

ACTION ON TWO FRONTS RENEWS MOMENTUM FOR REGULATION OF GREENHOUSE GAS EMISSIONS

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To Our Clients and Friends:

On September 30, 2009, two significant developments emerged in the country's efforts to curb emissions of greenhouse gases ("GHGs"): the introduction of the United States Senate's version of a climate change and clean energy bill, the Clean Energy Jobs and American Power Act (the "Senate Bill"), and the announcement by the U.S. Environmental Protection Agency (the "EPA") that it intends to regulate GHG emissions from large stationary sources.

The Senate Bill. The Senate Bill, which is co-sponsored by Senators John Kerry (D-Mass.) and Barbara Boxer (D-Calif.), includes climate change and GHG reduction provisions that are similar to the corresponding provisions of the American Clean Energy and Security Act ("ACES"). ACES, also referred to as the Waxman-Markey bill, was narrowly passed by the U.S. House of Representatives in June 2009. However, the Senate Bill lacks many of the clean energy provisions found in ACES. The Senate addressed many of the same energy issues dealt with by ACES in the American Clean Energy Leadership Act, which was reported out of the Senate Energy and Natural Resources Committee in July 2009.

CLIMATE CHANGE PROVISIONS

Like ACES, the Senate Bill implements a cap-and-trade program in which the GHG emissions of facilities included in the program are subject to an annual cap. Owners of subject facilities can sell their excess emission allowances, save such allowances for future use or purchase additional allowances as needed. Covered facilities include electricity sources, suppliers of liquid fossil fuels, natural gas local distribution companies and large emitters of GHGs.

The Senate Bill is more demanding than ACES in its emissions requirements; the Senate Bill calls for a 20% reduction in GHG emissions from 2005 levels by 2020, whereas ACES requires only a 17% reduction. Both bills seek reductions in emissions from covered sources of 42% below 2005 levels by 2030 and 83% below 2005 levels by 2050.

The Senate Bill calls for oversight of the carbon markets (both cash and derivatives markets) by the Commodities and Futures Trading Commission ("CFTC"), whereas ACES divides oversight between the Federal Energy Regulatory Commission (cash market) and the CFTC (derivatives).

Regarding the distribution of emissions allowances, the Senate Bill provides for a combination of auctioning and allocation. One quarter of emissions allowances are to be auctioned annually to fund the government's cost of administering the GHG programs included in the Senate Bill. To help contain costs, emissions allowances will be subject to an annually loosening "price collar" that will keep allowance prices within a defined range. Initially, emissions allowance prices will be limited to between \$11 and \$28 per ton. In addition, a gradually increasing percentage of allowances, up to 5%, will be allocated as an incentive for carbon capture and sequestration ("CCS") projects. Allocation of the remaining emissions allowances is to be decided by the Senate committees marking up the bill.

As in ACES, the Senate Bill provides that covered facilities can purchase "offset credits" from facilities that are not subject to the federal emissions cap. In order to generate offset credits, a facility outside the federal program must voluntarily reduce GHG emissions in addition to any reductions required by law. Compared to ACES, the Senate Bill reduces the number of offsets available from international sources.

Finally, ACES and the Senate Bill differ in their preemption of other GHG emission programs. The Senate Bill preserves the EPA's ability to regulate large sources of GHGs, while ACES essentially strips the EPA of this authority. Both bills preempt state and regional cap-and-trade programs for five years (from 2012 to 2017), although states could enact other types of air pollution laws affecting GHG sources.

CLEAN ENERGY PROVISIONS

The Senate Bill does not contain extensive clean energy provisions or address issues such as energy transmission, both of which are addressed in ACES. Rather, such topics are included in the Senate's American Clean Energy Leadership Act.

However, the Senate Bill does contain some notable clean energy provisions. For example, there are several provisions related to CCS, such as those requiring the EPA to study the legal and regulatory barriers to commercial-scale CCS and the legal framework governing CCS. The bill also calls on the EPA to promulgate regulations addressing geologic carbon sequestration. Moreover, it authorizes utilities to consider establishing a CCS development program financed by customer surcharges. It also includes an incentive program to encourage CCS development funded by sales of emission allowances.

The Senate Bill includes provisions discouraging electric generators from operating traditional coal-powered plants. One such provision includes strict GHG emissions standards for coal-fired power plants permitted after January 1, 2009. Compliance with the new emissions standards is dependent on the commercialization of CCS technology. Under

the bill, owners of electric power plants are to receive payments for achieving GHG emission reductions beyond the national average GHG emission levels for the utility sector.

The EPA “Tailoring” Announcement. EPA Administrator Lisa Jackson announced the EPA’s decision to tailor GHG regulation to cover only those facilities annually emitting 25,000 tons or more of GHGs. Currently, the federal Clean Air Act requires the EPA to regulate a number of airborne pollutants from facilities that emit greater than 100 tons or 250 tons of such pollutants (depending on the pollutant). By changing the scope of regulation to include only large GHG emitters, the EPA will avoid the fallout that would result from regulating smaller businesses such as bakeries, hospitals, office buildings and dry cleaners. Facilities that annually emit at least 25,000 tons of GHGs are primarily power plants, refineries and large industrial complexes. Such facilities account for nearly 70% of the country’s GHG emissions.

If the “tailoring” rule survives the litigation likely to result from industry opposition, facilities covered by the EPA regulations will be required to obtain construction and operating permits and lower their GHG emissions. Approximately 14,000 existing large GHG emitters, most of which already require permits for other pollutants, would need to obtain permits for their GHG emissions. New and modified facilities emitting greater than 25,000 tons of GHGs would need to demonstrate the use of “best available control technology” (“BACT”) and energy efficiency measures minimizing GHG emissions. What constitutes BACT will likely be defined through litigation.

Two hurdles remain before the EPA can regulate GHG emissions from large stationary emitters of GHGs. First, the EPA must issue a final “endangerment finding” stating that GHGs are a threat to public health. The EPA has already issued a preliminary endangerment finding; a final finding will likely be issued within the next two months. Second, as required by the Clean Air Act, the EPA must write regulations limiting emissions of GHGs from mobile sources. The EPA has already submitted proposed regulations to the White House Office of Management and Budget.

What’s Next? The Senate Bill is only a starting point in the drafting of comprehensive climate change and energy legislation; six Senate committees may begin marking up the bill later this month. Some Senators have stated that Congress should focus on passing the less controversial clean energy provisions as soon as possible and defer passage of a GHG emissions reduction bill. However, leading lawmakers expect the final bill to contain both the clean energy and GHG emissions provisions addressed in the Senate Bill and the clean energy provisions found in the American Clean Energy Leadership Act.

With the Senate currently focused on healthcare reform legislation, it does not appear likely that the Senate will vote on the Senate Bill until 2010. Carol Browner, the White House

coordinator of energy and environmental policy, recently said that a comprehensive climate change bill is not likely to be signed prior to the December 2009 international climate summit in Copenhagen.

While it is generally believed that there are not currently enough votes to pass the Senate Bill, the incentives and mandates for CCS and the allocation of emissions allowances for certain energy-intensive industries may sway a number of presently undecided lawmakers.

We will continue to monitor these developments. Please feel free to contact us with any questions.

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