

March 17, 2008

Climate Change Policy Update Week of March 10-14, 2008

Commentary: *Senate Democratic leaders say that they plan to bring the Lieberman-Warner bill to the floor of the Senate in June. However, they caution that if amendments appear likely to weaken the bill, they will pull it and await an expected Democratic ascendancy in 2009 . . . EPA came out with its analysis of the Lieberman-Warner bill. The Agency predicts allowance prices of \$62-83/tCO₂e in 2030, and \$159-220/tCO₂e in 2050. EPA further project electricity prices to increase 44% in 2030 and 26% in 2050. EPA indicates that rules on offsets have a substantial impact on expected costs and allowance prices . . . A study released by the National Association of Manufacturers and the American Council for Capital Formation predicts much more adverse impacts, including a doubling of electric prices by 2030 . . . Underscoring the importance of offsets, a new coalition of energy companies, financials, and offset providers sent a letter to all U.S. Senate offices advocating that regulated entities be able to use offsets for compliance in any cap-and-trade program. Van Ness Feldman provides counsel to the coalition, which is called the Coalition for Emission Reduction Projects.*

Congress

- **Leaders Announce Floor Strategy for Lieberman-Warner Bill.** Democratic leaders in the Senate have promised to pull the Lieberman-Warner climate change bill (S.2191) from the Senate floor if amendments that weaken the bill are added during Senate consideration. The Democratic leadership's rationale for pulling the bill if it is weakened is their belief that the 111th Congress and the new President would support strong climate change legislation. Senate Majority Leader Harry Reid announced plans to bring the bill before the full Senate for consideration in June.
- **Climate Change Amendments to the Senate Budget Resolution.** During votes on the Senate budget resolution (S. Con Res 70) this week, several amendments were offered that included provisions related to GHG emissions. Sen. Bill Nelson (D-FL) offered an amendment (S. Amdt. 4329) for the development of carbon capture technologies. The amendment was adopted, but a similar amendment (S. Amdt. 4207) offered by Sen. Alexander (R-TN) was rejected because of provisions allowing offshore drilling and oil shale development. An amendment (S. Amdt. 4209) offered by Sen. Collins (R-ME), which creates a tax credit for both cellulosic ethanol production and the purchase of plug-in hybrid vehicles, passed by unanimous consent. The Senate budget resolution contains the outline of consensus Senate thinking on spending and policy issues. However, it is not binding on the Senate.
- **Rep. Waxman Sends Letter to EPA Seeking Information on Regulation of Vehicle GHG Emissions.** In a letter to EPA Administrator Stephen Johnson, Rep. Waxman (D-CA) accused the agency of halting work on GHG regulations for new motor vehicles, contrary to a mandate from the Supreme Court. Rep. Waxman said that he has learned that, in December, the EPA sent an "endangerment finding" to the White House and a proposed vehicle GHG regulation to the Department of Transportation, but according to senior EPA officials, all work on the project has ceased since then. An "endangerment finding" is the agency's conclusion that a specific air pollutant presents a danger to human health and the environment; the finding is a necessary prerequisite for EPA to assert regulatory authority over the pollutant. Senior EPA officials also testified before the House Committee on Oversight and Government Reform that a team of EPA staff members was assembled in order to determine whether GHG emissions

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March 17, 2008

endanger the health and welfare of the public. The U.S. Supreme Court ordered the agency to consider this issue in its *Massachusetts v. EPA* decision last year. Rep. Waxman's letter asks EPA Administrator Johnson to provide more information on the status of the endangerment finding and the motor vehicle regulation.

- **House Climate Committee Holds Hearing on Nuclear Power and Climate Change.** The House Select Energy Independence & Global Warming Committee held a hearing about the role of nuclear power with respect to climate change. The witnesses at the hearing testified about the advantages and disadvantages of nuclear power. Although a long-time critic of the nuclear industry, Committee Chairman Markey already stated that he supports allowing the market to sort out clean energy "winners," whether nuclear, wind, solar, or other types.
- **Coalition Sends Letter to Senators Advocating Workable Provisions for Offsets.** The Coalition for Emission Reduction Projects sent a letter to each U.S. Senator advocating that any cap-and-trade program allow regulated entities to use emission reduction projects as "offsets" for compliance purposes. The Coalition's letter also outlined recommendations for legislative provisions, including: (i) avoiding arbitrary quantity and geographic limits on the use of offsets; (ii) use of a multi-year crediting period for projects; and (iii) establishing a "positive list" of eligible project types that can benefit from streamlined review. The Coalition's members include American Electric Power, Blue Source, 3C – The Carbon Credit Company, Deutsche Bank, Dominion, Econergy, EcoSecurities, El Paso Company, Environmental Credit Corp, Equator Environmental, Leaf Clean Energy Company, and Stark Investments. Van Ness Feldman provides counsel to the CERP. For more information, see www.uscerp.org
- **House Bill Would Require New Coal-fired Power Plants to Capture and Sequester GHG.** Reps. Waxman (D-CA) and Markey (D-MA) introduced a new bill, H.R. 5575, which would prohibit the permitting of any new coal-fired power plant unless it is able to capture and sequester 85 percent of its GHG emissions. The requirements of the legislation, if passed, would expire when a program of federal CO₂ regulation takes effect.

