Senate Delays Climate Change Legislation - Major Legislative and Regulatory Issues Still Remain

After spending much of August in Town Hall meetings listening to public concern over rising deficits and increased government control (primarily related to health care but also more broadly), the Senate has announced that introduction and committee consideration of Climate Change legislation will be delayed until later this fall. Under this schedule, Senators Barbara Boxer (D-Calif.) and John Kerry (D-Mass.) would introduce a bill in late September, committee markups would take place in October, and the bill could be considered on the Senate floor by December (if Congress is still in session). This means no climate legislation will be enacted in calendar year 2009 because there will not be time to complete a House-Senate Conference to reconcile the bills produced by each body. A House-Senate Conference will be particularly difficult if, as some believe, the Senate ultimately chooses not to pass a bill that includes a cap-and-trade program for greenhouse gas emissions, and focuses instead on clean energy.

Major Legislative Issues

Impact on the Economy
The biggest issue surrounding climate legislation remains the impact of the bill on the economy. Vastly different cost estimates have been produced by the Environmental Protection Agency (EPA), the Congressional Budget Office (CBO), the Department of Energy’s Energy Information Administration (EIA), the Heritage Foundation, and Science Applications International Corporation (SAIC) for the National Association of Manufacturers (NAM) and American Council for Capital Formation (ACCF), and others. The estimates are different because each uses different assumptions, different discount rates, and cover different time periods.

Despite their differences, all except CBO estimate similar reductions in the U.S. Gross Domestic Product (GDP) as a result of Climate Change legislation. The EIA analysis is perhaps most informative because it includes consideration of the renewable electricity standard, carbon capture and sequestration (CCS) development, and energy efficiency. EIA
also is transparent about the assumptions and discount rates underlying each of the scenarios modeled.

EIA’s “Basic Case” (most often cited) is a rosy scenario where nuclear, coal with CCS technology, and renewable energy all appear as needed to meet emission reduction requirements of the bill. It also assumes offsets, both domestic and international, are freely available, and that utilities and industry bank allowances to allow for use after 2030 (when most allowances to phase out).

A less rosy scenario is considered under the “No International/Limited Case.” This case assumes only seven to 11 new nuclear power plants, only four to eight commercial-sized coal plants with CCS, and assumes that international offsets are severely limited by cost, regulation, and/or slow progress in reaching international agreements. The “No International/Limited Case” was originally included in EIA’s April 2008 analysis of the Lieberman-Warner Climate Security Act (S. 2191) pursuant to a request from Senators Barrasso (WY), Inhofe (OK), and Voinovich (OH).

One can debate how likely it is that states and the federal government will be able to issue permits for a large number of nuclear power plants and carbon sequestration sites or how likely it is that the federal government will be able to negotiate and approve a program for international allowances. However, it is clear that the success of these efforts significantly impact the effect of climate legislation in the U.S. economy. Under EIA’s Base Case (rosy scenario), the GDP declines by .3 percent from 2013 to 2030 (using a 4 percent discount rate), while under the No International/Limited Case (not so rosy scenario), GDP is predicted to decline by .9 percent (discounted). The undiscounted impacts in 2030 are .8 percent under the Base Case and 2.3 percent under the No International/Limited case. Even more significant is the impact on the U.S. industrial sector, which under the Base Case (rosy scenario) would decline by 3.2 percent from 2012 to 2030 (discounted) or 6.8 percent by 2030 (not discounted). Impacts on the manufacturing sector are even greater, particularly manufacturing employment.

**Allocation of Allowances**

By creating marketable allowances, the House bill creates assets worth billions of dollars. The appropriate distribution of this wealth remains subject to intense controversy, particularly among the following sectors.

