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5 Things Corporate Counsel Should Know About EPA's Clean Power Plan

From the Experts

Cameron Prell and Sherrie A. Armstrong

On Aug. 3, the U.S. Environmental Protection Agency (EPA) released a groundbreaking package of rules regulating carbon dioxide (CO_2) emissions from coal- and gas-fired power plants. That package includes the Clean Power Plan, which mandates aggressive CO_2 emission reductions for existing electric generating units (EGUs) under Section 111(d) of the Clean Air Act (the 111(d) Rule). The 111(d) Rule will be effective 60 days after it is published in the Federal Register, which is expected to be in late October. Litigation over the rule is inevitable, and review by the U.S. Supreme Court is a significant possibility.

The 111(d) Rule affects every aspect of the electric power sector. Impacts will vary by state, with states that rely heavily on coal-fired generation experiencing the most stringent emission reduction requirements. The 111(d) Rule will result in increased use of natural gas-fired, nuclear and renewable energy resources, and is expected to promote innovation in the way companies consume energy. The rule will also likely result in closure of more coal-fired power plants. Utilities, competitive power companies, clean technology firms and companies that consume large amounts of electricity should carefully evaluate the rule to determine how it affects them. The impact will depend on how each individual state chooses to implement the rule over the next few years. Affected companies should therefore consider participating in state proceedings to establish implementation plans. Here are the five initial points that corporate counsel should know about the 111(d) Rule.

1. Owners of Fossil-Fuel EGUs Will Shift Generation to Lower-Emitting Sources

The 111(d) Rule requires a 32-percent national reduction in CO_2 emissions from 2005 levels by 2030. This objective will be accomplished by imposing uniform emission rates (what EPA calls "performance rates") on two categories of EGUs: steam generating units (coal-fired) and stationary combustion turbines (natural gas-fired). The performance rates are 1,305 lbs CO_2/MWh-net and 771 lbs CO_2/MWh-net, respectively. Beginning in 2022 and concluding in 2030, regulated EGUs must meet those rates or their equivalent.

By EPA's own admission, the rates are so stringent that they likely cannot be achieved by existing EGUs themselves through available technological or operational measures. EPA's modeling predicts that some owners will close existing coal-fired EGUs in the coming years. While businesses must determine for themselves how best to comply, the Clean Power Plan encourages a shift in generation from coal power plants to lower-emitting sources of electric energy – e.g. natural gas, solar, wind, and nuclear. This shift will lower the average state-wide emissions rate, and individual EGUs can then "count" the shift through use of emissions trading instruments.

2. States Can Customize Compliance, but the Rule Encourages Mass-Based Goals

EPA has imposed state-wide rate- and mass-based emission goals, measured in pounds of CO_2 per megawatt hour and short tons of CO_2, respectively. EPA calculated those goals by applying the above performance rates to a weighted average of each state's particular mix of coal- and gas-fired generation as measured in the baseline year of 2012. States are required to formulate implementation plans to meet those goals and to submit those plans to EPA for approval.

States have several different compliance options. They may impose (i) rate- or mass-based standards under an "emissions standards" plan or (ii) "state measures" that achieve equivalent CO_2 emission reductions from EGUs and/or from other sources not directly regulated under the 111(d) Rule (such as demand response or end-use efficiency upgrades). A state measures plan must include a federally enforceable backstop and must be mass-based. States may also cooperate by adopting certain common elements or joining a multi-state compliance pact.

The 111(d) Rule encourages states to adopt mass-based goals by offering streamlined state planning requirements. EPA believes that mass-based trading is easier to implement, more affordable nationally ($5.1 billion versus $8.4 billion) and more reliable than rate-based trading.

3. EPA Encourages States to Employ Trading Programs

The establishment of emissions trading is all but certain, although states are not required to adopt trading. Under a model trading system, each EGU would have an individual budget (i.e., a CO_2 cap) equivalent to the uniform performance rates or its portion of the state-wide emission goal. It would demonstrate meeting the cap by retiring EPA-recognized tradable instruments – emission rate credits (ERCs) under a rate-based approach or Allowances under a mass-based approach. If an EGU emits more than its cap, the owner or operator would have to purchase ERCs or Allowances to make up the difference. EGUs can sell excess ERCs or Allowances if it emits less than its cap.

