

ClientAlert

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House Passes Ground-Breaking Energy and Climate Change Bill—An Analysis of the American Clean Energy and Security Act of 2009¹

Introduction

On June 26, 2009, the US House of Representatives approved the American Clean Energy and Security Act of 2009 (the “**ACES Bill**”) by a narrow vote of 219 to 212, along with a more than 300-page long amendment proposed by Congressman Henry Waxman (D-CA). If enacted, the ACES Bill, sponsored by Congressmen Waxman and Edward Markey (D-MA), would, among other things, establish a national renewable energy standard (20 percent by 2020) and a nation-wide cap-and-trade program to reduce greenhouse gas emissions in the US (83 percent reduction below 2005 levels by 2050). As the first such energy and climate change bill to ever be approved by either chamber of Congress, the ACES Bill marks a significant milestone in US environmental and energy policy and is consistent with the Obama Administration’s continuing efforts to overhaul and modernize US energy policy generally. At over 1,200 pages long, the ACES Bill is sweeping in its scope, and if enacted would affect many different areas of US energy policy and would modify several pieces existing federal legislation.

Many observers believe that the contours of the ACES Bill, if not the act itself, are a strong indicator of what the form and substance of federal climate change legislation will ultimately look like if enacted in the US. Acceptance of the ACES Bill in the Senate, however, will be difficult to obtain given the condition of the US economy generally and the controversial nature of many of the act’s provisions.

The Bill is a step toward transitioning the US economy from one reliant on fossil fuels to a low-carbon economy. Broadly speaking, such a systemic shift will require increased energy efficiency measures coupled with an increasing use of low-carbon energy sources. In order to meaningfully expand the use of renewable energy it must be commercially competitive with traditional fossil fuels (coal, oil, and natural gas). The ACES Bill fosters this competition by making high-carbon fuel sources more expensive while encouraging the growth of renewable energy. Government incentives in the form of direct spending measures and tax breaks are two primary ways the US Government can directly enhance the commercial viability of renewable energy and the ACES Bill supplements recent measures taken in the American Recovery and Reinvestment Act of 2009 (the “**ARRA**”), enacted in February.



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Key substantive issues to follow as this legislation is debated in Congress include:

- **Distribution of carbon credits.** The ACES Bill would freely distribute most emission credits—only a small percentage would be auctioned—and would create a government reserve of credits to serve as a cushion against price volatility in carbon markets. How the final legislation calls for the distribution of such credits could affect how costs are passed through to consumers, the price of credits, and the predictability of carbon markets.
- **GHG Reductions.** The ACES Bill would significantly impact the US electric generation mix as the number of carbon credits is reduced. Investments in lower emission and zero emission sources will become more economic.
- **Renewable Projects.** The ACES Bill would place the whole country on a renewable energy standard and stimulate substantial renewable investment before the price of carbon credits increases.
- **Offsets.** The ACES Bill would allow a significant amount of emissions reductions to be met through projects in the forestry and agricultural sectors. This would increase the scope of carbon markets and decrease the price of emission credits. The extent to which final legislation allows such offsets from nonindustrial sectors will affect the size of potential carbon markets.
- **Trade.** One difficult issue related to emission reduction legislation is avoiding the creation of adverse competitive effects on US goods compared to goods imported from countries without similar emission reduction requirements. The ACES Bill attempts to address these trade issues by offering rebates and emission allowance requirements to benefit domestic industries subject to a high degree of international competition. How Congress finally addresses these trade issues will affect the competitiveness of US industry and compliance with WTO obligations.
- **Regulation of carbon markets.** The ACES Bill would divide regulatory responsibility among several federal agencies, including EPA, FERC, DOE, and DOA, and leaves open which agency would be responsible for regulating carbon markets. How carbon markets are regulated, and by which agency, will have significant effects on businesses operating in those markets.

For additional information regarding the ARRA, see our Client Alert, dated February 27, 2009, titled [“Reshaping US Energy and Climate Change Policy—Renewable Energy and Clean Technology Provisions in the Stimulus Act.”](#)

Title Summary of the ACES Bill

The ACES Bill contains four titles that set forth its major policy initiatives:

Title I—Clean Energy

Establishing a national renewable energy standard and promoting renewable energy, clean fuels, carbon capture and sequestration, and smart-grid technologies.

