

CARBON ANALYSIS:

Draft Climate Bill Released by House Committee

March 31, 2009

This morning Chairman Henry A. Waxman of the Energy and Commerce Committee and Chairman Edward J. Markey of the Energy and Environment Subcommittee released a draft of "The American Clean Energy and Security Act of 2009", which proposes a cap in carbon emissions and programs to stimulate development of renewable energy resources.

Waxman and Markey's bill is the first comprehensive legislative attempt this Congress to address climate change. Below are key components of the bill:

Carbon Cap and Trade

COVERED SOURCES: The bill creates a market-based program to reduce greenhouse gas emissions from sources emitting more than 25,000 tons per year of CO₂ equivalent. This covers sources from the utility, refining, and the industrial sectors contributing to roughly 85% of U.S. emissions.

EMISSIONS CAP: The emissions cap ratchets down from 3% below 2005 levels in 2012, to 20% below 2005 levels in 2020, to 42% below 2005 levels in 2030, and, finally, to 83% below 2005 levels in 2050 and beyond. This represents an allocation of 4.7 billion tons in 2012 and 1 billion tons in 2050.

ALLOCATION/AUCTIONING: The bill contains provisions mandating the auction of at least a portion of allowances, but the free allocation/auctioning ratio is not yet defined. This will be the topic of discussions among committee members in the coming days.

BANKING/BORROWING: The bill permits unlimited banking of allowances. The bill also has a rolling two-year compliance period, effectively allowing for borrowing one year ahead.

OFFSETS:

- The bill allows covered sources to use offsets for compliance under the program. The total quantity of offsets allowed each year cannot exceed 2 billion tons, split evenly between domestic and international offsets.
- Regulated entities must submit five offsets for every four tons of carbon – or a 1.25 ratio.
- Eligible offset types must be 'additional' and will be determined by an EPA Advisory Board. However, the bill provides guidance to the EPA, defining offset 'additionality' as: a.) activities not required under existing regulations; b.) activities starting after January 01, 2009 or activities started after January 01, 2001 and issued credits by an EPA-approved voluntary carbon offset program; and c.) activities not exceeding project type baselines established by the EPA.
- The bill allows for the import of international credits, including sectoral reductions. CDM credits can be imported only after a finding by the EPA that the United Nations program meets standards for integrity.

INTERNATIONAL FORESTRY: The bill instructs EPA to invest approximately 5% of allowance auction revenues in projects to prevent international deforestation (or REDD). This program will achieve at least 720 million tons of reductions by 2020 and at least 6 billion tons of reductions by 2025. These tons are in addition to the offsets quota referenced above. Qualifying countries must enter into an agreement with the U.S. and agree to certain program elements ensuring integrity and preventing leakage.

STATE PROGRAMS: Emissions allowances issued before December 31, 2011 by either California or the Regional Greenhouse Gas Initiative (RGGI) can be exchanged for Federal carbon allowances. The EPA will make rules for this exchange in such a way that compensates allowance holders for the value of their allowances. The bill indicates that the value of state allowances will be based on the average

auction price for allowances issued in that year.

STRATEGIC RESERVE: EPA is directed to hold a 'strategic reserve' of 2.5 billion allowances. The Agency can make a portion of these allowances available for sale at auction if prices rise to unexpectedly high levels.

MARKET REGULATION: Carbon markets will be regulated by the Federal Energy Regulatory Commission (FERC). Regulations would include provisions to foster market transparency, establish position limits, and limit counterparty risk in the over-the-counter market. Specifics would be determined by FERC. The bill punts on the regulation of carbon derivatives, which is likely to be regulated by the Commodities Futures Trading Commission (CFTC).

Federal RPS

- The bill will establish a nationwide renewable portfolio standard (RPS), which will require electricity suppliers to meet a specific percentage of their load with renewable energy.
- The RPS requirement begins with 6% in 2012 and rises to 25% in 2025.
- Qualifying renewable resources will include solar, wind, hydro, geothermal, biomass, landfill gas, wave, and certain hydro resources (online or refurbishment date after January 01, 2001).
- The bill calls for the Department of Energy to cooperate with States that have existing RPS and use existing REC tracking systems.
- States can petition DOE to reduce up to 20% of the required RPS percentage by engaging in energy efficiency measures.
- The alternative compliance payment (ACP) would be the lesser of 200% of the average market value of a Federal REC or \$50 on an annually adjusted basis.

The bill is considered a discussion draft, which provides members of the Committee (and the public) an opportunity to comment on its provisions. The Energy and Commerce Committee will complete consideration of the legislation by Memorial Day. The preliminary schedule follows:

- Week of April 20: Energy and Environment Subcommittee Hearings
- Week of April 27: Energy and Environment Subcommittee Markup Period Begins
- Week of May 11: Full Energy and Commerce Committee Markup Period Begins

We will continue to provide updates and analysis of carbon market legislative developments in the U.S. Congress. If you have any questions regarding the legislation, the legislative process, or how either will impact the existing U.S. carbon markets, please contact our Carbon Markets Group for the Americas at: +1 914.323.0265.

If you have questions regarding the Federal RPS provisions of the bill and how the national market may form, please contact Andrew Kolchins, Director, Renewable Energy Markets (East) at: +1 914.323.0257 or Nicole Finerty, Director, Renewable Energy Markets (West) at: +1 415.963.9130

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