of negotiations led by Sens. Kerry, Lieberman and Lindsey Graham (R-SC). Sen. Graham recently withdrew from the negotiations, citing disagreements with Senate Democratic leadership over legislative priorities for the remainder of the year, and announcing that it would be “impossible” for “serious debate” to move forward with the politics of immigration reform “hanging over the Senate” and until Congress responds to the Gulf of Mexico oil disaster.


The Kerry-Lieberman bill has garnered tentative praise from some industry stakeholders, including several major electric utilities and the Edison Electric Institute, the leading trade association for investor-owned utilities. Other key players, such as the American Petroleum Institute, the U.S. Chamber of Commerce and the National Association of Manufacturers, did not express immediate opposition following the American Power Act’s unveiling. Whether this compromise legislation will garner enough votes to pass the Senate before the 2010 midterm elections remains highly uncertain.

KEY ELEMENTS OF THE AMERICAN POWER ACT

GHG Emissions Reduction Program

Emission Limits. The Kerry-Lieberman bill adopts economy-wide greenhouse gas (GHG) emission reduction targets and timetables that are almost identical to the Waxman-Markey bill passed by the House in June 2009 (H.R. 2454, the “American Clean Energy and Security Act”). The cap on GHG emissions would begin a year later than in Waxman-Markey, in 2013, at a level equal to 4.75% below 2005 emission levels, with a 17% reduction below 2005 levels required by 2020, 42% by 2030, and 83% by 2050. However, the APA differs from Waxman-Markey in many respects, highlights of which are noted below.

Sector-by-Sector Phased-In Schedule of GHG Regulation. The draft bill would phase in regulation of four sectors that are major contributors to GHG emissions—electricity generation, industrial operations, natural gas distribution, and petroleum-based fuels. Electricity generation facilities and producers of refined petroleum products would be covered starting in 2013. Large industrial sources and natural gas local distribution companies would be covered starting in 2016, a four-year delay relative to the Waxman-Markey bill.



Treatment of Petroleum Fuels. As a compromise with members of the petroleum industry who preferred a fixed “linked fee” on carbon, the bill requires refined petroleum product providers to purchase allowances from the government at a set price (determined by the allowance auction price) and then to retire the allowances. Banking and allowance trading are prohibited in this sector.

“Price Collar.” What is labeled in the bill summary as a “hard price collar” is actually a combination of a hard floor and a price ceiling based on an allowance reserve. As in Waxman-Markey, the bill sets a minimum auction reserve price at which allowances can be purchased—\$12 per ton in 2013—which would rise at 3% above inflation. The APA also sets aside a pool of 4 billion allowances in a cost containment reserve, from which covered sources (other than refined petroleum product providers) can purchase allowances to meet up to 15% of their compliance obligation. The reserve allowances would be drawn from the emission caps for future years, and would be offered at a ceiling price of \$25 per ton in 2013 (rising at 5% over inflation annually). Revenues from any sales of reserve allowances would be used to replenish the reserve by purchasing offset credits.


Offsets. Each year, the APA would allow 2 billion tons of offset credits to be used by covered sources (except refined petroleum product providers) for compliance. Of that total, 500 million tons may be derived from international offset projects.

The bill incorporates the majority of the offset provisions of the Clean Energy Partnerships Act (S. 2729), introduced in the fall of 2009 by Senator Debbie Stabenow (D-MI). As under that bill, the U.S. Department of Agriculture would oversee domestic agriculture and forest-based offset projects, and the Environmental Protection Agency (EPA) would oversee all other types of offset projects. Certain types of emission reduction projects would be deemed presumptively eligible to generate offset credits.

Although the APA incorporates many of the international offset provisions of the Waxman-Markey bill, it makes some significant changes, including restricting the circumstances under which offset credits may be generated by projects to reduce emissions from tropical deforestation.

Allowance Disposition. Like the Waxman-Markey bill, the APA would, in the early years of the program, allocate a significant portion of allowances to electric and natural gas local distribution companies (LDCs), to be used for the benefit of ratepayers. Seventy-five percent of the allowances provided to electricity LDCs would be distributed based on the historic emission intensity of the electricity they distribute, and the remainder would be distributed on the basis of sales.

In addition to allowance value to be passed through to consumers, allowances are also allocated within the electric sector to long-term contract generators and merchant coal generators. Further allowance allocations are directed towards deficit reduction; energy-intensive, trade-exposed industrial sources; merchant coal generators that retire their plants or switch to “less emissive fuels” like natural gas; and surface transportation infrastructure projects designed to reduce GHG emissions.



Over time, allocations are phased-out in lieu of an allowance auction. Beginning in 2026, the revenue from auctioning 8% of allowances will be deposited in a trust fund. Seventy-five percent of the fund will be distributed to households via the tax code and 25% will be dedicated to deficit reduction. The percentage of allowances auctioned to fill the trust fund rises to over 75% by 2035.

Limitations on EPA Authority Under the Clean Air Act. Most of the programs established under the bill would be administered by the EPA. However, the bill also contains language that is intended to preclude EPA from regulating GHGs under the following Clean Air Act programs: New Source Review, Title V Operating Permits, National Ambient Air Quality Standards, and National Emission Standards for Hazardous Air Pollutants.