Title II—Energy Efficiency

Increasing energy efficiency standards in the building, utilities and transportation industries, and standards applicable to household appliances.

Title III—Reducing Global Warming Pollution

Establishing a national cap-and-trade program to reduce greenhouse gases beginning in 2012.

Title IV—Transitioning to a Clean Energy Economy

Providing support to consumers and industry for the transition to a more energy efficient, low carbon economy.

Title I—Clean Energy

Title I of the ACES Bill includes several measures to foster the growth of renewable energy, such as creating a national renewable energy standard, and facilitating the delivery of that renewable energy to market with the further development of “smart grid” technologies. In addition the ACES Bill also promotes programs designed to assist existing fossil-fuel energy sources (*i.e.*, coal) to operate with lower greenhouse gas emissions.

Title I also includes provisions on low carbon transportation fuels, vehicle efficiency (including low carbon fuel standards, the deployment of plug-in electric vehicles, and fuel efficiency standards for certain vehicles), a new federal fund for state energy and efficiency programs, and provisions requiring the purchase of renewable energy by federal agencies.

National Renewable Electricity Standard

The ACES Bill establishes a federal renewable energy standard, requiring that a specified percentage of the energy delivered by retail electricity suppliers must come from renewable energy sources. The percentage requirement would start at 6 percent in 2012 and gradually increase to 20 percent by 2020. Eligible sources of renewable energy include wind, solar, certain

hydropower, geothermal, and marine and hydrokinetic projects, among others. As an alternative to purchasing (or producing) renewable energy, retail electricity suppliers can also comply by obtaining renewable electricity credits (“**RECs**”). Notably, the ACES Bill provides that individual state-level renewable portfolio standards (of which there are approximately 33) can continue to exist along with the federal program, so long as they are at least as stringent as the federal program.

Carbon Capture and Storage

The ACES Bill promotes various carbon capture and storage (“**CCS**”) programs. Among these provisions are financial incentives for the commercial deployment of CCS technologies at coal-fired power plants. Among other provisions concerning CCS, the ACES Bill also contemplates the creation of a “Carbon Storage Research Corporation” to accelerate the development of viable CCS technology. The corporation would pay for its programs by collecting an assessment from electricity distribution utilities at rates that vary depending on the fuel source for that power, with coal-fired electricity being charged the highest rate at \$0.43 per megawatt hour.

Smart Grid and Electricity Transmission

The ACES Bill also promotes the deployment of smart grid technologies and enhances electricity transmission planning. Among the smart grid provisions are several new initiatives and programs, such as a program to develop and implement peak-load reduction goals that are applicable to certain public and private energy utilities, and a program to integrate smart grid technologies into products that are part of the “Energy Star” program, administered by the US Department of Energy (“**DOE**”) and the US Environmental Protection Agency (“**EPA**”).

Provisions on electricity transmission planning call for the Federal Energy Regulatory Commission (“**FERC**”) to reform regional planning in order to modernize the electricity transmission and distribution grid and work to provide new transmission lines for the delivery of energy from renewable sources. In this role, FERC is to adopt national electricity grid planning principles. These principles are to then be applied in the planning of interstate electricity transmission programs. FERC is also responsible for working with state governments, transmission operators and electricity utilities to assist with the development of regional electric grid plans, based on the planning principles, and to review all such plans.

Title II—Energy Efficiency

Title II of the ACES Bill includes sweeping energy efficiency measures, among others, relating to the energy efficiency of buildings, efficiency standards for lighting and electrical appliances, and a provision calling for a regional approach to the implementation of transportation efficiency measures. In addition, the title includes a program on industrial energy efficiency standards, including an award program for innovation in energy recovery methods such as combined heat and power plants and efficient motors.

Title III—Reducing Global Warming Pollution

Introduction

Overall, the cap-and-trade system established under the ACES Bill is structurally similar to other market-based cap-and-trade programs such as the international emissions trading system established under the Kyoto Protocol and the Regional Greenhouse Gas Initiative (“**RGGI**”) in the Northeastern US.

