

# KIRKLAND ALERT

July 2009

## The American Clean Energy and Security Act

### 1. Introduction

On June 26, 2009, the House of Representatives passed the American Clean Energy and Security Act, H.R. 2454 (“ACES”). The stated goals of ACES are to create clean energy jobs, achieve energy independence, reduce global warming pollution, and transition to a clean energy economy. In order to reach these goals, ACES includes measures addressing greenhouse gas (“GHG”) reduction, increases in renewable energy production and energy efficiency, transmission investment and upgrades, energy derivatives and market reform, and a nationwide building efficiency code.

ACES establishes the following objectives for the reduction of GHGs and renewable energy production and efficiency gains:

<b>Renewable Energy Production and Efficiency:</b>		<b>GHG Reduction:</b>	
2012-13	6%	2012	3% below 2005 levels
2014-15	9.5%	2020	17% below 2005 levels <sup>1</sup>
2016-17	13%	2030	42% below 2005 levels
2018-19	16.5%	2050	83% below 2005 levels
2020-39	20%		

ACES, if it becomes law, would create a cap-and-trade system of emissions allowances to achieve the above levels of GHG emissions. Covered Entities (as defined in section 2(a) below) would be required to limit their GHG emissions to levels equal to the number of allowances held by such Covered Entity. This may be achieved by a combination of allocated allowances, auctioned allowances, and eligible offsets. The allowances initially will be primarily allocated for free to utilities, coal-fired generators, domestic refineries, certain generation facilities with power purchase agreements that do not compensate for GHG emissions costs, and trade-vulnerable industries. After 2025, an increasing percentage of allowances will be auctioned, until by 2031 approximately 70 percent of the allowances will be auctioned. Allowances and offsets will be tradable and bankable, with some limitations.

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Additional changes made by ACES include sweeping changes to derivatives trading, modification of the transmission siting process, and regulation of motor vehicle and non-road vehicle emissions.

The Senate currently has no formal counterpart to ACES. However, the Senate Environmental and Public Works Committee is expected to mark up climate change legislation modeled on ACES before the August recess. The Senate leadership currently anticipates a vote on a climate change bill later in the fall.

The design of ACES impacts a broad swath of the federal regulatory landscape, including the

Environmental Protection Agency (“EPA”), Federal Energy Regulatory Commission (“FERC”), the Commodity Futures Trading Commission (“CFTC”), the Department of Energy (“DOE”), the Department of Transportation (“DOT”), the United States Department of Agriculture (“USDA”), and the Federal Trade Commission (“FTC”). Implementation is to be achieved through rulemakings at the various agencies. Additionally, ACES expands the regulatory authority of a number of agencies, including:

<p><u>EPA:</u></p> <ul style="list-style-type: none"> <li>♦ Authority to create cap-and-trade system for GHG emissions.</li> <li>♦ Authority to designate GHGs for cap-and-trade system.</li> <li>♦ Authority to regulate banking and trading of emissions credits for non-road vehicles and engines.</li> <li>♦ Authority to designate specific industries and entities eligible for emissions allowance rebates.</li> <li>♦ Authority to regulate emissions standards for motor vehicles and non-road vehicles and engines, including marine vehicles, trains, aircraft, and industrial and construction equipment.</li> <li>♦ Authority to award funding to freight carriers for low-GHG technologies and strategies.</li> </ul>	<p><u>FERC:</u></p> <ul style="list-style-type: none"> <li>♦ Cease and desist authority under the Federal Power Act (“FPA”), the Natural Gas Act (“NGA”) and the Natural Gas Policy Act (“NGPA”).</li> <li>♦ Temporary restraining order authority under the FPA, the NGA and the NGPA.</li> <li>♦ Authority to regulate and enforce emissions allowance and federal renewable electricity credit markets.</li> <li>♦ New transmission siting authority for the Western Interconnection.</li> <li>♦ Mandate to develop grid planning policies based upon low-GHG sources for use in interstate transmission planning proceedings.</li> <li>♦ Authority to create a national program to reduce peak electric demand for load-serving entities.</li> </ul>	<p><u>DOE:</u></p> <ul style="list-style-type: none"> <li>♦ Authority over expanded loan guarantee programs. Acquires superior lien-rights for all guaranteed loans.</li> </ul> <hr/> <p><u>CFTC:</u></p> <ul style="list-style-type: none"> <li>♦ Authority, with FERC, over the emissions allowance derivatives market.</li> </ul> <hr/> <p><u>USDA:</u></p> <ul style="list-style-type: none"> <li>♦ Authority to determine eligible domestic agriculture and forestry offsets and to regulate such offsets.</li> </ul> <hr/> <p><u>DOT:</u></p> <ul style="list-style-type: none"> <li>♦ Authority to require manufacturers to carry a minimum percentage of fuel-choice vehicles.</li> </ul>
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## 2. GHG Cap and Trade System

