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MEMORANDUM

To: **Friends and Clients of the Firm**
From: **Mike Bloomquist**
Josh Greene
Date: **January 14, 2008**
Subject: **Climate Change Legislation In The 110th Congress**

Climate Change Legislation in the 110th Congress

– "If you're not at the table, you're on the menu." –

CLIMATE CHANGE LEGISLATION

In mid-October of 2007, Senator Lieberman (I-CT) and Senator Warner (R-VA) introduced S. 2191, The Lieberman Warner Climate Security Act. On December 5, 2007, the Senate Committee on Environment and Public Works (EPW) reported S. 2191 out of Committee. Throughout 2007, the corresponding Committee in the House of Representatives, the Committee on Energy and Commerce, conducted over twenty hearings on climate change, issued white papers for public comment, and stated plans to introduce and act on climate change legislation early in 2008.

We cannot overstate the potential for disruption to the energy sector from climate change legislation. Though legislation will undoubtedly attempt to mitigate against extreme alterations to lifestyle, the marketplace, and particular industrial sectors, the unprecedented financial incentives and deterrents inherent in any cap and trade system will alter behavior almost immediately. One obvious and highly predictable result based on the European Union's experience will be a massive fuel switch from high green house gas emitting fuel sources (e.g., coal) to low emitting fuel sources (e.g., natural gas and renewables). Each decision made in climate change legislation regarding phase-in dates, the severity of the cap, the distribution of allowances, the penalties for noncompliance, and acceptable carbon offsets will produce winners and losers. Legislators and regulators, not the invisible hand of the market, will determine how a company or industrial sector fares in a green house gas constrained world.

What follows is a summary and review of S. 2191, the Lieberman-Warner Climate Security Act and concludes with some thoughts on the future of climate change legislation in the 110th Congress.

OVERVIEW OF S. 2191

As reported, S. 2191 would establish a national "cap and trade" scheme for "greenhouse gas" emissions. Under a cap and trade regime, "covered facilities" would be allocated a limited number of greenhouse gas emission allowances (or permits) based on 2005 emission levels. If emission levels would exceed the number of allowances held, the owner or operator of a covered facility must purchase additional allowances to cover those additional emissions. In the early years of the cap and trade regime this would primarily be accomplished by purchasing additional allowances or offsets from the marketplace, although a small percentage would be available via an auction process from the federal government. From 2012 onward, the federal government would reduce annually the overall number of available allowances for distribution at no cost to emitters and move toward a fully auctioned distribution scheme. In total, the bill aims to reduce greenhouse gas emissions by 70% below 2005 levels by 2050.

WHAT GASES ARE COVERED?

S. 2191 divides greenhouse gases into two groups:

- Group I – carbon dioxide, methane, nitrous oxide, sulfur hexafluoride, and perfluorocarbons; and
- Group II – hydrofluorocarbons

The bill proposes separate, annually declining caps for each Group.

WHAT ENTITIES ARE COVERED?

The bill's goal is to cover over 80% of the Nation's greenhouse gas emissions. "Covered facilities" must submit to EPA at the end of each year sufficient emission allowances to cover all Group I and II green house gases that the facility emitted in that year. Specifically, a "covered facility" is one that:

- uses more than 5,000 tons of coal annually;
- is a natural gas processing plant, produces natural gas in the state of Alaska, or any entity that imports natural gas (including liquefied natural gas);

- produces or imports petroleum or coal-based fuel that, absent capture and sequestration, will emit a Group I green house gas when combusted;

- produces for sale, distribution, or import more than 10,000 carbon dioxide equivalents of Group I green house gases, assuming no capture and destruction or sequestration; and

- emits as a byproduct of the production of hydrochlorofluorocarbons, 10,000 carbon dioxide equivalents of Group I green house gases of hydrofluorocarbons.

In short, this definition covers the importation and production of petroleum fuels.

ALLOCATION OF "FREE" ANNUAL ALLOWANCES

The bill grants outright a certain percentage of each year's allowances to particular industrial sectors. S. 2191 provides that the following percentages decline ratably and terminate in 2031.