The cap-and-trade program envisaged in the ACES Bill also provides a set-aside for emissions allowances to help reduce deforestation in developing countries, and gives credit to entities that took early action in compliance with state or regional cap-and-trade programs such as RGGI.

Basic Features

1. Caps and Reductions

Gases covered by the ACES Bill’s cap-and-trade regime include the principal greenhouse gases (“**GHGs**”) such as carbon dioxide, methane, nitrous oxide, and sulfur hexafluoride among others.² The baseline year for measuring reductions is 2005. In 2005, total GHG emissions were the equivalent of approximately 7.2 billion metric tons of CO₂. The ACES Bill would impose economy-wide emissions reduction targets according to the following schedule:

- By 2012, a reduction of 3 percent below 2005 levels
- By 2020, a reduction of 20 percent below 2005 levels
- By 2030, a reduction of 42 percent below 2005 levels
- By 2050, a reduction of 83 percent below 2005 levels

This schedule is generally consistent with the GHG reduction goals of the Obama Administration and is designed to achieve a minimum level of reductions that the U.N. Intergovernmental Panel on Climate Change has indicated must be achieved in order to mitigate the worst effects of global warming.

² Also included are hydro-fluorocarbons or “**HFCs**,” any perfluorocarbon, nitrogen trifluoride, and any anthropogenic gas designated as a GHG by the EPA.

2. Entities Covered by the Caps

Entities covered by the caps (“**Covered Entities**”) include:

- any electricity source;
- any stationary source that produces, or entity that imports:³
 - petroleum-based or coal-based liquid fuels, petroleum coke, or natural gas liquid (ethane, propane, butane and isobutene) the combustion of which would emit 25,000 tons or more of CO₂ equivalent;
 - 25,000 tons or more of CO₂ equivalent of fossil fuel-based CO₂, nitrous oxide, perfluorocarbons, sulfur hexafluoride, fluorinated gases or any of their combination;
- any geological sequestration site;
- any stationary source in a thirteen-member list of industrial sectors, including aluminum production, cement production, and oil refineries, among others;
- any stationary source in the chemical or petrochemical sectors whose operations emit 25,000 tons or more of CO₂ equivalent;
- large natural gas distribution companies the customers of which are not, themselves, Covered Entities;
- other large industrial emissions sources (e.g. ethanol producers, and iron and steel producers) that burn coal, oil or natural gas and annually emit over 25,000 tons of CO₂ equivalent;
- any fossil-fuel fired combustion device (e.g. a boiler) that has emitted in 2008 (or any subsequent year) 25,000 tons or more of CO₂ equivalent.⁴

3. Federal GHG Registry

The ACES Bill establishes a federal GHG registry, administered by EPA, to record and monitor the emissions from Covered Entities, and others (“**GHG Registry**”). Those entities are required to record their own emissions data and report this information to EPA electronically, generally on a quarterly basis. The information is recorded by the GHG Registry, made publicly available and is used to determine how many emissions allowances a Covered Entity must hold at the end of each compliance year in order to satisfy its regulatory obligations under the ACES Bill.

4. Compliance Obligations for Covered Entities

Starting in 2012 and every year thereafter, every Covered Entity must hold one emission allowance for each ton of CO₂ equivalent of GHG that the Covered Entity emitted, imported, or delivered in

the previous calendar year. In lieu of holding regular emissions allowances, Covered Entities may also hold (a) qualifying offset credits or (b) certain international emissions allowances from qualifying foreign cap-and-trade programs. In order to use international emissions allowances, EPA must determine that the foreign program is at least as stringent as the program established under the ACES Bill.⁵ Offset credits are further discussed below.

The owner or operator of a Covered Entity that fails to meet its emissions allowance obligations will be liable for payment to the EPA of an excess emissions penalty. The penalty will be equal to twice the market value of an emissions allowance for each excess ton of CO₂ equivalent that the entity emitted, imported, or delivered during the compliance year and for which the Covered Entity did not submit a sufficient number of emissions allowances, qualifying offset credits, and/or international emissions allowances.