### (a) Targets for Reductions in GHG Emissions

ACES will create targets for the reduction of GHG emissions from domestic sources starting in 2012. This will be achieved with a cap-and-trade system using a set number of emissions allowances based upon carbon dioxide equivalency of specified GHG emissions. These emissions allowances will be bankable and tradable, with the allowance market regulated by FERC. Emissions allowances initially will be allocated free of charge to various carbon emitting stakeholders, and eventually will be mostly auctioned with a set price floor per allowance. Covered GHGs include: carbon dioxide, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons from a chemical manufacturing process at an industrial stationary source, perfluorocarbon, nitrogen trifluoride, and other gases designated as a GHG by the EPA. Each GHG's global warming equivalency for purposes of emissions allowances is defined in terms of the equivalent amount of carbon dioxide that would yield the same global warming impact. New GHGs may be listed by a petition process and EPA review of the gas' contribution to global warming.

As of January 1, 2012, with a few exceptions, each electricity source, fuel producer and importer, and industrial gas producer and importer emitting more than 25,000 tons per year of carbon dioxide equivalent emissions (each, a "Covered Entity"), is prohibited from emitting GHGs in excess of the equivalent level of emissions allowances or offset credits it holds as of April 1 of the following calendar year.

In order for a Covered Entity to comply with the individual emissions allowance requirement, it may obtain allowances via free allocations, purchases from an auction, or from the emissions allowances market. A Covered Entity may also obtain tradable offset credits that are created from eligible forestry and agriculture projects as defined by the EPA and USDA. If a Covered Entity fails to obtain the required number of allowances or offsets, it will be liable for a penalty of two times the auction clearing price for the earliest vintage year emissions allowances in the last auction prior to the deadline such entity failed to meet, in

addition to other non-compliance penalties.

### (b) Allocation of Emissions Allowances

The original cap and trade proposal called for auctioning all emissions allowances at an estimated cost of \$646 billion over ten years. However, to win passage of ACES, major concessions were made regarding the quantity of allowances to be allocated "free" rather than sold through auctions. Until 2025, electric and natural gas utilities and home heating oil suppliers will receive approximately 50 percent of the emissions allowances for each vintage year. The justification for these free allocations is to protect customers of these utilities from rate increases associated with the cost of emissions allowances.

Allowances are also set aside for a wide variety of uses including: promoting energy efficiency, renewable energy research and implementation, assistance to low income persons and displaced workers, and preventing negative impacts on the competitiveness of domestic energy-intensive, trade-vulnerable industries. Some specific emissions allowances allocations are as follows:

- ♦ Generation facilities that are subject to power purchase agreements that were executed prior to March 1, 2007 and do not compensate the generator for GHG emissions costs will receive emissions allowances. The generation facility must be: (i) a FERC defined small power producer or qualifying facility; (ii) an independent power producer subject to FERC rate regulation; or (iii) owned by an electric cooperative. Such generation facilities will receive allowances equal to the carbon dioxide emitted from the generation of electricity and, if applicable, useful thermal output. As noted below, coal-fired generators are granted a specific allowance allocation. However, coal-fired generators are not specifically excluded from the more favorable independent power producer definition;
- ♦ A coal-fired generator that is subject to FERC rate regulation will receive allowances equal to 50 percent of its emissions based on its average emissions from 2006-2008, with the number

of allowances declining each year through 2029 at the same rate as those allowances available to the electric industry generally;

- ♦ Domestic refineries are allocated two percent of the allowances for each vintage year;
- ♦ Owners and operators of entities in eligible industrial sectors may receive allowances for their compliance costs. The EPA determines which entities are eligible for rebates based on an assessment of economic factors, including whether the industrial sector meets or exceeds (i) a threshold for energy or GHG intensity; and (ii) a threshold for trade intensity; and
- ♦ Deployment of carbon capture and sequestration technology generally will be allocated 1.75 percent of allowances in 2014, rising to approximately five percent from 2018 through 2025.

After 2025, an increasing percentage of allowances will be auctioned, until by 2031, approximately 70 percent of the emissions allowances will be auctioned. During an emissions allowance auction, there are a few restrictions upon the participants. No party may, individually or jointly, purchase more than five percent of the allowances offered at any auction. Additionally, the minimum reserve price for each allowance will be \$10, increasing each year by five percent plus the consumer price index.

#### (c) Offsets

ACES will create a system of GHG offset credits from agriculture, forestry, and other projects. These offsets are tradable and bankable like emissions allowances and can be used to satisfy Covered Entities' emissions allowance requirements. These offsets will be created from authorized domestic projects designated by the EPA or USDA, or from international projects designated by the EPA in consultation with other agencies. Covered Entities may use offsets for reductions of up to 2 billion tons of GHG emissions annually divided pro rata. Half of the offset credits must come from domestic sources. One domestic offset credit or 1.25 international offset credits will be equivalent to one emissions allowance, provided that

prior to 2018, one international offset credit shall be equivalent to one emissions allowance.

