Kerry and Lieberman Unveil Energy/Climate Legislation

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On May 12, Senators Kerry and Lieberman introduced their long-awaited energy/climate bill, the "American Power Act." Kerry and Lieberman introduced the bill with support from environmentalists, power production companies, and industrial interests, but without any Republican support, after Senator Graham removed himself as a co-sponsor several weeks ago, citing concerns about Majority Leader Reid's decision to take up immigration reform before this bill.

Although passage of the APA is anything but assured, it does seem likely to provide the basis for Senate negotiations over energy/climate legislation, so it is worth understanding the bill's highlights.

TITLE I – DOMESTIC CLEAN ENERGY DEVELOPMENT

Subtitle A – Nuclear Power

The bill provides significant incentives for nuclear power development, including $54 billion in loan guarantees (up from the current level of $18.4 billion), regulatory risk insurance of up to $500 million for 12 nuclear reactors (compared to the current 6), and tax incentives. It also streamlines the licensing process for nuclear facilities by requiring the Nuclear Regulatory Commission to "establish and implement an expedited procedure for issuing combined construction and operating licenses for qualified new nuclear reactors."

Subtitle B – Offshore Oil and Gas

Taking account of the catastrophic oil spill in the Gulf of Mexico, the bill gives states more power to determine whether offshore drilling will take place near their coastlines. States may prohibit offshore oil and gas leasing within 75 miles of the state's coastline, substantially increasing their control of drilling beyond the 3-mile extent of state waters. (Texas and Florida have 10-mile coastal boundaries).

On the other hand, the bill also contains incentives for offshore drilling for those states that elect to take advantage of them. The bill authorizes revenue sharing in areas that were previously withdrawn from leasing, with 37.5% of revenues directed to states and 12.5% of revenues directed to programs under the Land and Water Conservation Fund. As a concession to adjacent states, the bill includes a "spill-veto" provision that requires the Interior Department to study the environmental and economic impact of any potential oil spill in areas that previously were covered by drilling moratoria. Based on outcomes of the study, significantly impacted states may prevent leasing from proceeding.

With respect to on-shore oil and gas development, Section 4131 amends the Emergency Planning and Community Right-to-Know Act to require companies that use hydraulic fracturing (or "fracking") to extract oil and natural gas from rock formations to disclose all chemical constituents used in the fracking operation on the Internet, for the benefit of the public and local authorities.

Subtitle C – Coal

The bill directs the EPA, Department of Energy and Department of the Interior to create a unified and comprehensive strategy to identify and address the barriers to commercial scale deployment of carbon capture and storage (CCS). If a majority of state regulatory authorities sign on, a program will be created which provides funding to develop mid-scale (100 MW) or larger CCS facilities. The special funds will come from an assessment on electric utilities for all fossil-fuel based electricity sold to electric consumers (though not residential consumers) which reflects the carbon content of the electricity sold.

The bill employs more carrots than sticks for coal: merchant coal generators who notify EPA prior to 2014 that they intend to retire the unit or repower it with a lower-emitting fuel can qualify for free allowances for up to 1/2 of their would-be emissions for up to 10 years. Emission reductions from CCS are entitled to the same reward. Although the bill also removes consideration of GHGs from the New Source Review process under the Clean Air Act, mandatory use of CCS is still likely, as new coal-fired plants will be subject to strict GHG emission standards no later than 2020.

Subtitle D – Renewable Energy and Energy Efficiency

This part of the bill requires the EPA Administrator to allocate allowances to support the rural energy savings program, states and Indian tribes, with the percentage of allowances decreasing over time.

Rural Energy Savings Program

This provision amends the Consolidated Farm and Rural Development Act (7 USC 2008) to create a new low interest energy efficiency loan program administered by the Secretary of Agriculture for public power districts, public utility districts, electric cooperatives and other similar entities presently or previously financed through the Rural Utilities Service.

For vintage years 2013 through 2016, EPA is required to allocate to the program 0.5% of the emission allowances established each year, with a cumulative allocation of not more than $1B, and distribute such allowances to carry out the program.

Support of State Renewable Energy and Energy Efficiency Programs

For vintage years 2013 through 2022, the Administrator of EPA is required to allocate to states the emission allowances established each year and distribute allowances to states as follows:

- Allowances not distributed under the Rural Energy Savings Program are to be distributed in support of state smart grid programs, with 0.5% of such allowances to be distributed to Indian tribes on a competitive basis for renewable energy and energy efficiency programs; and
- Remaining allocations are to be distributed to the states in the following proportions:
- 1/3 among states equally;
- 1/3 ratably among states based on population; and
- 1/3 ratably based on energy consumption.

Distributed allowances are to be used for implementation of: energy efficiency programs; end use consumer efficiency programs; smart grid development; and providing the non-federal share of certain surface transportation capital projects.