5. Allocation of Allowances

The ACES Bill establishes the default number of annual emissions allowances from 2012 through 2050, but allows the EPA to adjust the number for a particular year under certain circumstances. In keeping with the ACES Bill’s overall GHG emissions reduction targets, the number of total annual allowances permitted under the federal program decreases through the years from 4.62 billion allowances in 2012 to 1.03 billion allowances by 2050. The EPA is to directly allocate to certain categories of entities a percentage of annual emissions allowances free of charge, as described below, and auction the remaining allowances in accordance with specified bidding procedures.

(i) Direct Allocation of Allowances

The main beneficiaries of free emissions allowances are local electricity distribution companies, natural gas distribution companies, States, and certain eligible entities which deploy carbon capture and sequestration technology.

Local electricity distribution companies receive over 43.75 percent of the annual emissions allowances in 2012, the first year of distribution for this category. Half of the allowances allocated to this category are distributed ratably among companies based on their annual average CO₂ emissions attributable to generation of electricity that is sold at retail by such companies, and the other half is distributed ratably based on the companies’ annual average retail electricity deliveries from 2006 through 2008.

Natural gas distribution companies receive 9 percent of the annual allowances in 2016, the first year of distribution for this

³ The Category includes only production or importation activities occurring from 2008 onward.

⁴ Entities covered by the ACES Bill are identified in Section 700(13) under the definition of “Covered Entity.”

⁵ By allowing the use of international emissions allowances, the ACES Bill provides the potential for US participation in (and recognition of) an international cap-and-trade regime that may be developed as the successor to the Kyoto Protocol. The relevance of the ACES Bill with respect to these international discussions is also addressed in the Conclusions of this Client Alert.

category. From 2016 through 2018 allowances in this category are distributed ratably, based on the companies' natural gas deliveries in the 2006-2008 period. From 2019 through 2029, the EPA will then update the formula of distribution every three years and distribute allowances accordingly.

States receive 9.5 percent of emissions allowances for investments in energy efficiency and renewable energy in 2012, the first year of distribution for this category. One-third of these allowances are to be distributed equally among the states; one-third are to be distributed ratably among them based on population; and one-third is distributed ratably among them based on energy consumption.

Emissions allowances to certain electric generating sources and industrial sources that use carbon capture and sequestration technology ("**CCS technology**") to sequester at least 50 percent of their CO₂ emissions constitute 1.75 percent of the annual emission allowances in the first four years of distribution to this category, but the percentage goes up to 4.75 percent in the fifth year. Allowances are to be allocated to CCS-eligible entities on a phased approach, based in part on how quickly eligible projects achieve the first 6 gigawatts of electricity generating capacity.

(ii) Auctioning of Allowances

In addition to direct allocations, the EPA is to distribute a large percentage of allowances by auction and the Bill contemplates three types of auction. Under the first type of auction, the EPA is to auction 15 percent of the annual allowances established for the current compliance year (or allowances of same-year "vintage") in an auction open to the public.

In the second type of auction, which will be open to the public, on an annual basis the EPA is to sell "future year" allowances (or allowances of future-year "vintage") in the following amounts:

- For the period from 2015 through 2020, the EPA is to auction 700 million future allowances each year;
- For the period from 2021 through 2025, the EPA is to auction 500 million future allowances each year; and
- For the period from 2026 through 2030, the EPA is to auction 300 million future allowances each year.

In the third type of auction, on a quarterly basis, the EPA is to sell "strategic reserve allowances" (discussed below) to Covered Entities. The number of strategic reserve allowances a Covered Entity can buy at such an auction is limited to 20 percent of the GHG emissions attributable to such entity in the previous compliance year. The minimum auction reserve-price for strategic reserve allowances is set at US\$28 in 2012, and increases by 5 percent (plus the rate of inflation) in 2013 and 2014; then in

2015, and for every year thereafter, the minimum auction price shall be 60 percent above the three-year average price of that year's emissions allowance vintage.

6. Leakage

As a structural matter, there is a concern that where costs for GHG emissions are imposed on industries in one jurisdiction (by way of a cap-and-trade regime or otherwise), those industries will naturally migrate to another jurisdiction where they do not face the same regulatory costs of doing business. This dynamic is commonly called "leakage." To address leakage, the ACES Bill includes certain rebate provisions for eligible industries as discussed below.