The EPA will create a list of eligible offset projects, taking into account recommendations from an independent advisory board. The base requirements for offset projects as laid out in ACES are that each project: (i) is not undertaken to comply with any law, regulation or consent order; (ii) generally was not commenced before January 1, 2009; and (iii) exceeds an EPA determined "activity baseline" of carbon sequestration for that respective project. For international offset credit projects, EPA shall coordinate with the Secretary of State and the United States Agency for International Development to promulgate eligible projects.

Notwithstanding the above, the USDA will have sole authority to govern the generation of offset allowances from domestic agriculture and forestry sources. USDA will create a list of specified activities, such as cover cropping or reduced deforestation, that qualify for agricultural offsets.

ACES also will assist the agriculture sector by limiting EPA's analysis of indirect emissions resulting from domestic production of ethanol. Under this provision, the international impacts from increased corn production will not be considered in analyzing the GHG effects of ethanol production. The offset program will analyze domestic indirect emissions. This provision is a reversal of the Energy Independence and Security Act of 2007 that required EPA to analyze indirect emissions in foreign countries. Further, ACES exempts existing biodiesel plants from requirements to analyze life-cycle emissions of GHGs, and also expands the definition of biomass energy in existing law.

#### (d) Trading of Emissions Allowances

##### (i) Regulation of Trading

FERC is required to promulgate regulations no later than 18 months after the enactment of the legislation for the establishment, operation, and oversight of markets for regulated allowances, including emissions allowances and offset credits. The goal of such regulations is to, among other things, establish position limits for market participants, limit or eliminate

counterparty risk for trading outside of trading facilities, and prohibit fraud and manipulation. FERC's enforcement power will include the ability to suspend an entity's trading in regulated allowances for six months, assess fines of up to \$1 million per day, and order disgorgement of unjust profits.

To defray costs of administering the trading of regulated allowances, each trading facility on which the regulated allowances trade will pay FERC \$15 per \$1 million of trades of regulated allowances.

The President is to convene an interagency working group within 30 days of the enactment of the legislation so that, no later than 180 days after such enactment, a written report can be provided that includes recommendations to the President and Congress regarding CFTC regulations for the establishment and oversight of derivatives markets for regulated allowances.

#### (ii) Banking

Regulated allowances may be banked indefinitely, unless the EPA determines that any such allowance should be retired to preserve the authenticity and integrity of allowances. Covered Entities may borrow allowances from future vintages. However, vintages must be no more than five years from the compliance period and such entity may use borrowed future allowances for no more than 15 percent of its compliance obligation. In addition, Covered Entities will be charged "interest" by retiring other allowances they hold in the amount of .08 multiplied by the number of years between the compliance period and the vintage used. There will also be a strategic reserve of allowances that would be available for auction if clearing prices exceed 160 percent of a three-year price average.

#### (e) Emissions Allowance Program Reporting

##### (i) EPA Reporting

The EPA is to issue a report no later than July 1, 2013, and every four years thereafter, on global climate change analysis based on the latest scientific data, capabilities to monitor and verify GHG reductions worldwide, and an analysis of the progress of

worldwide efforts to reduce GHG emissions. If the report concludes that the U.S. will not achieve the GHG emissions reductions or that global activities will not maintain safe global average temperature and GHG thresholds, the President shall no later than July 1, 2015, and every four years thereafter, submit to Congress a plan indentifying domestic and international actions to achieve necessary additional GHG reductions.

##### (ii) GHG Registry

As a necessary prelude to a cap-and-trade system and building on the EPA's proposed GHG reporting rule under the current Clean Air Act ("CAA"), ACES creates a federal GHG registry which would require reporting entities<sup>2</sup> to submit data relating to: (i) GHG emissions; (ii) the production, manufacture, and potential export of fuels and industrial gases which may result in GHG emissions; (iii) deliveries of natural gas; and (iv) the capture and sequestration of GHGs.

Additionally, any entities that deliver electricity to facilities in energy-intensive industries that meet certain GHG intensity criteria will also be required to report the above data.

#### (f) Coal-Fired Generation

##### (i) Performance Standards for Coal-Fired Power Plants

Section 116 of ACES requires that coal-fired power plants (30 percent or more fuel is coal and/or pet-coke) receiving a CAA preconstruction approval or permit between January 1, 2009 and January 1, 2020 must achieve a 50 percent reduction in carbon dioxide emissions produced by the unit by the earlier of January 1, 2025 or a date four years after certain technological and project hurdles have been met. These hurdles include two commercial projects over 250 megawatts that capture or sequester carbon dioxide in a geologic formation other than an oil and gas field and a total capture and sequestration of over 12 million tons of carbon dioxide per year in the aggregate.