Support for Voluntary Renewable Energy Markets

This provision sets forth the findings of Congress and its statement of policy with respect to voluntary markets for the purchase of renewable energy and renewable energy credits. It directs the Comptroller General to submit to Congress within 2 years of the statute's enactment a report detailing the growth and effectiveness of voluntary markets, including recommendations to support further growth.

Subtitle E – Clean Transportation

Emissions from transportation will be regulated under the national carbon cap, through the regulation of refined fuels. Producers and importers of gasoline and diesel must buy emissions allowances at a fixed price on a quarterly basis, based on the allowance auction price in the prior quarter. Sections 4111 to 4124 also provide incentives for the manufacturing and operation of "clean vehicles", including plug-in electric vehicles, mixed-fuel vehicles, and vehicles that operate on liquefied natural gas.

Subtitle F – Clean Energy Research and Development

Under this provision, two percent of annual allowances will be distributed on a competitive basis to institutions of higher education, companies, research foundations, trade and industry research collaborations or consortia to support research and development activities meeting clean energy technology development goals under the ARPA-E program. Eligible clean energy technology includes: renewable energy, nuclear energy, efficiency, transmission, smart grid, advanced and sustainable materials with an energy or efficiency application, water management and conservation, and transportation efficiency including electric vehicles.

TITLE II – GLOBAL WARMING POLLUTION REDUCTION

Targets

The bill would amend the Clean Air Act to impose an economy-wide reduction of greenhouse gas emissions (CO_2, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons from chemical manufacturing, perfluorocarbon, and nitrogen trifluoride) plus any others the EPA determines to be as potent as CO_2) of 4.75% below 2005-levels by 2013, 17% by 2020, 42% by 2030 and 83% below 2005-levels by 2050, by limiting the emissions of certain covered entities (essentially those who produce more than 25,000 tons of CO_2e annually) to specific capped levels of allowances which decline over time. The bill phases in compliance-generating facilities are subject to the program in 2013, but manufacturing facilities will not be subject until 2016 **–** and is intended to cover 66.2% of US GHG emissions in 2013 and 84.5% from 2016 and on.

Emission Allowances

The bill sets a number of allowances to be issued each year from 2013-2050 and beyond, which can be adjusted by EPA. Covered entities **–** which include electricity generators, geologic sequestration sites, any entity that falls into certain enumerated industrial categories (primarily the production of chemicals), sources that emit more than 25,000 tons of CO_2e in 2008 or subsequent year, or any entity or group of affiliates that produces or imports for sale or distribution products that would add more than 25,000 tons of CO_2e to the atmosphere each year **–** must hold their allowances or offsets by April 1 of each year to be in compliance. Allowances may be banked and traded without restriction, and can be borrowed from the next year without interest and up to 5 years into the future at an 8% reduction for each year. In addition, up to 2 billion offsets may be used for compliance each year. If a covered entity does not have adequate allowances for the previous year's emissions on April 1, it must pay a penalty of twice the latest clearing price for allowances as well as offset the missing allowances over the next year.

CO_2 emissions from renewable biomass are excluded from the calculation of allowances required to be held by electricity generators and industrial stationary sources. There are also provisions for the CO_2 that is used to produce algae-based fuels not to be double counted.

Refined product producers must quarterly pay for the potential emissions of their products by paying the auction clearing price at the most recent auction. Although the items that a refined product producer purchases are termed allowances and come out of the general economy-wide pot of allowances, they may not be traded, sold, banked or borrowed.

Price Collar and Floor

The bill provides for a Cost-Containment Reserve account of allowances, to be filled with 4 billion allowances by allocating 1.5% of each year's allowances, escalating to 5% for 2030-2050. These allowances may be sold, if necessary, for $25+ per allowance, and used for up to 15% of an entity's compliance obligation. Proceeds from the sale of these allowances are to be used by the Administrator to purchase international offset credits. These emergency allowances may not be banked or sold. The bill also sets a reserve price of $12 for 2013, increasing by inflation plus 3% in future years.

Categories of Offsets

The bill creates an advisory committee to report on types of offsets that should be considered, with a national registry of offsets to be established within a year. The offsets recommended by the committee must include a wide variety of programs: methane collection at mines and landfills, fugitive emissions from O&G sector, organic waste methane collection or anaerobic digestion projects, afforestation, forest management resulting in an increase in forest carbon stores, forest-based manufactured products, geologic sequestration without enhanced oil recovery, recycling and waste minimization projects, biochar production, destruction of ozone-depleting substances, agricultural, grassland and rangeland sequestration and management (including changing fertilizer), land management practices, manure management, and projects that reduce the intensity of GHG emissions per unit of agricultural production. To ensure that there is an early supply of offsets, EPA can also approve programs that were established before 2009, if they meet certain criteria. The bill also sets out requirements for international offsets which can be created to support activities that reduce or avoid GHG or increase sequestration of GHG in developing countries.

