Understanding Climate Change Legislation

An energy bill designed to reduce CO_2 emissions is working its way through Congress, and will likely be signed into law next year. If Congress fails to act, the EPA will, and the resulting statutes and regulations will affect the entire economy. This Executive Counsel special section examines the proposed legislation, how it might change, and what regulations will fill the gap if it doesn't pass.

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Comprehensive Regime, Ambitious Goals, in Waxman-Markey

By Joe Stanko, David van Hoogstraten and Mark Menezes

On May 21, 2009, the House Energy and Commerce Committee reported out favorably on the American Clean Energy and Security Act of 2009 (the Waxman-Markey Bill), and Speaker Nancy Pelosi pushed other House committees claiming jurisdiction (Ways and Means, and Agriculture) to finish their work. After granting concessions to farm state members, House leadership brought this legislation, which aims for comprehensive control of greenhouse gas emissions, to a vote on June 26. The bill passed 219-212. Thus, the broad outlines of a carbon control regime have emerged.

While many specifics could change when this legislation is reconciled in conference, some key concepts and issues appear largely resolved.

• **Ambitious GHG reductions to below current levels.** Actual reduction goals have been set for 2020, 2030 and 2050. The shorter-term goal presents the greatest challenge. The 2020 goal is 17 percent below 2005 emissions levels. That number could be reduced during Senate conference.

• **An economy-wide regime.** The regime is comprehensive, with some 7,400 facilities and 86 percent of all U.S. emissions covered. The scope of coverage may expand. It is unlikely to contract.

THE 2020 GOAL IS 17 PERCENT BELOW 2005 EMISSIONS LEVELS.

• **Hydrofluorocarbon reductions.** HFCs are chemical refrigerant alternatives to ozone depleting substances. The most potent HFCs trap heat up to 12,000 times more effectively than CO2. Separate limits and emission allowances are established that would slash their use by 85 percent after 2032.

• **Cap-and-trade to meet emission reduction goals.** Emissions reductions will be achieved through an open market cap-and-trade system, in which anyone may participate by purchasing, holding, exchanging or retiring emission allowances. It will function so that

2050
2030
2020
CO2

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those able to meet their emission reduction targets may sell excess rights to those who cannot. The Congressional Budget Office estimates that in 2012, the secondary market for GHG allowances acquired from the federal government will exceed $60 billion in value.

• **Free allocation of emission allowances gradually giving way to auction.** The bill provides for the great majority of allowances to be given away, at least through 2020. Therefore, relatively few auction proceeds will be available to fund climate-related initiatives, aid in the development of new reduction technologies or reduce the federal deficit.

THE BILL PROVIDES FOR THE GREAT MAJORITY OF ALLOWANCES TO BE GIVEN AWAY AT LEAST THROUGH 2020.

• **Banking and borrowing of allowances.** There is unlimited "banking" of allowances. Companies that have reduced emissions in any year can use them in future years when, in all likelihood, their value will have increased. Allowances may also be "borrowed" from future allocations for present use, subject to certain restrictions.

• **Strategic allowance reserve to help control rapid allowance price spikes.** A reserve comprising one percent of each year's total allowance pool from 2012-2019 may be injected into the auction market by EPA to stabilize prices should they rise to unexpectedly high levels.

• **Regulation of allowance and offset markets.** Regulatory authority is split between the allowance and derivatives markets. The bill gives the Commodity Futures Trading Corporation exclusive authority to regulate financial products developed from the carbon market, such as futures and derivatives. The Federal Energy Regulatory Commission, in conjunction with EPA, is directed to promulgate regulations for the cash market in allowances.

• **U.S. and foreign-generated offsets limited and strictly regulated.** GHG emissions reductions occurring outside the overall carbon cap may be bought as credits or "offsets" by regulated industries to meet up to 30 percent of their compliance obligation. Up to half may be sourced domestically and up to half abroad. International credits may increase if the domestic supply is insufficient.

• **Encouragement of carbon capture and storage technologies.** Successful development and implementation of CCS technologies is a key element of the legislation. It injects up to $200 billion into commercial development, and an additional $1 billion annually to fund large-scale demonstration projects.

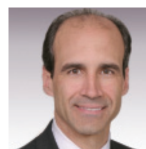
• **Global competitiveness concerns addressed.** The bill also provides that beginning in 2020, importers of certain manufactured goods from countries that have not negotiated a GHG emission reduction agreement with the U.S. shall purchase special allowances in order to protect U.S. industry from competitors not subject to comparable carbon controls.

Unresolved questions with potentially large bottom-line impacts remain. Reduction targets may be adjusted. Allocation of emission allowances could be altered. The overall regulatory regime and the roles various agencies will have in enforcement have yet to be decided. Protection of intellectual property rights as cutting-edge technologies are transferred to rapidly-developing countries will need to be addressed, as will the question of whether national legislation should preempt more stringent regional, state and local regimes.

Affected industries and other interest groups will be active on these issues this year and next, as the legislation moves toward completion.

Joe Stanko is a partner in the Washington D.C. office of Hunton & Williams LLP, where he heads the firm's government relations practice. He advocates before Congress and the Executive Branch on issues involving environmental and energy policy and homeland security. He formerly served as Counsel to the House Energy and Commerce Committee.
jstanko@hunton.com

David van Hoogstraten is Counsel in the environmental practice group at Hunton & Williams. He is a former senior lawyer at the U.S. EPA and Department of State, and former Associate Director for International Negotiations at the White House Council on Environmental Quality. He advises companies on domestic climate change law and policy, global environmental agreements and environmental health and safety laws.
dvanhoogstraten@hunton.com



Mark Menezes served as Chief Counsel to the House Energy and Commerce Committee before joining Hunton & Williams, where he is a partner in the Washington, D.C. office. He advises companies and associations on a variety of environmental and energy policy matters and on corporate and environmental laws, including the Energy Policy Act, Federal Power Act, Clean Air Act and the Public Utility Holding Company Act of 2005.
mmenezes@hunton.com