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The American Power Act - U.S. Senate Climate and Energy Bill Released

The long-awaited U.S. Senate climate and energy bill was unveiled on May 12, 2010, although it has not yet been formally introduced. Officially titled the "American Power Act," the bill is nearly 1,000 pages long and was crafted over the past year by Senators John Kerry (D-MA), Joe Lieberman (I-CT) and Lindsay Graham (R-SC). The Kerry-Lieberman bill, much like the Waxman-Markey bill that passed the House in 2009, would mandate limits on greenhouse gas (GHG) emissions for the electric utility, oil refining, natural gas and "energy-intensive" manufacturing sectors. The bill would also create a comprehensive GHG emissions trading system and would provide funding and incentives for a variety of energy and environmental initiatives.

Kerry-Lieberman has the following key elements (click on the links for a more detailed description):

- Mandates a shrinking cap on total GHG emissions from major industrial sources, starting with a 17% cut in emissions (below 2005 levels) by 2020 and achieving reductions of 42% by 2030 and 83% by 2050;
- Distributes annual "emissions allowances" to electric utilities and oil refiners (starting 2013) and certain energy-intensive industries (starting 2016). These allowances are used to pay for a regulated entity's GHG emissions for a given year;
- Establishes a highly regulated emissions allowance trading system;
- Allows regulated entities to purchase a limited number of "carbon offsets" in lieu of emissions allowances by funding reforestation and other GHG-reducing projects in the domestic and foreign agricultural sector;
- Imposes a tariff on imports from countries that have not established mandatory limits on GHG emissions to protect "trade-sensitive" U.S. industries and deter businesses from outsourcing their operations to avoid GHG regulations;
- Preempts EPA's ability to limit GHG emissions under existing Clean Air Act mechanisms, although it phases in Clean Air Act new source performance standards for coal-fired power plants by 2020 and retains EPA authority to continue to regulate GHG vehicle emissions;
- Permits expansion of offshore drilling;
- Provides a variety of financial incentives for the construction of new nuclear power plants; and
- Funds the development of renewable energy sources and carbon capture and sequestration technology.

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The bill is considered more industry-friendly than its House counterpart. Waxman-Markey, for example, lacks provisions for nuclear power, offshore drilling and protective tariffs. Moreover, Kerry-Lieberman would phase in regulations on energy-intensive industries over four years, while Waxman-Markey would generally impose emissions limits on regulated sectors contemporaneously.

Kerry-Lieberman is presently in "discussion draft" form. The bill's sponsors have predicted a full Senate debate as early as late next month.

Kerry-Lieberman may face an uphill battle. Notably, however, the bill's sponsors have persuaded three major oil companies, a consortium of electric utilities, and a wide range of interest groups ranging from the U.S. Chamber of Commerce to the Christian Coalition either to support the bill or not campaign against it. Kerry-Lieberman's prospects may also be influenced—for better or worse—by the impending midterm elections, political fallout from the Gulf oil spill, and the prospect of EPA regulation of GHG emissions under existing Clean Air Act authorities.[1]

Katten Muchin Rosenman LLP will continue to monitor Kerry-Lieberman and other climate change-related regulatory and legislative developments.

GHG EMISSIONS LIMITATIONS

The Kerry-Lieberman bill would require major sources of GHG emissions to obtain an "emissions allowance" for every ton of carbon dioxide (CO_2) (or its equivalent)[2] produced each year. As in Waxman-Markey, the primary regulated entities would include:

- Electrical utilities;
- Producers and distributors of refined liquid fuels, including gasoline, fuel oil and liquid natural gas;
- Stationary sources (newly defined to include the operations comprising any plant, building, structure or stationary equipment, including support buildings and equipment) that emit more than 25,000 tons of CO_2-equivalent; and
- Manufacturers in specified industries, including aluminum, cement and ammonia manufacturers, regardless of the quantity of their GHG emissions.

Allocation of Allowances

In the first few years after its passage, Kerry-Lieberman would provide for the majority of emissions allowances to be issued without cost to regulated industry sectors. The remaining allowances would be sold in quarterly auctions to regulated entities and certain eligible GHG market participants. As in Waxman-Markey, the percentage of free allowances would be phased out by 2029, and the percentage of allowances to be auctioned off would increase accordingly. The major recipients of free allowances would include:

Electric Utilities and Distributors of Natural Gas and Home Heating Oil

Starting in 2013, electricity generators and vendors of natural gas and home heating oil would be required to obtain allowances for their emissions. Over 60% of total allowances would be given to these industries at no cost. The allowances, however, must be used for the benefit of ratepayers who might otherwise face increased energy costs. The Senate bill differs from Waxman-Markey in that the formula for allocating allowances among utilities calls for 75% of the allotment to be based on the previous year's emissions, while 25% of the allotment is based on electricity sales. Waxman-Markey called for a 50/50 split, meaning Kerry-Lieberman provides greater allocations to utilities with higher-emitting facilities.