- **Utility Sector**

Electric utilities generate about 40 percent of U.S. greenhouse gas (GHG) emissions. In the House bill, utilities receive 35 percent of the allowances, with a phase-out between 2025 and 2030. Thirty percent of the allowances go to local distribution companies, which are regulated, with instructions to pass the savings on to customers. Five percent would go to merchant generators, which are not regulated and sell electricity on the open market. Merchant generators supply about 20 percent of the electricity generated from coal in the U.S. The 5 percent allocation to merchant generators represents one half of their base year emissions, so merchant generators will have to purchase allowances as soon as the caps go into effect.
Edison Electric Institute, representing investor owned utilities, helped negotiate the allocation of allowances to utilities in House bill, but would like to see a phase-out period of 15 years rather than five to avoid steep electricity price increases. Under the formula in the House bill, allowances are allocated to individual utilities based half on their historic GHG emissions and half on retail sales. This formula benefits low emitters (utilities that already have a large percentage of their load from nuclear or renewables).

Publicly owned utilities (American Public Power Association and the National Rural Electric Cooperative Association) and their regulators (National Association of Regulatory Utility Commissioners) are opposing any allocation of allowances to merchant generators, claiming the potential for windfall profits.

Another group of eight Midwest utilities (a subset of the 15 members of the Midwest Climate Coalition) are opposing the formula for allocation of allowances to utilities because companies that have greater emissions because they generate more of their electricity from coal will need to purchase more allowances, and their customers will end up paying substantially more for electricity. These companies serve customers in Iowa, Nebraska, Colorado, North Dakota, Montana, South Dakota, Wyoming, Minnesota, Illinois, Michigan, and Wisconsin. While some of these states have small populations, each has two senators. Already, Senators Dorgan (N.D.), Conrad (N.D.) and Nelson (Neb.) have indicated they don’t support cap-and-trade legislation.

- **Oil Industry**
  Oil refineries generate about 4 percent of GHG emissions. However, because the House bill puts a compliance burden on upstream generators for emissions from consumer uses of petroleum products, like gasoline, oil refineries must hold allowances for 43 percent of the covered emissions in the House bill. The oil industry receives only 2.25 percent of the free allowances and that allocation drops to zero in 2026. As a result, the American Petroleum Institute is opposing climate change legislation.

- **Energy Intensive/Trade Vulnerable Manufacturing**
  Although energy intensive/trade vulnerable industries receive a significant number of allowances (approximately 15 percent from 2014-2025), these industries remain concerned about the impacts of climate legislation on their sector. The American Iron and Steel Institute (AISI) is seeking improvements in the Senate, noting that industry costs will increase in many areas, over and above the cost of emission allowances. In particular, AISI is seeking strengthening of the “border adjustment” provisions. Under the border adjustment provision of the House bill, beginning in 2020, the importers of goods from countries that have not adopted binding GHG emissions reductions will have to purchase allowances (called international allowances) to offset the cost of compliance with GHG emission caps by U.S. industries in the same industrial sector.

  Some have argued that these provisions amount to tariffs that would trigger a trade war. President Obama opposes them and Senators Kerry and Baucus have said publicly that they want to change the border adjustment provision to avoid retaliation from other countries. However, U.S. manufacturers have many friends in the Senate, particularly in Midwestern states. In August, 10 Democrat senators sent a letter to President Obama
asserting that the border adjustment provision and the provision of sufficient allowances to energy intensive industries were essential components of climate change legislation. The letter was signed by Senators Bayh (Ind.), Brown (Ohio), Feingold (Wis), Franken (Minn.), Levin (Mich.), Stabenow (Mich.), Casey (Pa.), Specter (Pa.), Byrd (W.Va.) and Rockefeller (W.Va.).

- **Consumers**

  From 2026 through 2050, as the free allowances to other groups phase out, revenue from the sale of all allowances not allocated is placed in a trust fund called the Climate Change Consumer Refund Account. Each year the revenue in this account is to be allocated in the form of a tax refund to each household in the U.S., on a per capita basis.

Some consumer advocates argue that all allowances should be sold and the revenue distributed in this way. They argue that this strategy would be more effective in off-setting the increased costs people will incur as a result of climate change legislation than allocating allowances to industries and utilities.

