

## Congress Prepares to Debate Climate Change Legislation This Fall

As Members of Congress return from their August recess and begin working on a packed agenda, climate change is one of the issues expected to receive continued attention. The committees of jurisdiction in both the Senate and the House will focus on climate change legislation, and the leaders of those committees have emphasized their interest in having climate bills considered on the floor of each chamber by the end of the year. Such a timetable, however, could be more ambitious than realistic. This issue alert highlights the key proposals – and the primary issues – that will be in play as Congress wrestles with climate change legislation this fall.

### SENATE CLIMATE CHANGE PROPOSALS: BINGAMAN/SPECTER AND LIEBERMAN/WARNER

The Chair of the Senate Committee on Environment & Public Works (EPW), Barbara Boxer (D-CA), has committed to hold a hearing in the near-term at which each of the Senate sponsors of climate change bills will have an opportunity to present their proposals. While there have been a number of bills introduced, the focus is likely to be on two leading proposals.

One is the “Low Carbon Economy Act of 2007,” which was introduced by Senators Jeff Bingaman (D-NM), Chairman of the Committee on Energy and Natural Resources, and Arlen Specter (R-PA) in July with endorsements from some major electric utilities and labor unions. The second is a 16-page outline of a cap-and-trade proposal by Senators Joe Lieberman (I-CT) and John Warner (R-VA) that was released in August. They have been collecting input on the outline and intend to introduce a bill for consideration in the fall. Chairman Boxer has said that the Lieberman/Warner bill, when ready, will be the primary vehicle in the EPW Committee.

Comparing the Bingaman/Specter and Lieberman/Warner proposals suggests where there has been a convergence in views on the design of cap-and-trade legislation, and also those key issues that have yet to be resolved.

### Emissions Targets

The Bingaman/Specter bill and the Lieberman/Warner outline would both establish cap-and-trade programs to limit emissions beginning in 2012. Bingaman/Specter calls for GHG reductions to 2006 levels by 2020. The Lieberman/Warner outline is somewhat more stringent, calling for a 10% reduction below 2005 levels by 2020. Both plans also envision consistent and steady emissions reductions through 2050.

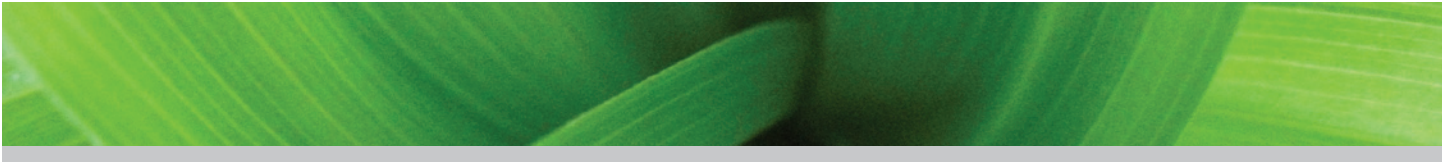
### Points of Regulation

The Bingaman/Specter bill would regulate carbon dioxide (CO<sub>2</sub>) emissions from petroleum and natural gas consumption

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on an “upstream” basis, by regulating petroleum refiners and natural gas processors. The bill would reach CO<sub>2</sub> emissions from coal consumption on a “downstream” basis, i.e., by regulating large consumers of coal (primarily coal-fired electric power plants).

The proposal by Senators Lieberman and Warner also would regulate petroleum on an “upstream” basis. However, they otherwise would regulate large sources of CO<sub>2</sub> emissions on a “downstream” basis. Their program would require practically all electric power plants to submit allowances. It also would regulate industrial and commercial facilities that emit 10,000 metric tons or more of CO<sub>2</sub>-equivalent GHG emissions per year.