##### (ii) Carbon Capture & Sequestration

Under Section 115 of ACES, a carbon capture and

sequestration project may receive emissions allowances. To qualify, a project must, among other things, implement technology that meets all permitting and certification requirements for geologic sequestration generated by the EPA, have a nameplate capacity over 200 megawatts (and if a retrofit, the technology must apply to flue gas from over 200 megawatts of capacity), derive at least 50 percent of its fuel from coal and/or pet-coke, and achieve a 50 percent reduction in emissions of carbon dioxide. Qualifying projects will only receive carbon dioxide emissions allowances for their first 10 years of operation. In total, only 72 gigawatts of capacity is eligible for emissions allowances and the allowances must be distributed for carbon dioxide already sequestered or captured.

Carbon dioxide emissions allowances for carbon capture and sequestration at industrial sources may be no more than 15 percent of all carbon capture and sequestration emissions allowances. Industrial source emissions allowances will be distributed through a reverse auction or on an incentive basis based on regulations to be promulgated by the EPA.

#### (g) Transportation Emissions Regulations

Title II, Subtitle C of ACES focuses on the creation and implementation of regulations and programs designed to reduce GHG emissions by mobile sources, including motor vehicles, motor vehicle engines and non-road vehicles and engines, including marine vessels and locomotives, and aircraft and aircraft engines.

##### (i) Non-road Vehicle and Engine Emissions Regulation

ACES requires the EPA to identify classes or categories of non-road vehicles or engines that, in the judgment of the EPA, both contribute significantly to the total emissions of GHGs and provide the greatest potential for significant and cost-effective reductions in the emissions of GHGs. Non-road vehicles and engines can include: (i) commercial and recreational marine vessels; (ii) locomotives and locomotive engines; (iii) aircraft and aircraft engines; (iv) industrial and construction equipment and vehicles; and (v) other equipment and vehicles (other than motor vehicles) fueled by diesel fuel, gasoline, propane or natural gas

and used for mining, railway maintenance, logging, and other commercial or recreational purposes.

The EPA is required by December 31, 2012 to publish regulations relating to standards for the emissions of GHGs from such non-road engines and vehicles. Further, the EPA is authorized to establish provisions for averaging, banking and trading GHG emissions credits within or across classes or categories of motor vehicles and motor vehicle engines and non-road vehicles and engines.

##### (ii) National and State Emissions Reductions Goals

Under Section 222 of ACES, the EPA, in consultation with the Secretary of Transportation, will be required to publish final regulations to establish:

- ♦ National GHG emissions reduction goals relating to the transportation sector;
- ♦ Standardized models and methodologies for use by states and metropolitan areas in setting targets for GHG emissions reduction in transportation planning; and
- ♦ Methods for collecting data to measure the achievement of such targets and goals through improvements in vehicle efficiency, the performance of transportation fuels, increased efficiency in utilizing transportation systems, and the effects of local and state planning.

Under this section, Sections 134 and 135 of title 23 of the United States Code would be amended to require state and metropolitan transportation planning organizations to consider projects and strategies that would:

- ♦ Reduce surface transportation-related GHG emissions;
- ♦ Reduce reliance on oil; and
- ♦ Adapt to the effects of climate change.

Further, as part of their transportation planning process and programs, state and local governments are

required to develop (i) GHG emissions reduction targets; and (ii) strategies to meet such targets, in each case, based on the models and methodologies developed by the EPA and in compliance with the national reduction goals for the transportation sector as published by the EPA. If a state or local planning organization fails to demonstrate progress in stabilizing and reducing transportation-related GHG emissions in their respective planning area, it would risk losing federal funding for state or local transportation-related plans and programs.

(iii) Freight Carrier SmartWay Programs

Section 223 of ACES expands the EPA’s existing SmartWay Transport Partnership program (which currently focuses on trucking operations) to include freight carriers operating rail, marine and other freight operations. The EPA is also authorized to establish a SmartWay Financing Program, which would allow the EPA to competitively award funding to eligible entities for the purpose of adopting low-GHG technologies or strategies in the mobile source sector, which includes motor vehicles and engines as well as non-road vehicles and engines. The EPA will develop the design and requirements of the program.

**3. Renewable Portfolio Standard**

ACES amends the Public Utility Regulatory Policies Act (“PURPA”) by adding a new Section 610, which creates a federal combined efficiency and renewable energy standard. Qualified renewable generation will create one federal renewable electricity credit for each megawatt-hour of electricity generated by the renewable facility, except that qualified renewable distributed generation will create up to three federal renewable electricity credits for each megawatt-hour of electricity generated by the renewable facility. Renewable electricity is electricity generated from:

- ♦ Wind;
- ♦ Solar;
- ♦ Geothermal;
- ♦ Renewable biomass;

- ♦ Biogas derived exclusively from renewable biomass;
- ♦ Biofuels derived exclusively from renewable biomass;
- ♦ Qualified hydropower;
- ♦ 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.

