

# CARBON ANALYSIS: Climate Bill Passes House

## Major Changes Made to Federal RES and Cap & Trade Provisions



**June 30, 2009 (revised 07/01/09)**

Last Friday evening, the U.S. House of Representatives passed comprehensive legislation to encourage the development of clean energy sources and reduce concentrations of greenhouse gas emissions. The measure, titled the "American Clean Energy and Security Act of 2009" and authored by Congressmen Waxman and Markey, passed by a vote of 219 – 212.

Several changes were made to the bill at the 11th hour and a "clean" version of the 1,200-page legislation as it passed the House floor is not yet available. However, based on our understanding of amendments that were approved late Friday, below you will find an overview of the Federal Renewable Energy Standard and Climate Change programs in the bill.

We will continue to provide you updates on the House-passed bill as they become available. If you have any questions regarding the legislation, its impact on global carbon markets, or are considering transacting in the market, we encourage you to contact our U.S. Carbon Markets Group at: +1 914.323.0265.

## Federal Renewable Energy Standard

### Program Overview

- Retail electric suppliers that have sold more than 4 million megawatt hours of electricity to retail consumers in an annual period must have a specified portion of the power they sell come from renewable energy sources.
  - Of note, the baseline calculation excludes electricity generated by hydropower that is not classified as "qualified hydropower" (see below), nuclear power placed in service after enactment of the bill, and coal-powered electricity using carbon capture and storage technology.
- Retail electric suppliers can submit renewable energy credits and energy efficiency credits as part of their obligation.

### Renewable Energy Standard

- The Renewable Energy Standard (RES) is 6% in 2012, ramping up to 20% in 2020, and remaining at that level until 2039
- Covered electric suppliers must use RECs for at least 75% of their obligation. They can also use energy efficiency credits for up to 25% of their obligation.
  - States may petition Federal authorities for an exemption if renewable energy supply is insufficient in their region. If the petition is successful, these states can then use up to 40% of their obligation from energy efficiency credits.
- In 2020, this equates to a 20% RES, with at least 15% of all electricity sold coming from RECs and up to 5% coming from energy efficiency credits. Should a state successfully petition for an exemption, then 12% can come from RECs and up to 8% from energy efficiency credits.

### Renewable Energy Sources

- The Federal government will issue one Federal renewable electricity credit for each megawatt hour of renewable energy generated from the following sources:
  - Wind energy,
  - Solar energy,
  - Geothermal energy,
  - Renewable biomass,
  - Biogas derived exclusively from renewable biomass,

- Biofuels derived exclusively from renewable biomass,
- Qualified hydropower (incremental increases to facilities placed in service after January 01, 1988),
- Marine and hydrokinetic renewable energy,
- Landfill gas,
- Wastewater treatment gas,
- Coal mine methane used to generate electricity at or near the mine mouth, and
- Qualified waste-to-energy.

### **Banking**

- Credits can be used in the compliance year in which they are issued, or for any of the three immediately subsequent compliance years.

### **Alternative Compliance Payment (ACP)**

- The bill contains an ACP of \$25, adjusted for inflation each year.

### **Existing State RPS Programs**

- States can retain systems that are more stringent than Federal program.

## **Cap and Trade Provisions**

### **Program Overview**

- 17% reduction in emissions from 2005 levels by 2020
- Ramps up to 83% reduction in emissions from 2005 levels by 2050
- Penalties for non-compliance: product of "shortfall" tons and twice the auction clearing price for the earliest vintage year emission allowances in the last auction carried out.
- Moratorium on implementation of state or regional climate trading programs (i.e. RGGI, California, WCI) from 2012 to 2017.
- Agricultural and Forestry sectors are exempt from compliance.

### **Allocation of Allowances**

- 80% of allowances are distributed without charge in early years
- 2012-2025 General Overview
  - 55% used to protect consumers from energy price increases (ie. distributed to utilities)
  - 19% to assist trade-vulnerable industries
  - 13% used to support investment in clean energy and energy efficiency
  - 10% for domestic adaptation
  - 3% auctioned for budget neutrality
- Free allocation starts to phase out after 2025
  - By 2031, 70% of allowances are auctioned

### **Allowance Auction**

- The EPA is authorized to hold quarterly auctions of allowances. The first auction must take place before March 31, 2011.
- Auction will be in a single round, sealed bid, uniform price format.
- There are no restrictions on who may participate in the auction, but no single entity can purchase more than 5% of allowances at the auction.
- Reserve Price
  - Auction has a reserve price of \$10 with an annual escalator of 5% plus the rate of inflation. This is considered by some market participants as a potential price floor.