### Allowance Allocation and Auction Provisions

The distribution of allowances (i.e., rights to emit) will be a significant and controversial issue in the Congressional deliberations. Both the Lieberman/Warner and Bingaman/Specter proposals have detailed provisions on the distribution of allowances – with some portion allocated for free and some portion auctioned. Under both programs, approximately three-quarters of allowances would be allocated at no cost in the first year and the remaining quarter would be auctioned. Under each proposal, the share of allowances auctioned would steadily increase over time while the percentage of free allocations would fall.

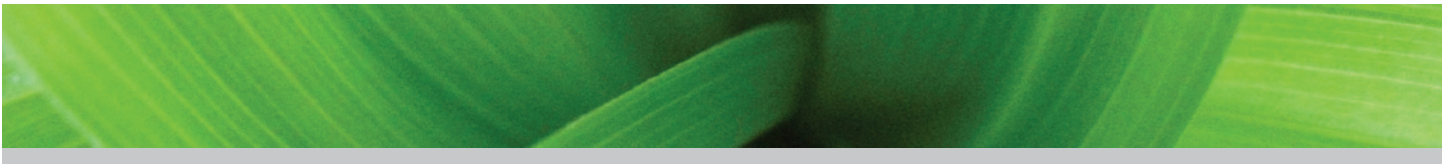
The proposals have different approaches for allocating allowances to individual facilities within industry sectors. In particular, they vary in their approach to allocation within the electric power sector; unlike the Bingaman-Specter proposal, Senators Lieberman and Warner propose to allocate a portion of the sector’s allowances to load-serving entities. Under each proposal, some allowances are also allocated to states and to create incentives for carbon capture and sequestration programs, for early reduction projects and for other initiatives. Moreover, both programs call for auction proceeds to fund low-carbon technologies, relief for low-income households, and climate change adaptation measures.

### Cost-Containment Strategies

Another key – and unresolved – issue is what kinds of mechanisms a climate bill will include for containing compliance costs.

The Bingaman/Specter bill includes a “safety valve” mechanism that allows regulated entities to pay a “technology accelerator payment” (TAP) in lieu of surrendering an allowance. The TAP price would begin at \$12 per metric ton of carbon dioxide-equivalent emissions and increase annually by 5% above the inflation rate. The TAP mechanism effectively would place an escalating ceiling on allowance prices.

The Lieberman/Warner outline eschews the safety valve in favor of “softer” cost containment strategies. The Senators have proposed a Carbon Market Efficiency Board, modeled after the Federal Reserve, to oversee the allowances market. In “extreme economic circumstances,” the Board could expand the quantity of available allowances, provided that the expansion is accompanied by a steeper reduction in the GHG cap in future years. Lieberman and Warner also have proposed that regulated entities have the ability to borrow a limited amount of allowances from their future allocations, subject to an interest rate. The Carbon Market Efficiency Board would have authority to set the interest rate and other terms for allowance borrowing.



## Offset and International Credit Provisions

Both proposals would allow for the use of offset credits for emission reductions achieved by projects outside the scope of the emissions cap. Bingaman/Specter would streamline approval procedures for certain types of projects and authorize the President to promulgate rules allowing a regulated entity to use allowances or credits from foreign programs to cover up to 10% of its annual allowance requirements.

Senators Lieberman and Warner propose to limit the use of domestic offset credits to 15% of a regulated entity's allowance requirements, but would have a slightly more generous limit for use of foreign credits than the Bingaman/Specter bill (15%).

Credit for offset projects could be a significant issue in the climate debate. Some NGOs have argued that there should be no or only very limited credits for offset projects, citing concerns about the environmental integrity of the trading market.

## Measures to Address Impacts on Trade and Competitiveness

A major emerging issue for climate legislation is how it addresses trade competitors that have not adopted comparable domestic caps on their GHG emissions. Both the Bingaman/Specter and Lieberman/Warner proposals embody the concept that the President may require importers of carbon-intensive goods from such countries to submit allowances in an amount sufficient to eliminate their economic advantage from not being subject to regulation. This concept likely will be further debated and developed during deliberations in the fall.