Additionally, retail electricity providers will be able to meet their annual obligation partially through demonstrated electricity savings. A retail electricity provider must meet at least 75 percent of its annual target through federal renewable electricity credits. However, the governor of any state may submit a petition to FERC seeking an increase in the percentage of such state’s retail electricity providers’ annual combined efficiency and renewable energy standard met through electricity savings, provided such percentage may not exceed 40 percent. Section 610 sets the annual combined efficiency and renewable energy standard at:

<u>Year:</u>	<u>Annual Obligation:</u>
2012-13	6%
2014-15	9.5%
2016-17	13%
2018-19	16.5%
2020-39	20%

Section 610 establishes an alternative compliance payment of \$25 in lieu of each federal renewable electricity credit or megawatt-hour of electricity savings. Failure to comply with the combined efficiency and renewable energy standard, either through the submission of credits and electricity

savings or through the alternative compliance payment, may result in penalties of two times the alternative compliance payment for any shortfall. FERC also is granted the authority under the FPA to levy civil penalties for failure to comply with any requirement, regulation or order issued under Section 610.

Section 610 includes a number of provisions addressing ownership of federal renewable electricity credits. For renewable generation from projects supported by payments from retail electricity suppliers pursuant to state renewable electricity programs, FERC must issue a pro rata portion of the project's federal renewable electricity credits to the relevant retail supplier, with such pro rata portion determined pursuant to regulations issued by FERC. Where a generator sells renewable electricity to a retail supplier under a contract entered into before the enactment of Section 610 and such contract is silent as to the ownership of federal renewable electricity credits associated with the generation under the contract, FERC is to issue all federal renewable electricity credits to the retail supplier for the duration of the contract.

Federal renewable electricity credits may be traded or banked for a period of three years following the year in which such credit was created. Similarly, electricity savings may be transferred by contract. However, there is no provision for banking electricity savings.

Section 610 includes a savings clause permitting states, political subdivisions of a state, and Indian tribes to adopt standards more stringent than set forth in Section 610. The savings clause further clarifies that Section 610 does not diminish such entities' authority to regulate the acquisition or disposition of federal renewable electricity credits by retail electric suppliers subject to the jurisdiction of such state, political subdivision, or Indian tribe.

FERC is to promulgate implementing regulations within one year of the enactment of Section 610.

#### 4. FERC Cease and Desist Authority

ACES includes amendments to the enforcement provisions of the FPA, the NGA, and the NGPA providing FERC with the authority, after notice and hearing, to issue an order requiring that any entity that

“may be violating, may have violated, or may be about to violate” any provision of the FPA, the NGA, or the NGPA or any rule, regulation, restriction, condition, or order made or imposed by the Commission thereunder:

- ♦ Cease and desist from committing such violation or any future violation of the same provision, rule, or regulation;
- ♦ Comply with or take steps to effect compliance with such provision, rule, or regulation; and
- ♦ Provide an accounting and disgorgement.

**ACES relieves FERC from the notice and hearing requirements prior to entering any such order should it determine that such notice and hearing is impracticable or contrary to the public interest.**

Additionally, ACES includes amendments to the enforcement provisions of the FPA, the NGA, and the NGPA **providing FERC the authority to issue temporary orders requiring the respondent to take such actions, pending completion of the proceeding, as FERC deems appropriate** to prevent:

- ♦ Dissipation or conversion of assets;
- ♦ Significant harm to energy consumers;
- ♦ Substantial harm to the public interest;
- ♦ Frustration of FERC's ability to conduct the relevant proceedings; or
- ♦ Frustration of FERC's ability to redress the violation at the conclusion of the proceedings.

#### 5. CFTC Regulation of Energy Derivatives

The Additional Market Assurance provisions of ACES (Sections 351-358) include substantial changes to the energy derivatives market. If enacted, these provisions will fundamentally alter how energy companies transact business by:

- ♦ Requiring that certain energy transactions be cleared through a derivatives clearing organization (“DCO”);

- ♦ Imposing substantial collateral requirements as a result of such energy transactions being cleared through a DCO; and
- ♦ Imposing speculative position limits and reporting requirements on energy companies.