States and Cities

- **California Energy Regulators Submit Recommendations for Cap-and-trade Program.** California's two major energy agencies submitted to the California Air Resources Board (CARB) their recommendations for reducing GHG emissions within the state. CARB is charged with implementing California's 2006 Global Warming Solutions Act (A.B. 32), which limits state-wide GHG emissions to 1990 levels by 2020. The California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) recommendations call for CARB to develop a cap-and-trade program that regulates "first deliverers" of electricity into the state. The agencies also recommended that CARB use a hybrid approach to distributing emission allowances that would allocate some percentage of allowances to regulated entities and auction the remainder. The CPUC/CEC recommendations do not specify allocations for the different power companies. Auction revenues would be used to benefit electricity consumers by promoting energy efficiency and renewable electricity generation or reducing electricity bills.
- **WCI Issues Draft Recommendations for Regional Cap-and-trade Program.** Two subcommittees of the Western Climate Initiative (WCI) released draft recommendations for a cap-and-trade program intended to reduce regional GHG emissions to 15 percent below 2005 levels by 2020. The draft

March 17, 2008

recommendations call for regulation of power generators, industrial facilities, and other large stationary sources of CO₂, but initially would exclude the transportation, agriculture, and forestry sectors. The excluded sectors would be incorporated into the cap-and-trade program over time as accurate and cost-effective means to measure emissions reductions for those sectors are developed. The recommendations contain minimum thresholds to exempt small emission sources from regulation under the program. WCI members are expected to finalize the design of the cap-and-trade program by August of this year. WCI member states include Arizona, California, Montana, New Mexico, Oregon, Utah, Washington and the Canadian provinces of British Columbia and Manitoba.

- **Massachusetts Adopts Stringent GHG Emissions Targets.** The Massachusetts Senate sent to the state House legislation mandating statewide reductions of GHG emissions. If passed by the House, the “Global Warming Solutions Act” would cap state-wide GHG emissions at 20 percent below 1990 levels by 2020 and 80 percent below 1990 levels by 2050. The Massachusetts Department of Environmental Protection would be tasked with developing regulations to implement the emissions caps. In addition to limiting emissions from the electricity sector, the bill includes a low-carbon fuel standard and an emissions intensity standard that would require all new power plants to emit less than 1,100 pounds of CO₂ per megawatt-hour. The bill’s emission targets correspond to the targets in California’s 2006 climate legislation (A.B. 32) and exceed Massachusetts’ Regional Greenhouse Gas Initiative (RGGI) commitment to reduce GHG emissions to 10 percent below 1990 levels by 2020. Some observers expect that the Massachusetts legislation may encourage other RGGI states to adopt more stringent caps in line with the new Massachusetts targets.

Industry

- **U.S. Department of Agriculture Suspends Low-Interest Lending Program for Coal-fired Generation.** The Rural Utilities Service (RUS), which is an agency within the U.S. Department of Agriculture, announced that it will not be providing any low-interest loans to rural electric cooperatives for coal-fired generation in 2008 or 2009. The RUS is a major source of financing for new plant construction, with over \$ 1.4 billion provided since 2001. RUS cited escalating material costs and uncertainties about future controls on GHG emissions. The White House Office of Management and Budget asked that the loan program be put on hold until the cost and climate risks can be better quantified. At the time of suspension, four utilities had applied for loans totaling \$1.2 billion for proposed plants in Kentucky, Illinois, Arkansas, and Missouri.

Studies and Reports

- **EPA Analysis: Lieberman-Warner Bill Achieves Greater Reductions, but has Higher Costs Than Previous Climate Bills.** The Agency’s analysis found that the bill would achieve greater reductions than the McCain-Lieberman bill or the Bingaman-Specter bill at greater, but still “moderate,” cost to the economy. EPA predicts allowance prices of \$62-83/tCO₂e in 2030, and \$159-220/tCO₂e in 2050. EPA further projects electricity prices to increase 44% in 2030 and 26% in 2050, “assuming the cost of allowances can partially be passed on to consumers (as is the case in a full auction).” On the other hand, the Agency noted that “if allowances are given directly to power companies, the cost of these allowances would not be passed on consumers in regulated electricity markets, so electricity price increases would be smaller in much of the country.” EPA found that the bill’s limitation on use of offsets have a strong impact on allowance prices, even more so than assumptions about the availability of technologies. If quantity limits on domestic and international offsets are removed, allowance prices

March 17, 2008

fall by 71%. The Agency's analysis does not incorporate the impacts of the passage of the 2007 energy bill, so EPA will release a revised version in June. The Energy Information Administration is expected to release its analysis of Lieberman-Warner bill this month.