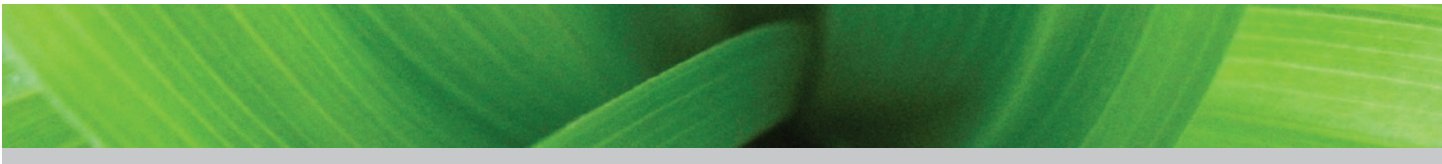
## Outlook

Chairman Boxer has emphasized her interest in moving a cap-and-trade bill through her Committee during this session of Congress. There are, however, a large number of very important policy design issues to be resolved. Already, a subcommittee markup planned for September has slipped to October.

Furthermore, even a committee-passed bill would need sufficient support from the full Senate (at least 60 votes) in order to overcome a likely filibuster. Given the considerable work needed to develop and build support for all the key elements of a comprehensive proposal, and the recent experience with the comparatively simple renewable portfolio standard, which appeared unable to attract 60 votes during the debate on energy legislation, it is difficult to imagine that a cap-and-trade bill could be passed by the Senate at this point in time. Nevertheless, while rapid passage seems unlikely, considerable behind-the-scenes efforts to refine climate legislation will continue.

## HOUSE CLIMATE CHANGE PROPOSALS: CAP-AND-TRADE AND CARBON TAX

The principal architects of climate change legislation in the House will be Representative John Dingell (D-MI), Chairman of the Committee on Energy and Commerce, and Representative Rick Boucher (D-VA), Chairman of the Subcommittee on Energy and Air Quality. Representative Boucher has set a goal of having a bill pass



through his subcommittee and the full committee process this fall, and Speaker of the House Nancy Pelosi (D-CA) recently said she wants to see a vote by the entire House on climate legislation by the end of 2007. However, it seems increasingly likely that this timetable will slip.

Little is known at this point about the bill that Representatives Boucher and Dingell are working on. Representative Dingell has expressed his views that both a cap-and-trade program and a carbon tax will be necessary for the U.S. to meet realistic emission reduction goals. However, only a cap-and-trade bill would be within the jurisdiction of his Committee.

In developing cap-and-trade legislation, the Members of the Energy and Commerce Committee likely will grapple with many of the same design issues that are before the Senate EPW Committee. Rep. Boucher has indicated that his cap-and-trade bill will start with a modest cap and become increasingly stringent toward 2050.

Efforts by the House Committee may be complicated by the fact that key Committee members will be representing the House in the House-Senate conference on energy legislation. Representative Boucher said recently that he believes the energy conference should be delayed until a cap-and-trade bill could be added, allowing for a consideration of a single energy-climate package during 2008. Other Members, however, may resist further complicating the already complex and controversial energy bill deliberation.

Another arena of activity will be the House Select Committee on Energy Independence and Global Warming, chaired by Representative Ed Markey (D-MA). While lacking jurisdiction to legislate, the Select Committee will be a continued source of hearings and investigations on climate policy issues.

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Van Ness Feldman has an experienced climate change and emissions trading team that assists a wide range of clients on policy, transactional, strategic and advocacy issues. The firm has been actively involved for clients in the development of climate change legislation. We are in a strong position to provide expert analysis and advice on the bills emerging in Congress, the surrounding policy and political debate, and the implications for your organization. If you would like more information, please contact Kyle Danish, Doug Smith, Robert Nordhaus, Stephen Fotis, or any member of the firm's Climate Change and Emissions Trading Practice group at (202) 298-1800.

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