Cost Mitigation Measures

The ACES Bill contains certain provisions designed to serve a cost mitigation function and mitigate the program's compliance costs on Covered Entities, consumers and the economy as a whole. These provisions are also intended to minimize extreme price volatility for emissions allowances as they are traded in the primary and secondary markets. Many of these cost mitigation provisions are common in the design of cap-and-trade regimes generally. The ACES Bill contains several different cost mitigation provisions, some of which are found in Title III and others that are found in Title IV, as are further discussed below.

1. Banking and Trading

A common component of cap-and-trade programs is the ability of an entity to hold onto emissions allowances obtained during one compliance period (or of one "vintage") and carry them forward to be submitted during a later period to satisfy the entity's compliance obligations. This practice is called "banking." Banking is also a useful tool to hedge against future price increases or market volatility, and indeed the second auction type described above (contemplating the sale of specified quantities of allowances of a future-vintage), further encourages this activity. Under the ACES Bill, Covered Entities can use an unlimited number of unused emissions allowances from previous compliance years and can also borrow an unlimited number of allowances from the immediately following year. They may also satisfy up to 15 percent of their compliance obligations by borrowing emissions allowances with vintage years 2 to 5 years into the future, but they must pay 8 percent interest (in allowances) to do so.

With respect to trading, the ACES Bill permits both Covered and non-Covered Entities to purchase, hold, sell or exchange emission allowances. "State emission allowances" can be exchanged for emission allowances established under the ACES Bill. State allowances, however, cannot be exchanged for federal allowances indefinitely. The EPA is to set a date by which state allowances

must be exchanged.⁶ An entity exchanging state allowances is to receive emission allowances established under the Bill in the amount that is sufficient to compensate it for the cost of obtaining and holding the exchanged state allowances. The cost of obtaining a state allowance is identified as the average auction price for emission allowances issued in the year in which the State allowance was issued.

2. Offsets

Covered Entities can submit offset credits in lieu of emission allowances to meet their compliance obligations. For the federal program as a whole, the total quantity of offsets available to be used for compliance purposes by all Covered Entities in a given year cannot exceed 2 billion, split evenly between domestic offsets and international offsets.

The Bill directs the EPA to issue offset credits with respect to qualifying projects that result in reductions or avoidance of GHG emissions or their sequestration. The EPA shall release the initial list of eligible offset projects and issue one offset credit for each ton of CO₂ equivalent that the EPA has determined the project reduced, avoided, or sequestered during the period covered by a verification report.

Although Covered Entities may use offset credits in lieu of emissions allowances, offset credits cannot substitute more than a specified percentage of emission allowances for any given year. From the combined total of 2 billion offset credits that can be used in any given year by Covered Entities, each entity cannot use more than its pro-rata share based on the total number of emissions allowances the entity is required to hold for that year.

An eleventh hour amendment to the ACES Bill would give the Secretary of Agriculture the authority to issue offset credits with respect to qualifying domestic agricultural and forestry “practice types” that result in reduction or avoidance of GHG emissions or their sequestration.

To ensure the quality of offsets that can be used under the federal program, the ACES Bill would also establish an “Offsets Integrity Advisory Board” for the offsets issued by the EPA and the “USDA Greenhouse Gas Emission Reduction and Sequestration Advisory Committee” for the offsets issued by the Secretary of Agriculture. These advisory boards would help assure that offsets represent emissions reductions that are real, enforceable, additional and permanent. In addition, the advisory boards would assist EPA and the Department of Agriculture in designating the types of projects that would be eligible to earn offsets under the federal program. Provision is also made for recognizing qualifying offset projects

⁶ The Bill defines “state emission allowances” as allowances issued before December 31, 2011, by the State of California, for the Regional Greenhouse Gas Initiative, or the Western Climate Initiative.

that were started after January 1, 2001, and for the issuance of international offset credits based on offset projects in developing countries, such as avoided or reduced deforestation projects.

3. Rebates for Specified Industries

The ACES Bill attempts to counteract the potential for leakage by including certain rebate provisions to help protect specified sectors such as the steel and concrete industries which are especially susceptible to foreign competition. The rebate program would essentially compensate qualifying Covered Entities for their costs of complying with the cap-and-trade program. The EPA is to determine sectors that are eligible for rebate allowances based on their GHG and trade intensities, as defined in the ACES Bill.⁷

4. Strategic Reserve

Under the ACES Bill, the EPA is to create a strategic reserve of emissions allowances to provide a cushion against potential price volatility for emissions allowances traded in the primary and secondary markets. Allowances for the reserve are obtained by setting aside a small percentage of the allowances established each year and allocating them through the specialized auction procedure described above.