As explained above, the 111(d) Rule encourages shifting generation from coal to clean energy resources, each called an "Eligible Resource" that would be awarded ERCs or Allowances based on their delivery of quantifiable and verifiable emission reductions. States can also "count" and distribute ERCs and Allowances to an array of emission-reducing activities, including end-use energy efficiency.

EPA has released for public comment a proposed model for state emissions credit trading concurrently with the 111(d) Rule. The model trading rule will be subject to a 90-day public comment period once published in the Federal Register. State plans that adopt those final model rules will be presumptively approvable.

EPA also provides an additional, early action incentive called the Clean Energy Incentive Program (CEIP). Under the CEIP, EPA and the state will award bonus ERCs or allowances to early investments in utility-scale solar and wind projects or demand-side energy efficiency programs (implemented in low-income communities), if those resources were implemented after submission of a state plan and if they reduce emissions in 2021 and 2022.

The resulting commodity market for ERCs and Allowances is intended to (i) enhance the likelihood that state-level compliance will be achieved at the lowest possible cost, and (ii) incentivize lower-carbon generation (e.g. natural gas, nuclear, renewable energy and energy efficiency) through the indirect subsidy provided by selling ERCs and Allowances. Trading mechanisms will have a measurable impact on wholesale and retail energy pricing. The carbon intensity of each EGU and Eligible Resource will have an additional carbon price component that is not currently reflected in market regimes that trade electricity as an undifferentiated commodity.

4. State Decisions Must Be Made Well Before Phased-In Compliance Starts

Although phased-in compliance does not begin until 2022, states must make compliance decisions now. States must submit at least an initial plan to EPA by September 6, 2016, but can seek an extension to September 6, 2018 to submit a final plan. States that fail to meet those deadlines or to submit an approvable plan will be subject to a federal implementation plan (FIP). EPA has proposed a draft FIP that will be subject to a 90-day public comment period once published in the Federal Register.

Many states have already begun formulating their plans, or at least announced a process to develop such plans. States must make many critical decisions, such as whether to pursue a rate- or mass-based approach, authorize a trading system, include other units in the compliance plan or tailor rates for specific units. All companies that face material compliance risks, or that see new business opportunities, should participate actively to ensure that their interests are fully reflected in the final state plan. They should also consider whether the proposed FIP and model trading rules work for them in their present form or whether comments should be filed with EPA during the upcoming 90-day public comment period.

5. Businesses Should Not Wait for the Outcome of Litigation to Begin Planning

There is no doubt that the 111(d) Rule will be vigorously challenged; indeed, some early suits have already been filed and more will follow almost immediately after the rule is published. The outcome of those challenges is impossible to predict with certainty and could result in the rule being upheld, reshaped and reissued--or struck down entirely. Although parties challenging the 111(d) Rule will no doubt ask the court to stay the rule pending review, prudent companies should begin now to understand how the rule will affect them and to prepare for compliance in the event the rule is upheld.

Counsel should help its client evaluate how the final 111(d) Rule, the model state trading rule and a final FIP will affect both existing assets and planned investments. Counsel should also become familiar with EPA's rate- and mass-based goals for their particular state(s) and determine which type of state plan will best suit their individual circumstances. Identifying when new assets will be placed in service, what types of resource planning decisions must be made (and when) and whether they should encourage the client to help shape the state's compliance plan so as to optimize its objectives. Depending on the company, there may be linkage between the rule and its long-term corporate sustainability commitment(s). Any environmental attributes associated with the client under such agreements may or may not have been retained or transferred. Any state-level or regional trading markets could greatly affect the value of post-2012 clean energy or energy efficiency assets, for example, yet if the client agreed to transfer all environmental attributes to the utility buying the electricity, that additional value may be missed. Over the longer term, counsel should help review existing energy agreements to evaluate client exposure to market price fluctuations and to assess how a transformation in the way utilities generate, deliver and transact electricity will affect the client's core business.

Cameron Prell is a counsel in Crowell & Moring's energy group and Sherrie A. Armstrong is an associate in the firm's environment and natural resources group.