Sections 351-358 almost exclusively amend the Commodity Exchange Act (“CEA”), the federal statute that provides a regulatory structure for the commodity futures and options markets under the jurisdiction of the CFTC. The purpose of these provisions is twofold: (i) to curb speculation that many believe creates high prices; and (ii) to regulate over-the-counter (“OTC”) derivatives. The drive to regulate the OTC market stems from the problems created by the credit default swap market. These provisions, if ultimately adopted, would subject a substantial number of energy transactions to a host of new regulatory requirements, including mandatory clearing through a CFTC-regulated clearing organization and continuing reporting requirements. The result would be substantial increases in collateral and transaction costs associated with many transactions.

ACES defines as energy commodities under the CEA: coal, crude oil, gasoline, diesel, jet fuel, heating oil, propane, electricity (other than FERC regulated financial transmission rights), natural gas, and any other substance the CFTC determines to be a source of energy. ACES then provides that the only way to exempt an energy commodity transaction from the CEA’s exchange-trading requirement is through a CFTC exemption. None of the previously enacted CEA statutory exclusions or exemptions is available for bilateral energy commodity transactions. ACES would therefore create the risk that any off-exchange bilateral energy transaction could be declared illegal under the CEA.

To avoid having an OTC energy transaction declared an illegal, off-exchange contract, such OTC energy transactions must qualify for a CFTC exemption from the statutory exchange-trading requirement. Under ACES, an exemption from the exchange-trading requirement would be available only for transactions that are cleared on a DCO (such as the Chicago

Mercantile Exchange or the IntercontinentalExchange). The CFTC could exempt energy transactions from the statutory clearing requirement if the CFTC determines the energy transaction is either (i) a spot or forward transaction; or (ii) eligible for a “highly customized” waiver. The “must be cleared” requirement applies to all energy derivative transactions whether executed through an electronic trading facility or on a principal-to-principal basis (by phone, email, or fax) or through a voice broker or inter-dealer broker. Under ACES, a spot or forward transaction includes “an agreement, contract, or transaction of any cash commodity for immediate or deferred shipment or delivery, as defined by the [CFTC].” This exclusion likely would cover, for example, bilateral transactions for the purchase of fuel for physical delivery or the sale of electricity for physical delivery. In effect, if an energy transaction is a CFTC-defined spot or forward contract, the CEA’s exchange-trading requirement will not apply and, even if it did, the spot or forward contract would be exempt from the clearing requirement.

Energy transactions that are not spot or forward contracts must either receive the CFTC-defined “highly customized” waiver or be cleared on a DCO. The CFTC may grant the “highly customized” waiver only for transactions that are entered into infrequently by parties with demonstrated financial integrity and do not serve a price discovery function. Customized transactions that receive the waiver must be reported to the CFTC.

Neither the spot or forward transaction exemption nor the “highly customized” waiver is likely to be available to index-based derivatives executed through standardized agreements, such as an ISDA. It appears that the sponsors of ACES intend such transactions to be required to be cleared through a DCO. **For transactions cleared through a DCO, the clearing parties will be subject to the collateral requirements of the DCO and its clearing members.** ACES also provides a transition rule that requires reporting to the CFTC for all non-cleared energy transactions entered into before or within 150 days after the enactment of ACES. **As such, existing transactions would become subject at least to the reporting or clearing provisions of ACES.**

ACES also would subject OTC energy transactions to CFTC-set speculative position limits as well as reporting rules and transaction fees. In addition, ACES would (i) allow FERC and the FTC to trump the CFTC's exclusive jurisdiction over futures markets for purposes of price manipulation; (ii) impose the "must be cleared" rules on interest rate, currency, equity, and agricultural commodity swaps; and (iii) effectively ban credit default swaps in the U.S.

If Congress subsequently passes separate legislation addressing derivatives regulatory reform, Sections 351-52 and 354-57 are to be repealed and any regulations promulgated under these Sections will become null and void.

## 6. FERC Transmission Siting Authority and Smart Grid

### (a) FERC Transmission Planning and Siting Authority

Section 151 of ACES directs FERC to implement changes to the regional transmission planning process, with greater attention placed on grid infrastructure. These efforts also significantly change FERC's role in the planning of the electric grid in the states of the Western Interconnection (including the authority to preempt state siting decisions).

### (i) National Electricity Grid Planning Principles

ACES adds Section 216A to the FPA that declares it the policy objective of the federal government that regional electric grid planning should further the use of renewable and other zero-carbon and low-carbon energy sources for generating electricity, with the aim of reducing GHG emissions while ensuring reliability, reducing congestion, ensuring cyber-security, minimizing environmental harm, and providing for cost-effective electricity services in the U.S. This policy states that regional electric grid planning should result from an open and transparent process, while taking into account all significant demand-side and supply-side options, including energy efficiency, distributed generation, renewable energy, zero-carbon electricity generation technologies, smart-grid technologies and practices, demand response, electricity storage, voltage

regulation technologies, and other enhanced and high-capacity transmission technologies. ACES directs FERC to issue rules within one year of enactment adopting these policies as National Electricity Grid Planning Principles to be applied in ongoing and future proceedings that implicate interstate transmission planning.

