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CLIMATE CHANGE BULLETIN

APRIL 3, 2009

U.S. CLEAN ENERGY AND CLIMATE CHANGE REDUX

THE AMERICAN CLEAN ENERGY AND SECURITY ACT OF 2009

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and John Vellone (*with thanks to Camille Kam*)

This Climate Change Bulletin is part of a series that is prepared periodically by BLG's Climate Change Group to alert our clients to emerging issues and initiatives that are relevant to their businesses and strategic interests. Future Climate Change Bulletins and Alerts will review and consider issues facing various provinces as well as different industrial sectors. Comments and questions are always welcome and should be directed to Adam Chamberlain.

On March 31, 2009, U.S. House Energy and Commerce Committee Chairman Rep. Henry A. Waxman and Energy and Environment Subcommittee Chairman Rep. Edward J. Markey released a discussion draft of *The American Clean Energy and Security Act of 2009* (the "Draft").

Canadian companies fearful of U.S. protectionist sentiment getting bundled into new climate change legislation should pay particular attention to the domestic competitiveness provisions of the Draft. These provisions would authorize "rebates" for companies in energy intensive and globally focused industrial sectors to compensate for additional costs incurred under the cap-and-trade program. In addition, the Draft contains a discretionary "border adjustment" program that would require foreign manufacturers and importers to pay for and hold special allowances to cover the carbon contained in U.S.-bound products to further correct for any perceived competitive imbalances. This approach has been referred to as the imposition of a "carbon tariff".

The 648-page Draft is divided into four sections addressing (i) clean energy, (ii) energy efficiency, (iii) reducing global warming pollution, and (iv) transitioning. It is positioned as comprehensive energy legislation, and those familiar with Ontario's proposed *Green Energy and Green Economy Act, 2009* ("Bill 150") will recognize some similar features and some interesting differences.

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Clean Energy

- **Renewable Portfolio Standard (RPS):** The Draft proposes a renewable portfolio standard, requiring retail electricity suppliers to meet a certain percentage of their load with electricity generated from renewable resources, like wind, biomass, solar, and geothermal. The renewable electricity requirement begins at 6% in 2012 and gradually rises to 25% by 2025.

A renewable portfolio standard is often compared to a feed-in tariff program (“FIT”) like the one Ontario has proposed under Bill 150, which is designed to encourage new renewable energy generation through “carrots” instead of “sticks”.

- **Promoting the Smart Grid:** The Draft facilitates the deployment of a smart grid, including measures to reduce utility peak loads through smart grid and demand response applications and to help promote smart grid capabilities in new home appliances. The Draft goes on to direct the Federal Energy Regulatory Commission to reform the regional planning process for the purposes of modernizing the electricity grid, as well as providing for new transmission lines to carry electricity generated from renewable sources.

Under Bill 150, Ontario’s electricity regulator is newly mandated to facilitate the implementation of a smart grid in the Province. Licensed electricity distributors must also prepare plans and obtain regulatory approval for the development and implementation of the smart grid in relation to their system. Finally the Minister may issue directives to the regulator to take necessary steps to establish, implement or promote a smart grid for Ontario.

- **Carbon Capture and Sequestration (CCS):** The Draft promotes the development of new technologies related to CCS, a method of reducing global warming pollution by capturing and injecting underground the carbon dioxide emitted from electricity generation plants that use fossil fuels. It includes a CCS early demonstration program, incentives for the wide-scale commercial deployment of CCS, and performance standards for new coal-fired power plants.
- **US Federal Power Purchase Agreements:** Provisions in the Draft authorize federal agencies to enter into long-term contracts for the purchase of renewable electricity and to develop a common repository for federal financial assistance for clean energy and energy efficiency projects in each state. The Draft also provides agencies with the authority to promote low-carbon fuel standards and to develop electric vehicles.

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Energy Efficiency

- **Industrial Energy Efficiency:** The Draft establishes industrial energy efficiency standards and creates an award program for innovation in increasing efficiency of thermal electric generation process.
- **Emissions Standards:** The Draft harmonizes the federal fuel economy standards, the U.S. Environmental Protection Agency (“EPA”) emission standards and California standards to simplify compliance for auto manufacturers and directs the EPA to set emissions standards for other mobile sources of pollution such as locomotives, marine vessels, and non-road sources.
- **Appliance Energy Efficiency:** The Draft codifies efficiency standards for lighting and specified appliances, improves the process for setting energy-efficiency standards, and creates a program to provide financial incentives to retailers who sell high volumes of “Best-in-Class” appliances.