5. International Reserve Allowance Program

Another cost-mitigation measure in the ACES Bill would establish a program to protect certain domestic industries from foreign competition. The program would require importers of certain goods to purchase “international reserve allowances” from the EPA for the GHG emissions associated with the production of those imported goods. The relevant provisions in the ACES Bill provide that if by January 1, 2018 the US has not entered into a multilateral agreement that addresses potential competitive imbalances created by the cap-and-trade regime, the President is to establish the International Reserve Allowance Program (“IRAP”).

Under IRAP, the EPA is to determine the quantity of international reserve allowances that must be submitted by companies in connection with their importation into the US of products manufactured by an “eligible industrial sector,”⁸ unless more than 85 percent of the global output for that sector is produced in countries subject to GHG caps at least as stringent as those imposed in the US. The price of the international reserve allowances available for purchase by the importers is to be equal to the price for emissions allowances in the most recent auction.

⁷ See ACES Bill § 763 for a definition of “presumptively eligible industrial sectors” and the criteria for determining additional eligible sectors. See ACES Bill § 764 for the formula of distributing allowances to entities within each sector.

⁸ The ACES Bill authorizes the EPA to determine the industrial sectors that fall in the “eligible industrial sectors” category according to a formula set out in Section 763 of the Bill. These are the same as the industrial sectors eligible for emission allowance rebates such as the steel and concrete industries discussed above.

Implementation of the Cap-and-Trade Regime

The implementation of the GHG emissions reduction targets involves coordinated efforts at the federal and state levels. The implementation effort at the federal level has a review and recommendation component, and an enforcement component. With respect to the review and recommendation component, the ACES Bill directs the EPA and NAS to issue reports that keep the Congress abreast of the latest science relevant to climate change and the progress in reducing GHG emissions. The EPA and NAS are also to identify the quantity of additional GHG reductions required to meet the emissions reduction targets as well as the strategy for achieving them. On the enforcement side, in most cases, the President is to implement NAS recommendations through the relevant Federal agencies. If the most recent NAS report concludes that the United States will not achieve its domestic GHG reduction targets, the President is to submit to Congress plans to achieve those targets, including any recommendations for legislative action.

At the state level, the ACES Bill provides for the creation of State Energy and Environment Development Accounts ("**SEED accounts**"). SEED accounts are designed to serve as state-level repositories for managing and accounting for all emission allowances designated primarily for renewable energy and energy efficiency purposes.

The ACES Bill preserves the states' existing authority to adopt and enforce stricter standards or limitations on air pollution, including GHG emissions, than those provided for in the ACES Bill but bars states from implementing or enforcing their own state-level cap-and-trade programs on GHG emissions for the period from 2012 through 2017.

Title IV – Transitioning to a Clean Energy Economy

The ACES Bill contains several measures designed to mitigate the costs of a national shift to a low-carbon economy. Title IV contains some of the measures already described, such as the rebate program designed to preserve the domestic competitiveness of certain US industries.

Title IV provides for other relevant programs such as the creation of "green job" worker training programs, the establishment of an "International Clean Technology Fund" to help deploy clean technologies to developing countries, and the creation of an "International Climate Change Adaptation Program," administered as part of the US Agency for International Development, to provide technical assistance and other aid to developing countries.

New Roles for Federal Agencies

Environmental Protection Agency

Under the ACES Bill, EPA would be the primary government agency responsible for administering the cap-and-trade program. In this role, EPA will have discretion on various matters such as deciding which types of additional emissions sources should be included as "Covered Entities." EPA would also have other responsibilities in connection with the CCS provisions of the ACES Bill, new vehicle emissions standards, and others.

Department of Energy

The ACES Bill gives DOE various responsibilities, one of the most important of which is the regulation of the federal renewable energy standard program. The Bill also specifies that the agency will participate in various other programs for promoting energy efficiency and CCS technology.