After FERC issues final rules on National Electricity Grid Planning Principles all regional grid planning entities are required to submit initial regional transmission grid plans to FERC no later than 18 months after the promulgation of FERC's final rules, subject to three-year updating thereafter.

ACES also provides FERC and/or DOE with the following transmission planning mandates:

- ♦ FERC must "encourage" regional planning entities to "cooperate and coordinate" grid planning across regions and overlapping jurisdictions to further FERC's national electricity grid framework;
- ♦ FERC is granted the authority to resolve any conflicts among regional grid plans;
- ♦ FERC must incorporate the new federal policy objectives into any ongoing planning efforts undertaken (including under Order No. 890, which required all transmission providers to amend their OATTs to implement transmission planning principles, and Section 217 of the FPA, in addressing transmission rights held by load-serving entities);
- ♦ FERC must coordinate with DOE, including when DOE carries out its functions to designate national interest electric transmission corridors (now, only in the Eastern Interconnection, as described below) under Section 216 of the FPA; and
- ♦ FERC and DOE are directed to provide technical and other assistance to regional planning entities.

(ii) New Siting Authority for the Western Interconnection

ACES modifies the FPA's existing provisions on siting electric transmission facilities, with an entirely new regime for projects in the Western Interconnection. The bill first modifies FERC's general "backstop" transmission siting authority found in existing Section 216 of the FPA, by adding to FERC's required findings that the transmission facility is interstate in nature or is an intrastate segment that is "integral" to an interstate facility. This change, however, would apply only to FERC siting actions for projects in the Eastern Interconnection, as ACES establishes new provisions applicable to Western Interconnection projects.

ACES would both exempt the Western Interconnection region from DOE's power to designate national interest electric transmission corridors, and create a new and separate statutory scheme in Section 216B of the FPA governing FERC authority over siting and construction of transmission facilities in the West. This new process for FERC siting authority would empower FERC to grant, after hearing, a certificate of public convenience and necessity ("CPCN") for the construction or modification of an interstate transmission facility in the Western Interconnection upon making certain findings. FERC would also be required to issue new rules to govern the Western CPCN process.

The findings FERC must make in issuing a CPCN include that the proposed transmission facility was identified in one or more regional or interconnection-wide electric grid plans submitted to FERC under the National Electricity Grid Planning Principles instituted under new Section 216A of the FPA. FERC must also find that the facility was identified as "needed in significant measure" to meet demand for renewable energy in such plans. Finally, among other requirements, FERC must find that the project developer submitted a siting application with the relevant state or other authorities, and that the relevant entity either (i) did not issue a final decision within one year; (ii) denied the application; or (iii) authorized the facility subject to "conditions that unreasonably interfere" with its development. **Notably, unlike FERC's previous siting authority, this new siting**

**power granted with respect to the Western Interconnection expressly authorizes FERC to preempt state entity decisions denying a transmission project siting application.**

In exercising its new CPCN authority in the Western Interconnection, FERC is also directed to incorporate siting constraints and mitigation measures geared toward the protection of the environment identified by state or local authorities, such as related to project routing, except to the extent FERC determines that they would be "infeasible, excessively costly," or inconsistent with the announced federal policy objectives for electric grid planning in new Section 216A of the FPA.

The new scheme for transmission siting in the Western Interconnection grants FERC the same responsibilities for coordination of federal authorizations and environmental reviews (including by serving as the lead agency) as were previously granted to DOE for federal coordination over transmission projects sited under Section 216 of the FPA (and DOE's role will be only with respect to the Eastern Interconnection). FERC's role in siting Western projects includes, consistent with the existing Section 216, providing a mechanism for prospective applicants to confer with the agencies involved regarding the likelihood of CPCN approval and key issues of concern.

(b) Peak Load Reduction for Load-Serving Entities ("LSEs")

Section 144 of ACES will require FERC to coordinate and support a national program to reduce peak electric demands for LSEs with peak loads in excess of 250 megawatts. This program will set goals that assume an aggressive effort to deploy smart grid and peak demand reduction technologies and methods. The applicable baseline is the average of the highest three annual peak demands experienced by the LSE since 2004. Participation by smaller LSEs is voluntary.

An LSE may reduce peak demand through (i) diminishing the end-use requirements for electricity; (ii) use of locally stored energy or distributed generation; or (iii) energy savings from use of smart grid technologies.

FERC may, for good cause, relieve an LSE of the peak demand reduction requirements and has the authority to modify the process of establishing peak demand reduction goals and accept adjustments to the goals as appropriate when sought by LSEs.