**Clean Air Act Authority/State Preemption**

The House bill precludes applying existing Clean Air Act (CAA) regulations to sources that are subject to the emissions cap (sources emitting 25,000 tons of CO2 equivalent or more a year). However, the bill does direct EPA to establish new source performance standards for uncapped sources with greenhouse gas emissions over 10,000 tons per year (not including methane emissions from livestock, i.e., no cow tax).

Some environmental and activist groups oppose any bar on the use of Clean Air Act authority to regulate GHG emissions. These groups include the Sierra Club and MoveOn.org. Recently, state organizations also weighed in. On Aug. 5, 2009, the National Association of Clean Air Agencies sent a letter to every senator urging changes to the House climate bill, including retaining Clean Air Act authority to regulate new and existing sources of GHGs.

The House bill preempts state cap and trade programs that would cap emissions between 2012 and 2017 using a state cap and state-issued allowances. However, the House bill does not preclude states from requiring sources to use federal allowances to meet stricter state GHG emission targets. Even though state authority is not completely preempted, on Aug. 6, 2009, the Environmental Council of the States sent letters to the Chairmen and Ranking members of the Senate Environment and Public Works Committee, the Senate Finance Committee, and the Senate Agriculture Committee, opposing any preemption of the authority of states to implement GHG regulations. State Attorneys General from CA, AZ, CT, DE, and NJ sent a similar letter to the Senate on Aug. 31, 2009.

**EPA Regulatory Activities**

The greatest pressure on Congress to pass climate change legislation may be the knowledge that, if Congress fails to act, EPA will. And, if EPA fails to act in a timely manner, environmental groups can file suits to place EPA under court-ordered deadlines that are often too short to allow for the information gathering needed to do responsible regulation.
Since the U.S. Supreme Court’s decision in *Massachusetts v. EPA* that GHGs are pollutants under the CAA, EPA has taken a number of steps to regulate GHGs under CAA authority. These actions fall into three general categories: data gathering, direct regulation, and indirect climate change protection measures.

- **GHG Data Gathering**
  Pursuant to directives in the 2008 Consolidated Appropriations Act, EPA proposed a Mandatory Greenhouse Gas Reporting Rule ("GHG Reporting Rule") in April 2009 to inform a variety of CAA-based decisions, including appropriate source standards and treatment requirements. Disagreements over how this rule should be implemented (e.g., proper thresholds and the quality of the data gathered) have led to concern within the regulated community; but more so, concern over this rule stems from murkiness over how the information gathered under this rule actually would be used in future climate change policy making. In all, the final form of this rule may indicate EPA’s wherewithal and momentum under the new administration to start expanding the scope of the GHG-regulated universe. EPA sent a final rule to the President’s Office of Management and Budget ("OMB"), Office of Information & Regulatory Affairs ("OIRA") on Aug. 18, 2009 for review before publication. Although not binding, the indicated final publication date in the OIRA submission is October 2009, which would be consistent with all prior indications from EPA that the final rule would be done in time to require 2010 data collection for 2011 reporting.

- **Direct Regulation of GHG Emissions**
  Pursuant to remand in *Massachusetts v. EPA*, EPA issued a proposed finding on April 24, 2009, that GHGs in the atmosphere endanger the public health and welfare, and that combined emissions of CO2, CH4, NOx, and HFC from new motor vehicle and motor vehicle engines are contributing to that endangerment. If finalized in its current form, these findings will give EPA the authority to directly regulate the GHG emissions from motor vehicles. EPA currently is evaluating the comments received during the public comment period and public meetings held on the finding in early summer. While there is no direct deadline for this finding, EPA must act quickly to allow it to meet a federal deadline of March 31, 2010 to meet a Presidentially-directed agreement to propose and issue GHG emission for motor vehicles that apply starting no later than 2012.

  While procedurally the endangerment finding above is necessary before EPA may develop regulations, EPA has wasted no time developing the proposed rules that will be applicable to vehicles once the endangerment finding goes final. On Aug. 25, 2009, EPA sent to OIRA a proposed rule regulating GHGs from light duty vehicles. The actual substance of this rule is unknown at this point. However, the implication of EPA’s submission is important in that it signals EPA’s motivation to produce GHG regulations quickly.