Department of Agriculture

The ACES Bill gives the Department of Agriculture the authority to issue offset credits with respect to qualifying domestic agricultural and forestry "practice types" that result in reduction or avoidance of GHG emissions or their sequestration.

Federal Energy Regulatory Commission

The ACES Bill gives FERC certain responsibilities relating to the emissions trading markets and the trading of RECs under the federal renewable energy standard. Specifically, the agency would be mandated to monitor and regulate the cash market for trading emissions allowances and offsets. The President would also designate which federal agency would be responsible for regulating the derivatives market for emissions allowance and offset trading. Some observers believe that the Commodities Futures Trading Commission would be the natural choice for regulating the trading of this derivatives market (to include futures and options contracts). FERC would also promulgate regulations which would provide for, among other things, comprehensive market oversight, the prohibition of fraud and market manipulation, and the assurance of market transparency and efficient price discovery. The ACES Bill also calls on FERC to develop regulations to ensure a transparent, fair and stable market for trading RECs and derivatives based on RECs.

Conclusions

The ACES Bill is a significant development in the Congressional debate over how to limit emissions of GHGs and likely will be the starting point for all future legislative negotiations.

Consideration of the ACES Bill in the Senate also occurs against the larger backdrop of international negotiations to find a successor to the Kyoto Protocol, which expires in 2012. As learned during the negotiation of the Kyoto Protocol under the Clinton Administration (where the US agreed with the program at the international level, but Congress refused to ratify it), many argue that the US must form its own domestic program on climate policy in order for its participation at the international level to be seriously considered. The next major round to advance Kyoto's successor will be in Copenhagen in December 2009. The Obama Administration wants a new climate change bill in hand.

The chances that federal climate change legislation will be enacted this year may increase since EPA issued in April its proposed "endangerment finding," determining that GHGs endanger public health and welfare. The proposed finding is the first important step in EPA's efforts to regulate GHG emissions under the Clean Air Act. Many believe that the Clean Air Act, as currently written, is poorly suited for the regulation of GHGs and that as EPA begins to use the Bill to regulate GHGs, it could put additional pressure on Congress to pass federal legislation better tailored to regulate GHGs.

For additional information regarding the EPA's proposed endangerment finding, see our Client Alert, dated April 20, 2009, titled "[EPA Issues Proposed Endangerment Finding, Taking First Important Step Towards Regulating Greenhouse Gases.](#)"

Procedural Process for the ACES Bill

Now that the ACES Bill has been approved by House of Representatives it goes to the Senate for consideration, where it would need 60 votes to overcome a potential filibuster. It may prove difficult for the ACES Bill to gain the support of every Democratic Senator. As the House vote indicated (where 44 Democrats reportedly voted against the ACES Bill), voting in the Senate will not likely be strictly along party-lines, but rather may fall along regional lines. Support from Senators representing Midwestern and other states with economies dependent on the coal industry, or that are home to large manufacturing industries, may be difficult to find. In any case, most expect debates to be politically charged and the Republican leadership continues to voice its lack of support for imposing any cap-and-trade-related costs on the nation during a recession.

It remains to be seen whether the Senate will maintain the House-approach of keeping climate change legislation and energy legislation together in the same bill or whether the two issues will be addressed in separate bills with separate schedules. An energy bill recently approved by the Senate Energy and Natural Resources Committee does not directly contemplate the establishment of a cap-and-trade program. When Senate majority leaders release their own climate change legislation, two of the primary Senate committees that will be heavily involved are the Environment and Public Works Committee, Chaired by Senator Barbara Boxer (D-CA), and the Energy and Natural Resources Committee, Chaired by Senator Jeff Bingaman (D-NM).

In early February, Senator Boxer released a set of principles for global warming legislation that would guide her committee in developing its own bill.⁹ Several of these principles appear consistent with the provisions of the ACES Bill, such as the use of enforceable emissions reductions to levels that are guided by science and the use of revenues from the carbon market to reduce the costs to consumers and businesses and to promote the development of clean energy technologies. Senator Boxer reportedly intends to pass comprehensive climate change legislation through her committee before December 2009 although she has been vague on the precise timing.

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⁹ See Juliet Eilperin, Democrats Pen Principles for Climate-Change Bills, Washington Post (February 4, 2009) at A02.