

## CARBON ANALYSIS: Senate Introduces Climate Bill

*Closely Follows House-Passed Bill, but with Important Changes*



**October 01, 2009**

Yesterday, Senators Barbara Boxer (D-CA) and John Kerry (D-MA) introduced comprehensive legislation to encourage the development of clean energy sources and to reduce concentrations of greenhouse gas emissions. The measure closely resembles the "American Clean Energy and Security Act of 2009" authored by Congressmen Waxman and Markey, which passed the House of Representatives in June by a vote of 219 – 212. ([CLICK HERE](#) for a link to our analysis of the House-passed bill.)

The Senate bill has a more ambitious reduction target and incorporates important changes to offset provisions. It also takes a pass on some of the more controversial issues, such as allowance allocation, market oversight, and trade protection. The bill is referred to the Senate Environment & Public Works Committee, which is chaired by Sen. Boxer. The Committee will take up consideration of the bill next week.

Below is an initial overview of the carbon cap and trade provisions of the Boxer-Kerry bill. We will continue to provide you updates on its progress in the Senate. 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.

### Cap and Trade Provisions

#### Program Overview

- 20% reduction in emissions from 2005 levels by 2020.
- Ramps up to a 42% reduction from 2005 levels by 2030 and an 83% reduction in emissions from 2005 levels by 2050.
  - The program will begin in 2012 with 4.6 billion allowances, then gradually add covered sectors, and allowances increase to 5 billion by 2020.
  - The cap ratchets down quickly after 2020, and in 2030 the program will have 3.5 billion allowances. By 2050 it will have only 1 billion.
- Penalties for non-compliance: product of "shortfall" tons and twice the fair market price for the vintage year in which emission allowances were due.
- Moratorium on implementation of state or regional climate trading programs (i.e. RGGI, California, and WCI) from 2012 to 2017.

#### Allocation of Allowances

- Allocation will be made to benefit electricity and natural gas consumers, as well as trade-vulnerable industries. Allocation will also assist in clean energy investment, domestic adaptation, and energy efficiency.
- Specific allocation percentages were not included in the bill.

#### Allowance Auction

- The EPA is authorized to hold quarterly auctions of allowances. The first auction must take place before March 31, 2011, and auctions will include current year and future year allowances.
- 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.
- Compliance entities can borrow allowances up to 15% of a single year's emissions.
- Borrowing is permitted without interest one year forward (essentially creates a two-year compliance period).
- Entities can borrow 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.

### **Exchange of State-Issued Allowances**

- Holders of state-issued carbon allowances (i.e. RGGI or future California allowances) will be compensated for these allowances.
- State allowances will be exchanged for federal allowances at the average auction price of the state-auctioned allowance in the year they were issued.

### **Market Stability Reserve**

- Additional allowances are made available at quarterly auctions ONLY to covered entities as a means to control costs.
- No one entity can buy more than 20% of allowances.
- Reserve price
  - Auction has a reserve price of \$28, plus a 5% escalator for years 2013-2017.
  - From year 2018 and thereafter reserve price escalates at a rate of 7% per year.

### **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.
  - 1.5 billion offsets or "term" offsets from domestic sources.
  - 500 million from international sources. If there is insufficient domestic supply of offsets (i.e. less than 900,000 tonnes in a single year), an additional 750 million tons of international offsets can be made available.
  - Starting in 2018, international offsets must be submitted on a 1.25 ratio to emissions.
- The bill includes the "term" offsets category introduced in the Waxman-Markey bill.
  - "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.
- Key Role for EPA
  - EPA determines eligible offset types and methodologies for all sources.
  - Establish an "Offsets Integrity Board" to ensure quality offsets.
- Stimulating Early Offset Investment
  - Offset Advisory Board will provide EPA with a list of eligible offset types and methodologies within 90 days of establishment.
  - The bill includes a list of eligible offset types for EPA to consider in addition to the list provided by the Advisory Board. They are:
    - Coal mine methane,
    - landfill gas,

- fugitive emissions from oil and natural gas operations,
  - agriculture methane
  - afforestation (not forested since Jan. 01, 2009),
  - forest management,
  - farm practices (no-till/low-till, nitrogen reduction, organic farming, etc.), and
  - land use practices (grassland conservation, avoided forest conversion, urban tree planting, etc.).
- Crediting Period
  - 5 years for "term" offsets
  - 5 - 10 years for traditional offsets
  - 20 years for forestry offsets
- 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
  - Projects commencing after Jan 01, 2001, and credits issued under a program established under state law (effectively, CAR and RGGI).
  - Early Credits available from Jan 01, 2009 and for a period of three years.
  - Other protocol programs (i.e. CCX, VCS) can apply to EPA for eligibility.
- International Offsets
  - Sector-based credit system.
  - Offsets eligible only from developing countries with which the US has a bilateral or multilateral agreement.
  - EPA can broaden the list of eligible countries if insufficient supply of offsets or the allowance price is too high.
  - EPA can make a determination to include credits from CDM but only until 2016, when offsets must be made on a sectoral basis.
  - REDD available on bi-lateral basis from nations with forestry plans.

### Market Regulation

- The bill calls for the "sense of the Senate" that there should be an appropriate oversight program for carbon markets.
- The language is effectively taking a pass on the oversight issue for now.

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