Under Bill 150, the Province has introduced controversial mandatory energy audits prior to the sale or lease of a home in Ontario. In addition, under Bill 150, the Province has largely re-enacted efficiency standards and labeling requirements applicable to specific appliances.

- **Building Code:** The Draft provides for federal training and funding assistance to states that adopt advanced building efficiency codes, authorizes funding for building retrofits to improve energy efficiency, and directs the EPA to develop procedures for rating building energy efficiency.

Under Bill 150, Ontario is implementing new include energy conservation as a purpose of Ontario's Building Code.

- **Utility Efficiency Targets:** The Draft requires electricity and natural gas distribution companies to demonstrate that their customers have achieved a required level of cumulative electricity or natural gas savings relative to business-as-usual projections.

Under Bill 150, licensed electricity distributors and other licensees will be required to meet specified conservation and demand management targets. Ontario distributors waiting to hear what their targets will be should be aware of the efficiency standards in the Draft, which start with a 1% electricity savings and

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0.75% natural gas savings in 2012 and gradually increases to a 15% cumulative electricity savings and a 10% cumulative natural gas savings by 2020.

Reducing Global Warming Pollution

The global warming provisions in the Draft are modeled closely on the recommendations of the U.S. Climate Action Partnership (“US-CAP”), a coalition of electric utilities, oil companies, chemical companies, automobile manufacturers, other manufacturers and energy companies, and environmental organizations.¹

- **Cap-and-Trade:** The Draft proposes a market-based cap-and-trade program for reducing global warming pollution from electric utilities, oil companies, large industrial sources, and other covered entities that are collectively responsible for 85% of U.S. emissions. The program would require covered entities to obtain tradable allowances for each ton of pollution emitted into the atmosphere. The Draft program would not cover entities that emit less than 25,000 tons of greenhouse gas (CO₂ equivalent) per year. The number of allowances issued each year is reduced to ensure that aggregate emissions from the covered entities are reduced by 3% below 2005 levels in 2012, 20% below 2005 levels in 2020, 42% below 2005 levels in 2030, and 83% below 2005 levels in 2050.
- **Offsets:** The Draft allows covered entities to increase their emissions above their allowances if they can obtain offsets from other sources at a lower cost. Unlike other regimes that apply a 1-to-1 ratio, under the Draft, covered entities would be required to submit 5 tons of offset credits for every 4 tons of emissions being offset. The total quantity of offsets per year would be capped at 2 billion tons.
- **Banking and Borrowing:** The Draft permits covered entities to bank an unlimited amount of allowances for use during future compliance years, as well as borrow from one year ahead without penalty pursuant to a rolling 2-year compliance period. Allowances from 2-5 years into the future may also be borrowed under limited circumstances.
- **Strategic Reserve:** The Draft directs the EPA to create a strategic reserve of approximately 2.5 billion allowances to create a cushion in case prices rise faster than expected.

¹ US-CAP's January 15, 2009 report titled *A Blueprint for Legislative Action* provides a detailed framework for legislation to address climate change. It is available online at: http://www.us-cap.org/pdf/USCAP_Blueprint.pdf (last accessed April 2, 2009).

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- **Carbon Market Assurance and Oversight:** The Federal Energy Regulatory Commission is charged with regulating the cash market in emission allowances and offsets. However, it remains unclear who will be given regulatory responsibility for the derivatives market.
- **Additional Greenhouse Gas Standards:** The EPA is required to set emission standards on sources not covered by the allowance system. Special programs to reduce emissions of hydrofluorocarbons and black carbon would also be created.
- **Clean Air Act Exemptions:** These provisions would prohibit the regulation of carbon dioxide and other greenhouse gases as criteria pollutants or hazardous pollutants on the basis of their effect on global warming and make new source review inapplicable to such global warming pollutants.

Transitioning

- **Exporting Clean Technology:** The Draft provides U.S. assistance to encourage widespread deployment of clean technologies to developing countries under certain conditions.
- Other provisions included under this title provide for, among other things, grants to universities and colleges to develop curriculum and training programs to prepare students for careers in climate change mitigation, establishing an interagency council to ensure an integrated federal response to the effects of global warming, and funding to provide federal support for state, local and tribal adaptation projects.

Initial reaction to the discussion draft has been mostly positive, with US-CAP praising it as a “strong starting point for enacting legislation to reduce greenhouse gas emissions,” though some commentators have criticized its targets for reducing emissions as unrealistic and overly aggressive.

The Energy and Commerce Committee responsible for releasing the Draft anticipates complete consideration of the legislation by May 25, 2009, with sub- and full-committee hearings and mark-up periods scheduled for late April and early May.

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