  Even more telling of EPA’s eagerness to promulgate climate change regulations, the Agency has sent to OIRA for review, proposed GHG thresholds for coverage under the CAA New Source Review program’s Prevention of Significant Deterioration ("PSD") requirements. These PSD thresholds would identify when a facility must include stringent PSD requirements, and are a logical extension if EPA finalizes its endangerment finding because the endangerment finding would apply whether a GHG was emitted from a mobile source or...
a stationary source. However, unlike vehicle emissions, PSD thresholds and PSD regulation of GHGs are not the direct subject of Massachusetts v. EPA, are not a result of a Presidential agreement, and have no impending deadlines. In other words, EPA’s PSD GHG regulation appears to be a pro-active measure to regulate GHG emissions from stationary sources of pollutants. Early indications are that the potential PSD threshold for GHG’s will be somewhere from over 250 tons per year ("TPY") of CO2 equivalent (standard PSD threshold for pollutants) to over 25,000 TPY CO2 equivalent (consistent with reporting level thresholds for the GHG Reporting Rule above). A lower end threshold (e.g., 250 TPY) likely would be accompanied by a “General Permit” that may present unique issues -- especially to the myriad of smaller facilities that such a threshold would encompass, but that would otherwise be subject to PSD because of other pollutant levels.

- **Indirect Climate Change Protection Measures**
  In contrast to direct regulation of GHGs, certain broader climate change activities have more established legal authority. For example, EPA proposed regulations in July 2008 to address the deep well injection of CO2 (“carbon sequestration”) as a means of removing the GHG from the carbon cycle. Deep well injection is a process that has been used frequently in other contexts to dispose of pollutants, including hazardous wastes. Deep well injection is regulated under the Safe Drinking Water Act (“SDWA”) to ensure that the injected pollutants will not impact potable water supplies, such as aquifers.

  EPA already has undergone all necessary public comment procedures on the July 2008 proposal; however, EPA will soon “re-open” the public comment period to seek comment on new data and issues raised in the previous comment period (i.e., state vs. federal waiver of requirement to inject below the lowermost Underground Source of Drinking Water). OIRA has reviewed EPA’s reopener and a pre-publication draft is available on EPA’s Web site at [http://www.epa.gov/safewater/uic/pdfs/prefr_uic_noda_2009-08.pdf](http://www.epa.gov/safewater/uic/pdfs/prefr_uic_noda_2009-08.pdf). Publication in the Federal Register is expected soon. Once published, EPA will provide 45 days to comment.

  EPA also has proposed renewable fuel standards that address climate change without direct regulation of emissions. Renewable fuel standards originally were mandated for refiners, blenders, and importers of motor vehicle fuel by the Energy Policy Act of 2005, and required specific blending requirements for U.S. fuels to include blending percentages of renewable fuels (e.g., ethanol) to achieve a target total renewable fuel volume in use. The 2007 Energy Independence and Security Act (“EISA”) modified the previous scheme to update renewable fuel standards as well as expand coverage from gasoline to all transportation fuels (e.g., including diesel and non-road fuels).

  In May 2009, EPA proposed revised regulatory blending percentages and total volume for renewable fuel blending (i.e., yearly increases up to 36 billion gallons) to be consistent with the EISA changes. Under the May 2009 proposed rule, to count as a renewable fuel the fuels addressed in the EISA (i.e., cellulosic, biomass-based, and advanced biofuel) must now demonstrate a 20% or more life cycle reduction in GHG emissions compared to the life cycle emissions from petroleum-based fuels. The concern over life cycle GHG emissions arose over the suggestion that there were indirect negative climate impacts from the production of some renewable fuels. For example, increased ethanol production allegedly has led to decreased U.S. corn exports causing other countries that typically relied on those exports to
cut down rainforests, thereby releasing CO2. Also, to make ethanol, some plants use
electricity generated by coal-fired power plants. The consideration of these indirect impacts
has met with considerable controversy. As a result, on July 2, 2009, EPA extended the
comment period on this proposal from July 27 to Sept. 25, 2009.

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