



## House of Representatives Passes Comprehensive Global Warming and Clean Energy Bill

On June 26, 2009, the House passed a global warming bill, the American Clean Energy and Security Act of 2009 (“ACES” or “Act”), which would establish the first federal cap on greenhouse gas (“GHG”) emissions and a trading scheme for covered entities. The bill was approved by a narrow margin, largely along party lines: 219 to 212, including 211 Democrats and 8 Republicans in favor and 44 Democrats and 168 Republicans against. In addition to the cap and trade provisions, ACES establishes a comprehensive system designed to spur investment in renewable energy. ACES was most recently revised by an amendment that was added to the bill early in the morning of June 26. The manager’s amendment of over 300 pages added several new sections, a new subtitle on energy efficiency and green housing programs, and a new title creating an offset credit program for agricultural and forestry offsets. It is expected that several Senate committees will be considering separate GHG cap and trade bills, some of which include key components of ACES, and that the full Senate will debate legislation in the fall.

### GHG Cap and Trade System

ACES will reduce GHG emissions from major sources by 17% below 2005 levels in 2020 and 83% below 2005 levels in 2050. To achieve these reductions, ACES requires covered entities<sup>1</sup> to hold an emissions allowance for each ton of CO<sub>2</sub>e of GHGs emitted, produced or imported. The compliance obligation is phased in for industrial stationary sources (requirements begin in 2014) and local natural gas distribution companies (requirements begin in 2016). The number of emission allowances to be established by EPA starts at 4.627 billion in 2012 and declines to 1.035 billion in 2050 and all subsequent years. Emission allowances may be used to comply in years after the establishment of the allowance, although ACES allows EPA to retire or establish an expiration date for allowances. Smaller sources of GHG emissions are also addressed under ACES, as the statute requires EPA to set GHG reduction performance standards for many sources emitting 10,000-24,999 tpy of CO<sub>2</sub>e.

Emission allowances are distributed as followed: 1) to electricity local distribution companies to be used for the benefit of retail ratepayers – 43.75 % in 2012, declining to 7% in 2029; 2) to

<sup>1</sup> A covered entity is a defined term under ACES that includes a number of sources, including all electric utilities; liquid fuel producers and importers whose products when combusted emit 25,000 tons per year of carbon dioxide equivalent (“CO<sub>2</sub>e”) beginning in 2008; producers and importers of 25,000 tons per year of CO<sub>2</sub>e of GHGs; stationary sources that emit 25,000 tons per year of CO<sub>2</sub> of nitrogen trifluoride beginning in 2008; geologic sequestration sites; stationary sources in certain industrial sectors including primary aluminum production, ammonia manufacturing, cement production, petroleum refining, and coal-based liquid or gaseous fluid production; stationary chemical or petrochemical sources that emit 25,000 tons per year of CO<sub>2</sub>e; stationary iron and steel producers, pulp and paper manufacturers, food processors, and other industrial sources that emit 25,000 tons per year of CO<sub>2</sub>e beginning in 2008; fossil fuel-fired combustion devices that emit 25,000 tons per year of CO<sub>2</sub>e beginning in 2008; and natural gas local distribution companies that deliver 460 million cubic feet or more of natural gas for delivery to customers that are not covered entities. Beginning in 2020, EPA may lower the threshold for applicability of the cap and trade provisions to as low as 10,000 tons of CO<sub>2</sub>e emissions.

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natural gas local distribution companies to be used for the benefit of retail ratepayers – 9% from 2016 to 2025 and 1.8% in 2029; 3) to states to be used for energy efficiency programs or rebates that benefit home heating oil, propane, or kerosene consumers – 1.875% in 2012 to 0.3% in 2029; 4) to energy-intensive, trade-exposed entities, like the cement and steel industries – 2% in 2012 and 2013, 15% in 2014, thereafter based on the percentage of reductions in the emissions cap; and 5) oil refineries – 2% in 2014. From 2014 to 2025, the number of emission allowances distributed to an energy-intensive source is based upon the sum of the entity's direct and indirect carbon factors<sup>2</sup>. ACES also provides for emission allowances to be distributed to states for investment in clean energy and energy efficiency, for domestic adaptation, the prevention of tropical deforestation, and worker assistance and job training. The manager's amendment to ACES allocates 1% of emission allowances established in 2012 to entities who reduced GHG emissions before January 1, 2009. The manager's amendment also provides for 0.14% of allowances from 2012 to 2016 to be distributed to agricultural activities that reduce GHGs and for renewable energy incentives programs. Approximately 80% of the emission allowances will be given away for free to help the country transition to a clean energy economy. By 2031, approximately 70% of the allowances will be auctioned.