## 7. Investment Incentives and Support

### (a) DOE Loan Guarantee Program

The Energy Policy Act of 2005 (“EPAAct 2005”) established a loan guarantee program administered by the DOE (the “DOE Loan Guarantee Program”). The American Recovery and Reinvestment Act of 2009 (“ARRA”) passed in February 2009 created a temporary, separately funded expansion of the DOE Loan Guarantee Program to focus on loan guarantees for renewable technology projects (the “DOE Loan ARRA Expansion”).

#### (i) Reforms To Loan Guarantee Program

ACES includes several important provisions that reform the operations of the loan guarantee program. These reforms include: (i) conditional commitments are now permitted, allowing negotiated term sheets for guarantee agreements to become binding upon completion of all conditions precedent; and (ii) DOE will now have superior lien-rights to any other person with respect to property acquired by DOE pursuant to a guarantee or related agreements. Further protections for DOE are required in the terms of agreements, including availability of technology and patents for DOE in the event of project default.

#### (ii) Expansion of Loan Guarantees

The DOE Loan Guarantee Program and DOE Loan ARRA Expansion are both amended to include advanced transmission property and manufacturing facilities for such property placed in service prior to December 31, 2016. Qualified transmission property must be either: (i) high voltage cable and related facilities that are determined by the Secretary of Energy to use ultra low resistance materials allowing transmission of at least five gigawatts for more than 300 miles with less than three percent energy loss; (ii)

high-voltage cable and related facilities that are determined by the Secretary of Energy as suitable for transmission lines up to 765kV and exhibit power losses at least 30 percent lower than traditional copper lines; or (iii) manufacturing facilities for the above transmission property.

The DOE Loan Guarantee Program has been expanded to expressly permit loan guarantees for renewable fuel pipelines (*e.g.*, ethanol and biodiesel).

### (b) Clean Energy Deployment Administration

ACES establishes the Clean Energy Deployment Administration (“CEDA”) as an independent, government-owned entity that is initially capitalized with \$7.5 billion of “Green Bonds.” CEDA’s goals are to provide financing for widespread deployment of: (i) clean energy technologies; (ii) advanced or enabling energy infrastructure technologies; (iii) energy efficiency technologies in residential, commercial, and industrial applications; and (iv) manufacturing technologies for anything described in (i) through (iii).

CEDA may issue direct support in the form of direct loans, letters of credit, or loan guarantees for projects. CEDA may also provide indirect credit support for portfolios of taxable debt obligations of private entities that enable the deployment of energy storage for electric drive vehicles, stationary applications, and electricity transmission and distribution.

Eligible projects will be reviewed by CEDA for: (i) maximizing clean energy per dollar invested; (ii) the project fit with the goals of CEDA; (iii) the potential for successful completion of the project; and (iv) insufficient commercial lending availability.

### (c) Automotive Incentives

ACES will allocate emissions allowances for plug-in electric drive vehicles. Further, each state regulatory authority and non-regulated utility must develop a plan and standards to support plug-in electric drive vehicles, including vehicle-charging infrastructure that is interoperable with all automobile manufacturers’ products within four years of the enactment of ACES.

ACES also increases from \$25,000,000 to \$50,000,000 direct loans to automobile manufacturers and component suppliers for re-equipping, expanding, or establishing a manufacturing facility in the United States to assist in the production of qualifying advanced technology vehicles and qualifying components. Additionally, the Secretary of Transportation is required to promulgate regulations requiring manufacturers of passenger and non-passenger automobiles to carry a minimum percentage of fuel-choice enabling vehicles (vehicles able to run on biodiesel, E85 or M85) in inventory, if fuel-choice vehicles are considered a cost effective way to achieve energy independence by the Secretary of Transportation in consultation with EPA and DOE. Additionally, funds allocated to programs under EPA Act 2005 to reduce diesel emissions are extended until 2016.

(d) Carbon Capture & Sequestration Corporation

The Carbon Storage Research Corporation (“CSRC”) is to be created by a referendum by the Edison Electric

Institute, American Public Power Association, or the National Rural Electric Cooperative Association upon approval by entities representing two-thirds of the total quantity of fossil fuel-based generation delivered to retail consumers, barring a state regulatory authority veto by more than 40 percent of the states. The CSRC will have the authority to levy an assessment, based on the amount of fossil fuel based electricity delivered to retail customers, for a 10-year period beginning six months after enactment of ACES. The CSRC will use the assessments to award grants, contracts and financial assistance to support commercial-scale demonstrations of carbon capture and storage technologies.

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- 1 Section 311 of ACES differentiates between economy-wide GHG reduction goals and GHG reduction targets from capped sources. These GHG reduction levels are identical except for 2020. In that year, the economy-wide GHG reduction goal is 20% below 2005 levels, while the GHG reduction target from capped sources is 17% below 2005 levels.
  - 2 Reporting entities include all Covered Entities and any entities the EPA may require to report.

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