Preemption of State Authority. The bill would permanently preempt state cap-and-trade programs for GHGs after 2013, but does not appear to place limitations on other types of state authority to regulate GHG emissions.


Incentives for Increased Domestic Energy Production

In addition to the cap-and-trade program, the bill contains significant provisions directed at encouraging clean energy technologies and development of new energy resources, including:

Nuclear Incentives. The APA offers financial incentives for the construction of new nuclear power plants, including an increase in dedicated loan guarantee funding under Title XVII of the Energy Policy Act of 2005; a new investment tax credit; and an accelerated depreciation period.

Offshore Drilling. The bill reforms federal regulation of offshore drilling and exploration by providing that 50% of federal revenues from new offshore oil and gas development be shared with states. However, states are authorized to enact laws that would “veto” such development within 75 miles of their coastlines, and could also prohibit oil and gas leasing in any area within a federal 5-Year Outer Continental Shelf Oil and Gas Leasing Program if the Secretary of Interior determines that a particular state could suffer significant adverse impacts in the event of an accident in that area. According to Sen. Lieberman, these provisions may be further amended pending a federal review of the major oil spill in the Gulf of Mexico.

Carbon Capture and Sequestration. The draft bill would create a national program for demonstration of carbon capture and sequestration (CCS) technology at power plants and industrial sources, financed by a 10-year, \$2 billion annual levy on all fossil-fueled power generation. The levy would require prior approval by at least 30 state public utility commissions. In addition, the bill would establish a per-ton incentive for up to 72 GW of commercial CCS projects. Qualifying CCS projects would receive bonus allowances based on a fixed formula or through a reverse auction.



Performance Standards for New Coal-Fired Power Plants. New coal-fired electric power plants permitted between 2009 and 2019 would be required to reduce carbon dioxide emissions by at least 50% within four years from the date upon which certain CCS commercialization targets are met, but by no later than 2020. Coal-fired plants permitted after January 1, 2020 must reduce carbon dioxide emissions by at least 65%.

Natural Gas in Power Plants. As referenced above, the bill allocates free allowances to merchant coal plants upon notification of retirement or repowering through “less emissive fuels” (e.g. natural gas). Although the bill provides few other direct incentives for “fuel switching,” the Coal-Fueled Fleet Transition Program requires EPA to establish a task force to study how existing programs affect the transition from coal to cleaner fuels and identify financial and regulatory incentives that would encourage a transition from coal to cleaner fuels.

Expanded Use of Natural Gas in Transportation. The APA offers incentives for the use of natural gas in heavy-duty vehicles, including federal tax credits, state and local bond financing, and tax deductions for investment in manufacturing facilities.

Hydraulic Fracturing. The draft bill requires mandatory public disclosure of chemicals used in hydraulic fracturing for natural gas extraction.

Mobile Source Regulation. The draft bill would require EPA to establish GHG emission standards for heavy-duty vehicles and nonroad engines (such as marine vessels and aircraft).

Renewables and Efficiency. The APA would expand Title XVII loan guarantees for non-nuclear qualifying projects, including renewable energy and efficiency projects, by \$17.5 billion. The APA may be merged at a later date with the bipartisan energy bill under consideration in the Senate Energy and Natural Resources Committee (S.1462 or the “American Clean Energy Leadership Act”), which includes a combined renewable electricity and energy efficiency standard and other energy policy measures. While a bipartisan majority of this committee reported a version of the bill last year, new amendments are currently being considered.

LOOKING AHEAD

EPA and the Energy Information Administration are expected to release their economic analyses of the bill in the coming weeks, and Senator Lieberman has said he expects the Senate to debate the legislation once these agencies release their findings. The bill has yet to be reviewed by any committees of jurisdiction, and may be significantly amended if it goes through such a process. In addition, as noted above, the bill may eventually be merged with the amended version of the Senate Energy and Natural Resources Committee’s American Clean Energy Leadership Act.

Whether the Kerry-Lieberman bill eventually will attain the 60 votes necessary to break a likely Republican filibuster depends on many factors, including the controversial issue of offshore oil drilling. Senator Bill Nelson (D-FL), for example, has promised to filibuster any legislation that would expand offshore oil drilling. Given



the limited time remaining on the legislative calendar in 2010, it is unclear whether this and other difficult issues can be resolved in this Congress.

FOR ADDITIONAL INFORMATION

Van Ness Feldman closely monitors congressional and executive branch developments on climate change and energy policy, and is in a strong position to provide expert analysis and advice on emerging legislation and regulatory activity, the surrounding policy and political debate, and the implications for your organization. If you would like more information about climate change and energy being considered in Congress or related regulations being considered by federal agencies, please contact Kyle Danish, Stephen Fotis, or any member of the firm's Climate Change practice at (202) 298-1800. Those interested in on-going coverage of climate change policy developments may wish to subscribe to the weekly Climate Change Policy Update at <http://www.vnf.com/news-signup.html>.

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