- Fossil Fuel Fired Electric Power Generating Facilities - (19%)

- Owners and Operators of Energy Intensive Manufacturing Facilities (e.g., iron, steel, aluminum, pulp, paper, cement, chemicals, and other products listed by EPS) - (10%)

- Owners and Operators of Facilities and Other Entities that Produce or Import Petroleum-Based Fuel – (2%)

- Hydrofluorocarbon Producers and Importers (2%)

- Rural Electric Cooperatives (1%)

Additional allowances will be given to the following sources:

- Electric load-serving entities (9%) and retail natural gas distributors (2%) receive allowances to mitigate economic impacts on low and middle income energy consumers. These annual allowances will continue without reduction until 2050.

- From 2012 to 2017, a declining number of allowances will go to "early actors" to reward covered facilities for actions taken since January 1, 1994 that reduce green house gas emissions. The percentage of available allowances for early actors will decline from a high of 5% in 2012 to 1% in 2016.

- To promote certain specified behavior by States to reduce green house gas emissions the States will receive up to 11% of the allowances. For example, the bill

rewards States with 2% of each year's total allowances for States that adopt "decoupling" regulations for the State's electric and natural gas utilities.

- For the period 2012 to 2030, 4% of the total allowances would be available for renewable energy generation from sources such as solar, wind, and geothermal and 4% of the annual allowances would go toward carbon capture and sequestration activities.

AUCTION OF ALLOWANCES

The percentage of annual allowances that will be auctioned by the Federal government (instead of distributed free of charge) will rise from a low of 22.5% in 2012 to 70.5% in 2031.

LOW CARBON FUEL PERFORMANCE STANDARD

At Committee, an amendment by Senator Lamar Alexander (R-TN) was adopted by a vote of 13 to 4 to require transportation fuel to contain 5% less carbon than current levels by 2015 and 10% less carbon than current levels by 2020. While less ambitious, this concept is similar to California's proposed Low Carbon Fuel Standard.

TRADING, BANKING, OFFSETS, AND BORROWING

S. 2191 allows anyone to buy, hold, sell, and retire emission allowances. The allowances never expire and an owner can "bank" or save surplus allowances for future use. Consistent with future EPA regulations, an owner or operator of a covered facility can meet up to 15% of a current year's allowance cap with allowances borrowed from future years. Similarly, an owner or operator of any covered facility can satisfy up to 15% of a current year's allowance cap with EPA certified offset allowances generated within the United States. Offset allowances are in addition to the annual emission allowances. S. 2191 also directs EPA to promulgate regulations that permit a covered facility to meet up to 15% of its annual cap through the use of international emission allowances purchased from a foreign trading market.

NEXT STEPS

Majority Leader Reid (D-NV) and Senate Committee on the Environment and Public Works Chairman Boxer (D-CA) both indicated that they look forward to bringing S. 2191 to the Senate Floor in 2008, perhaps as early as March. Senators on both sides of the issue, however, expect a heated floor debate and the bill's proponents will need 60 votes to end a certain filibuster. The Presidential election will also be an important factor regarding the consideration of climate change legislation.

Representative John Dingell (D-MI), Chairman of the House of Representatives Committee on Energy and Commerce, pledged on December 20, 2007, that he, along with his top Lieutenant on

the Committee, Representative Rick Boucher (D-VA), Chairman of the Subcommittee on Energy & Air Quality, will be "moving forward in the early part of next session" with global warming legislation that mandates reductions in greenhouse gas emissions from various industries through a cap-and-trade program. Representative Dingell said his bill might also include a tax on carbon emissions and "efficiencies of all kinds."

FORECAST FOR LEGISLATION

The Senate and the House will certainly continue to address climate change. There are considerable procedural, ideological, and substantive hurdles that must be overcome before each body can adopt a bill. The two chambers would then need to reconcile each chamber's "as-passed" climate bills and then pass a new, unified climate bill. To avoid a Presidential veto, the House and Senate must also work to achieve consensus with the Bush Administration. Needless to say, this would be a mammoth undertaking in any year, especially a Presidential election year.

Despite the considerable challenges confronting Congress as it attempts to pass a climate change bill that President Bush would sign, producers and heavy users of fossil fuels should remain very concerned. Concepts, alliances, and understandings will continue to be formed throughout this legislative process. It is far more effective and efficient to influence a process at an early stage than to try and upset basic understandings and rework long-settled compromises after a legislative "footprint" has been established. Patton Boggs stands ready to guide you through this process and help you effectively and constructively engage with Congress over climate change legislation.