## Banking/Borrowing

- Unlimited banking of allowances.
- Borrowing without interest one year forward (essentially creates a two-year compliance period).
- Borrowing with interest for up to five years.
  - 8% per year interest rate
  - Calculated by multiplying .08 x borrowed allowances x number of years borrowed forward

## Strategic Reserve

- Allowances are made available at auction ONLY to covered entities
- No one entity can buy more than 20% of allowances
- Reserve price
  - Auction has a reserve price of \$28 (plus 5% escalator for years 2012-2014)
  - From year 2015 and thereafter reserve price is 160% of the three-year average price of allowances

## International Linkage

- Entities can use allowances from comparable international programs (i.e. EU ETS)

## Offsets

- 2 billion tons of offsets may be used each year for compliance
  - Offsets can be submitted for compliance on a pro-rata basis by covered entities.
  - 1 billion offsets or "term" offsets from domestic sources
  - 1 billion from international sources. If insufficient domestic supply of offsets, an additional 500 million tons of international offsets available
  - Starting in 2017, international offsets must be submitted on a 1.25 ratio to emissions
- The bill creates a new offsets category: "term" offsets
  - "Term" offsets are domestic agriculture sequestration, time-limited offsets, with a maximum 5 year duration, that result in temporary compliance and a renewed liability post-expiration. Entities using term offsets have to provide financial assurances that liabilities will be covered post-expiration.
- Key Role for EPA
  - EPA determines eligible offset types and methodologies for non-agricultural sources
  - Establish an "Offsets Integrity Board" to ensure quality offsets
- Key Role for USDA
  - Establish eligible offset types and methodologies for domestic agricultural and forestry sources
  - Establish a "Greenhouse Gas Emissions Reduction and Sequestration Advisory Committee" to ensure quality offsets
  - USDA verifies and certifies offsets and sets up a registry for these offset classes
  - USDA-regulated agriculture and forestry offsets may have the following durations: up to 5 years for agricultural sequestration, up to 20 years for forestry sequestration, and up to 10 years for "other" practices.
- Additionality Definition
  - Reductions not already required by law
  - Activities commenced after Jan 01, 2009

- Exceed activity baselines for project types set by the EPA
- Early Offset Supply
  - Project commencing after Jan 01, 2009
  - Early Credits available from Jan 01, 2009 and for a period of three years
  - Issued under a program established under state law (effectively, CAR and RGGI)
  - Other protocol programs (i.e. CCX, VCS) can apply to EPA for eligibility
  - Trade-in value of pre-January 1, 2009, offsets from a qualifying program is the value, in emission allowances, of the average price of credits during the period from January 1, 2006 to January 1, 2009.
    - This section applies to all qualifying (and potentially qualifying) allowances credits, but it is particularly relevant for the conversion of credits held under RGGI and the CCX's voluntary program. Under the CCX, for instance, 2006 vintage credits the average price for this period is \$3.49 per credit. 2007 vintage credits are averaged at \$3.64 and 2008's are \$3.63.
- International Offsets
  - Sector-based credit system
  - EPA can make a determination to include credits from CDM
  - REDD available on bi-lateral basis from nations with forestry plans

### Market Regulation

- The CFTC is clearly defined as the regulator of carbon markets.
- Waxman's previous language, which would have mandated exchange trading except for primary offset transactions and potentially other non-standard carbon transactions, was replaced with language regulating all carbon transactions under the Commodity Exchange Act (CEA).
  - Under this amendment, carbon allowance, carbon offset, AND Federal REC transactions would be regulated under the CEA in a similar manner as agricultural commodities.
  - Agriculture commodities are subject to the most stringent form of regulation at the CFTC. For these commodities, the Commission mandates clearing except for unique transactions. The Commission also sets position limits and limits speculation.

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New York, US Emissions: +1 914-323-0255, GHG US: +1 914-323-0265

London, GHG: +44 (0)20 7264 4550