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[1] EPA issued its final "tailoring" rule on May 13, 2010, which subjects certain large emitters of GHGs (100,000 tons of annual emissions of carbon dioxide or its equivalent) to regulation under the Clean Air Act while exempting smaller facilities like small farms and restaurants.

[2] The bill includes a conversion table for other GHGs based on their potential to cause global warming, e.g., one ton of methane equals 25 tons of CO_2, one ton of nitrous oxide equals 298 tons of CO_2, etc.

Oil Refiners

The bill addresses GHG emissions from the transportation sector "upstream" from the point of combustion by requiring oil companies (and other producers and refiners of transportation fuels) to purchase emissions allowances at a fixed price starting in 2013. Each refiner would be required to obtain allowances based on the calculated "indirect emissions" that would result from combustion of the fuel that the refiner produces. Although the refining sector would initially be allotted 4.3% of total allowances, the oil refining industry members would only be able to use those allowances themselves and could not trade them on the open market. Unused allowances would be auctioned off at the end of each year.

Other Industries

"Energy-intensive" industries, such as steel and cement manufacturers, would be subject to regulation starting in 2016, when they would receive 15% of allocated emissions allowances. Also regulated starting in 2016 would be stationary sources (or groups of sources) that emit 25,000 or more tons of CO2 per year. Even before they are regulated, however, these entities would receive 2% of allowances for use in mitigating increased energy costs and retrofitting their facilities to become more efficient. The bill also would establish a "rebate" program to allow certain "trade-exposed" industries—to be determined by EPA—to petition EPA to recoup the costs of compliance with the new law.

Emissions allowances are also allocated in varying amounts for the funding of miscellaneous climate and energy-related programs, including climate adaptation, transportation infrastructure, and carbon capture and sequestration research.

Penalties for Noncompliance

A company that does not hold sufficient allowances to cover its GHG emissions for a given year would be subject to a civil penalty in the amount of twice the market price for the unpaid credits. Payment of such penalty would not absolve a company of potential liability under other statutory provisions. The company may also be required to offset its excess emissions. Required allowances would be calculated based on quarterly GHG reports which regulated entities will be required to submit to EPA. Companies are already subject to civil and criminal penalties for false statements in complying with existing GHG reporting obligations, and would face similar penalties under Kerry-Lieberman.

THE CARBON CREDIT MARKET

Kerry-Lieberman would establish a market in which emissions allowances can be bought, sold and traded. This market, however, would be highly restricted—in many respects more than in the Waxman-Markey bill that passed the House in 2009. For example:

- Participation in quarterly emissions allowance auctions and the "primary" carbon market would be limited mostly to regulated entities and qualified GHG market participants. Waxman-Markey did not contain this restriction.
- The bill directs the Commodities and Futures Trading Commission to place restrictions on the quantity of trading in the "secondary" carbon market so as to prevent excessive speculation and short sales.
- Fraud and market manipulation would be penalized under preexisting provisions of the Commodity Exchange Act, which mandates civil and criminal penalties.
- The bill establishes a "hard price collar" that requires emissions allowances to be valued at between $12 and $25, with those numbers increasing with inflation. Waxman-Markey does not have a similar price restriction.
- The bill establishes a "strategic reserve" of unused emissions allowances to ensure the availability of affordable credits in the event of a spike in carbon prices.
- A company may protect itself from unexpected fluctuations in its GHG emissions by "banking" unused emissions allowances for use in future years or borrowing up to 15% of its annual allowances from future years.
- Unlike in Waxman-Markey, state and regional emissions trading programs (such as the Regional Greenhouse Gas Initiative in the Northeast) are preempted.

OFFSHORE DRILLING

Notwithstanding the recent Gulf oil spill, Kerry-Lieberman contains incentives to expand offshore drilling in light of President Obama's recent lifting of a nearly 30-year moratorium. The bill proposes to amend the Outer Continental Shelf Lands Act (OCSLA) to increase to 37.5% the proportion of leasing revenue that a state can capture for offshore oil and gas exploration off its coast. Total revenues, however, would be capped at $500 million annually per state. An additional 12.5% of such revenue would be earmarked for coastal environmental protection under the federal Land and Water Conservation Fund. The remaining 50% of the revenue would be allocated to deficit reduction.

In light of recent events, Kerry-Lieberman also permits a state to veto any offshore drilling within 75 miles of its coastline "if the State would suffer significant adverse impacts in the event of an accident." To do so, the state would first need to enact a law proscribing the drilling. Upon enactment of that law, the governor of the state would then submit a petition to EPA requesting that the affected areas be withdrawn from consideration for oil and gas exploration.

Finally, the bill would require the Secretary of the Interior to assess the probability of an oil spill in each area opened to offshore drilling. If the Secretary makes a finding of significant impact, the affected state will be permitted to pass a law barring drilling in the proposed area.