How Markets Will Work

Allowances that are not allocated will be sold in one of three markets: 1) quarterly sales by the EPA directly to refined product producers; 2) quarterly auctions operated by EPA and 3) a secondary market controlled by the Commodity Futures Trading Commission. Participation in both the auction and secondary market will be limited to covered entities, unless the EPA and Secretary of the Treasury decide that additional participants are necessary for a liquid and well-functioning market. The auctions will be held quarterly, beginning no later than March 31, 2012. Each auction will offer allowances from that vintage year plus vintages up to 4 years into the future. Auctions will be subject to a reserve price, which has been set at $12 for 2003, increasing at the rate of inflation plus 3% for future years.

Allocation

The bill allocates a majority of the allowances, reserving the rest for quarterly auctions. Most of the allocations are to benefit and protect electricity consumers (51% through 2016, decreasing to 35% through 2025) and natural gas consumers (9%, decreasing over time). The draft also allocates allowances directly to industry and specially created funds, including, in part:

- energy-intensive, trade-exposed industries get 2-15% of total allowances (with the highest levels in 2016-2025);
- industrial energy efficiency receive 0.5% of allowances, up to a maximum value of $1.5 billion;
- refiners get 0.75-4.3% of total allowances (with the highest levels in 2013-2016);
- facilities that undertake commercial deployment of CCS can receive up to 7.4-10% of allowances by 2022-2034;
- the Clean Vehicle Technology fund receives roughly 1% annually;
- the Clean Energy Technology fund under ARPA-E gets 2% from 2013-2031 to fund research and development.

Although state authority to enforce their own cap-and-trade legislation is preempted by the bill, states that have established a mandatory cap and trade program by the date of the act are rewarded with allowances. These states are allocated allowances, which the state may distribute to entities and programs that decrease GHG emissions or fund research and development of renewable technologies or efficiency.

Preemption

As predicted, the draft preempts state and regional cap and trade programs, but does provide for the exchange of allowances issued by California, RGGI and the Western Climate Initiative before 2012. The bill also preempts regulation of GHGs through the Clean Air Act as criteria pollutants, hazardous air pollutants, new source review, Title V, and Sections 111 and 115 of the Clean Air Act. States retain authority under the bill to regulate their own GHG-reduction programs, including emission caps, but are preempted from operating their own cap-and-trade programs.

TITLE III – CONSUMER PROTECTION

Working Families Income Tax Credit

Each calendar year from 2013 through 2029, the proceeds of an auction for allowances would be made available to provide refundable income tax credits to working families earning less than 250 percent of the poverty line.

Energy Refund Program

Under this provision, households that earn not more than 150 percent of the poverty line and those participating in certain supplemental nutrition assistance and food distribution programs would be entitled to receive monthly cash payments based on a calculation of such households' annual total loss in purchasing power that would result from the American Power Act.

TITLE IV – JOB PROTECTION AND GROWTH

The bill establishes a program that rebates emission allowances on an annual basis to eligible industrial sectors to compensate these sectors for the cost of complying with the cap-and-trade program. A subsequent EPA rulemaking process will determine both the amount of the rebate and the sectors and subsectors that would be eligible for the rebate, based on the trade and GHG intensity of each sector.

It also establishes a mechanism that could restrict imports in the event that an international climate treaty and/or the free allowance mechanism of Title II do not adequately safeguard U.S. manufacturing industries from carbon leakage. Under the International Reserve Allowance Program, importers of "covered goods" (generally, the products of international manufacturing) to surrender, upon importation, international reserve allowances in an amount covering the greenhouse gas emissions associated with the manufacture of imported goods (the bill ensures that these international allowances would be the same price as domestic allowances). Imports originating in countries with emissions controls at least as stringent as those adopted in the bill, in least developed countries, or in countries accounting for less than 0.5 percent of total greenhouse gas emissions and less than 5 percent of production in the industrial sector would be exempted from international reserve allowance requirements.

Advanced Energy Project Credit

This provision increases to $7.3 billion from $2.3 billion the limitation on credits that may be allocated under the Advanced Energy Project Credit program established under the internal revenue code pursuant to 26 USC 48C and extends the deadline for placing in service a certified project to 5 years from 3 years.

TITLE VI – COMMUNITY PROTECTION AND GLOBAL WARMING IMPACTS

With respect to adaptation, the bill creates a "Natural Resources Climate Change Adaptation Panel" chaired by the CEQ, which would develop a national adaptation strategy to address the ongoing and expected impacts of climate change such as ocean acidification, flooding and wildfires. The bill requires federal agencies to develop and implement natural resource adaptation programs consistent with that strategy. States would also need to develop adaptation plans in order to be eligible for funds generated from allowances under Title II.