To assist in the administration of the cap and trade program, ACES establishes a federal GHG emissions registry. Sources required to hold emissions allowances must report their GHG emissions and the production of fuels and industrial gases whose use might emit GHGs by March 31, 2011. ACES requires U.S. EPA to promulgate regulations governing the cap and trade system within 24 months after the statute is enacted.

ACES allows covered entities to use offset credits instead of emission allowances to satisfy their compliance obligations. Covered entities may collectively use offset credits for up to 2 billion tons of GHG emissions a year. For each covered entity, only a certain percentage of emission allowances required to be held can be satisfied through offsets. Prior to 2018, covered entities can use international offset credits in lieu of the required emission allowances on a one to one basis. In 2018 and onward, 1.25 international offset credits must be held for each emission allowance required. Domestic offset credits can be used on a one to one basis. The manager's amendment allows term offset credits, which are issued under the domestic agricultural offsets program, to be used temporarily instead of domestic offset credits. Term offset credits expire the year after their term ends. The term of a term offset credit is determined using a formula but is limited to 5 years from the date of issuance.

## Renewable Energy and Energy Efficiency Programs

In its current form, ACES contains a number of programs designed to promote the use of renewable energy sources and energy efficiency technologies. One of the most significant energy provisions is the renewable electricity standard, which requires retail electric suppliers to supply 20% of their load from renewable energy sources and energy efficiency savings by 2020. The manager's amendment includes a renewable electricity standard for federal agencies. The federal renewable electricity standard requires federal agencies to use renewable electricity for 20% of their total electricity consumption by 2020.

ACES establishes a new government administration to support private investment in clean energy and energy efficiency technologies. The manager's amendment expands the goals of the Clean Energy Deployment Administration to include financial support for small businesses that develop clean energy technologies. The manager's amendment also establishes a program in which the Secretary of Commerce will award grants for the establishment of revolving loan funds. Loan from these funds will be provided to small and medium-sized businesses to help defray the costs of retrofitting manufacturing facilities to reduce energy use or GHG emissions, or building new manufacturing facilities that produce clean energy technology products, energy efficiency products, and their components.

ACES also has many provisions to promote energy efficiency, including energy efficiency standards for consumer products, buildings, and a requirement that EPA promulgate carbon emission standards for heavy-duty and off-road vehicles. ACES also has a new energy efficiency program for small utilities. The version of ACES passed by the House on June 26 includes provisions establishing green and energy efficiency housing programs under the Department of Housing and Urban Development.

## Markets in Emission Allowances

It is expected that the market in emission allowances and derivatives on emission allowances will eclipse all other commodity markets to date. As a result, it comes as no surprise that jurisdictional issues over what federal entity will regulate these markets sparked a very active debate and horse trading. Prior to its June 26, 2009 passage, ACES had delegated the regulation of underlying physical (or cash) commodities – *i.e.*, emissions allowances as defined in 401(a)(5) of the Federal Power Act – to the Federal Energy Regulatory Commission (“FERC”), and delegated the regulation of markets in regulated allowance derivatives to the Commodities Future Trading Commission (“CFTC”) to the same

<sup>2</sup> A direct carbon factor is the product of the average output for the two years prior to the date of distribution and the average direct GHG emissions per unit of output for all covered entities in the sector. An indirect carbon factor is the product of the average output for the two years prior to the date of distribution, the electricity emissions intensity factor, and the electricity efficiency factor for the year at issue.

extent the CFTC will regulate markets in “energy commodities.”

The last-minute amendments to ACES struck this provision in favor of solely vesting authority in the President to determine the appropriate regulatory body for overseeing the carbon derivatives markets, although the default rules still require sharing of the jurisdiction of the FERC with respect to “cash commodity” markets in emission allowances and the CFTC with respect to “allowance derivatives.” This change came about through late-stage negotiations between the White House and the Energy and Commerce Committee staff.

It is clear that legislators intend that markets in emission allowances are very strictly regulated by the agency that is most able and willing to do so. It is likely that the comprehensive bill on financial re-regulation will clarify these jurisdictional matters.

## Conclusion

Senate consideration of a climate change bill is anticipated, now that the House has passed its version of GHG cap and trade legislation. Concerns about increased electricity costs created by ACES have been raised, with some Republicans calling the bill an “energy tax.” The Congressional Budget Office has estimated that the total cost of the cap and trade system established in ACES would be \$175 per household in 2020. Regardless of what happens in the Senate, the passage of ACES through the House will be used by the Obama Administration during the Copenhagen climate change summit to show the United States is committed to addressing global warming issues.

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