- **Industry Study Predicts Significant Energy Price Increases, Economic Losses Under Lieberman-Warner Bill.** A study by the National Association of Manufacturers (NAM) and the American Council for Capital Formation (ACCF) on the economic impacts of the Lieberman-Warner bill reports that allowance prices would be \$55-64 per ton in 2020 and \$227-271 in 2030. The study predicts that natural gas prices would increase by 26-36 percent in 2020 and by 108-146 percent in 2030; electricity prices would rise by 28-33 percent in 2020 and by 101-129 percent in 2030. NAM and ACCF also predict significant economic and job losses under the emission caps contained in the bill.
- **Report Identifies Risk to Credit of U.S. Utilities from State Renewable Portfolio Standards.** A report released this week by the credit risk analyst Standard & Poor's identifies challenges that U.S. utilities will have with state renewable portfolio standards (RPS). The report, *The Race for the Green: How Renewable Portfolio Standards Could Affect U.S. Utility Credit Quality*, finds that RPS requirements are forcing utilities to procure renewable generation in large quantities at rates that are often above-market. The costs of RPS compliance could affect the creditworthiness of some U.S. utilities as the "feasibility and cost ramifications, while imminent, have not yet arrived in most RPS states." The report notes that most of the cost implications of RPS programs have not yet been passed on to consumers through retail rates because most states recently enacted their programs.
- **China's Emissions Projected to Increase Faster than IPCC Prediction.** Professors at the Universities of California at Berkeley and San Diego concluded in a report that China's GHG emissions will increase faster than predicted by the Intergovernmental Panel on Climate Change (IPCC). The IPCC predicted that emissions would increase between 2.5 and 5 percent from 2004 to 2010, but the University of California researchers found that an increase of 11 percent is more likely. The revised estimate is based on provincial data, rather than information provided by the Chinese central government. Overall, the researchers projected that CO₂ emissions in China will increase by 600 million metric tons from 2000 to 2010.

International

- **EU Likely To Remove Provision Restricting CDM Credit Banking from Post-2012 Period Proposal.** The European Union Emissions Trading Scheme (EU ETS) currently permits covered entities to use carbon credits generated under the Kyoto Protocol's Clean Development Mechanism and Joint Implementation to meet part of their emission reduction obligations. These credits can be used to meet obligations for during the 2008-2012 trading period or banked to meet emissions caps for the third trading period, which runs from 2013-2020. The current EU Commission proposal for the third trading period would limit banking to Kyoto credits that are approved by all member states. Given that each member state has different criteria for approving Kyoto credits, many member states oppose the banking restriction and EU officials now say that the restriction likely will be removed before the proposal is finalized.
- **EU Considers More Stringent Emissions Cap, Official Calls on Developing Countries to Reduce Emissions.** EU leaders met to consider for the first time a draft EU Commission proposal calling for more stringent cuts under the EU ETS. While the original proposal called for reducing European emissions to 20 percent below 1990 levels by 2020, the new proposal would tighten the cap to 30

March 17, 2008

percent below 1990 levels over the same time period. The proposal for a more stringent cap coincided with an announcement by an EU Commission official that developing countries should take on binding emissions targets in the coming years. The EU Commission's Head of Emission Trading, Yvon Slingenberg, suggested that a global agreement to achieve emissions reductions could not achieve the necessary emission reductions unless developing countries switch from merely being providers of offset credits to taking on binding targets for actual emission reductions.

- **U.S., EU Hold Talks on Global Emissions Cuts.** At the EU-U.S. High-Level Dialogue on Climate Change, Clean Energy and Sustainable Development, officials from the Bush Administration met with representatives from the EU to discuss prospects for combating climate change. Participants in the talks noted that the two parties have had some success in addressing GHG emission reductions through tightened vehicle fuel efficiency standards and improved energy policies, but the sides continue to differ on the nature of a long-term international agreement setting specific targets for global GHG emissions. The EU delegation supports setting a global goal to reduce emissions to 50 percent of 1990 levels by 2050. U.S. representatives at the talks agreed that global goals are necessary, but questioned whether such significant cuts are feasible in the face of growing global energy demand. The U.S. also remains adamant that any global agreement to reduce emissions include developing nations, such as India and China.

The Climate Policy Update is intended as a general summary of major climate change-related policy developments that we judge to be of interest to a broad range of our clients and friends. We welcome your comments and suggestions. Coverage in, and selection of topics for, the Update is not intended to reflect the position or opinion of Van Ness Feldman or any of its clients on any issue. This document has been prepared by Van Ness Feldman for informational purposes only and is not a legal opinion, does not provide legal advice for any purpose, and neither creates nor constitutes evidence of an attorney-client relationship.

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