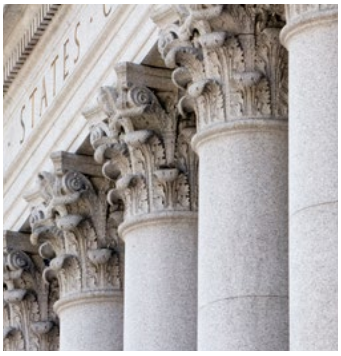
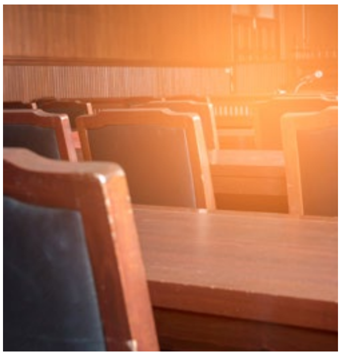
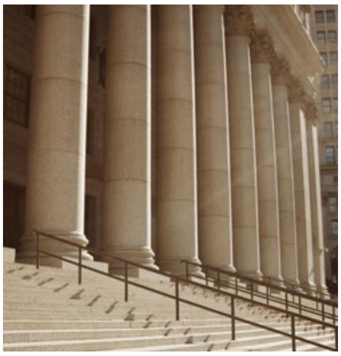
COP26 – Trends in the U.S.







Introduction

The January 2021 inauguration of Democrat Joseph Biden as president and the installment of Democratic party majorities in both houses of Congress has pushed climate change back into the spotlight as a matter of national political prominence. President Biden has promised to take a "whole of government" approach to climate policy and to re-assert the United States as a global leader in efforts to reduce carbon emissions and transition the global economy to a lower carbon future. This approach to climate change stands in contrast with the approach of the outgoing administration of former President Donald Trump, which took the view, broadly speaking, that robust climate change regulation needed to be viewed with caution given that it could undermine U.S. economic strength and energy independence. The Trump administration conducted climate change policy making accordingly, including by withdrawing from the Paris Agreement and rolling back federal regulations of carbon emissions enacted under the previous administration of former President Barack Obama.

At the federal level, the Biden administration's climate strategy includes appointing cabinet and agency leaders based in large part on their climate bona fides, restoring and strengthening Obama-era regulations of carbon emissions, and restraining fossil fuels extraction on federal property. Where the President's regulatory powers on climate issues fall short, the Democrat-led Congress will seek to fill the gaps with legislation. Lawmakers are preparing to vote on a $1.2 trillion infrastructure bill and a $3.5 trillion budget reconciliation package that call for, among other programs, historic levels of investment in renewable energy, although both measures face an uncertain fate. At the U.S. state level of government, governors and state legislators have worked to implement their own climate measures and joined voluntary carbon trading programs, and to use the power of the state in other ways – for example, by directing state pension funds to divest from certain carbon intense businesses -- to drive reductions in the U.S. economy's carbon output and to facilitate a transition to a lower carbon economy.

The White House and many federal and state legislative proponents of greater climate change regulation tout climate action as a way to not only protect U.S. and global citizens from the adverse environmental and economic effects of climate change, but also as a way to create jobs and "future-proof" the U.S. economy. That said, lawmakers from both parties rely on the votes of millions of Americans for whom a clean energy "revolution" could represent job loss and increase the cost of a variety of goods and services, which may temper ultimate legislation around climate change and energy transition issues.

The changes taking place in Washington, D.C., and within state governments with respect to climate change reflect, not surprisingly, a shift on climate issues among the U.S. population. A recent Economist/YouGov poll, for example, found that climate change was the second most important issue for Americans, ahead of the economy and behind only health care. Millennials and Gen Z, in particular, who now comprise more than one-third of the U.S. electorate, tend to view climate policy as a matter of political and social importance. Investors and shareholders in U.S. companies have taken heed of these political and social shifts as well, including through the rise of ESG investing priorities, with increasing investor pressure for companies to reduce their carbon footprints and account for climate risk in their financial planning. U.S. companies themselves continue to innovate in looking for ways to reduce their emissions and transition their businesses to a lower carbon future.

As the U.S. heads to COP26 in November, the call for climate action continues and is likely to gain further momentum. This article provides a high level overview of some of the measures taken to combat climate change in the U.S. thus far and predictions for what additional action can be expected in the lead up to COP26.

Government trend shift on climate change

Both federal and state governments have in recent years (and particularly since the inauguration of President Biden) increased rhetoric and political action around efforts to address climate change. We highlight a few of these key developments below.

Federal action on climate change

Prior to the 2020 election season, climate change had taken back seat as a matter of U.S. domestic and foreign policy. In the White House, President Trump withdrew the U.S. from the 2015 Paris Agreement and rolled back Obama-era emissions regulations. In Congress, a partisan divide between the Democrat-controlled House and Republican-controlled Senate meant that substantive and significant climate change legislation had no realistic chance of passage. Government efforts to strengthen regulations aimed at tackling climate change largely took place at the state level, where governors and state legislatures in certain U.S. states that tend to lean Democrat set targets to achieve net-zero carbon emissions within their jurisdictions or joined regional carbon trading programs to reduce pollution from power utilities. President Biden and congressional Democrats have promised to reverse course.

i. Executive orders

During his first week in office, President Biden issued a cascade of executive orders to signal his administration's commitment to climate action. Of note, the President ordered federal agencies to purchase carbon-neutral electricity and electric vehicles; "paused" new oil and gas leases on federal property; and rescinded the permit for the Keystone XL oil pipeline. The President has also sought to reengage the international community on climate issues, appoint climate-ambitious people to his cabinet, and restore or strengthen climate-focused regulations of U.S. industry and finance through the executive branch agencies under his authority.

ii. International diplomacy

On his first day in office, President Biden signed an executive order to rejoin the 2015 Paris Agreement. Then, in April, the President hosted a virtual climate summit with 40 world leaders, during which he pledged to cut U.S. emissions by up to 52 percent from 2005 levels within the decade. President Biden also created a new diplomatic post, the Special Presidential Envoy for Climate, filled by former Secretary of State John Kerry. Secretary Kerry, who will lead the U.S. delegation to COP 26, has said he must confront a range of diplomatic challenges at the conference, including a loss of U.S. credibility on climate issues caused by the outgoing administration and China's continued, heavy investment in carbon-emitting power utilities.

iii. Cabinet appointments

The Biden administration has sought to make climate change a higher priority in decision-making across the federal bureaucracy. To that end, President Biden established a National Climate Task Force chaired by Gina McCarthy, who served as the Environmental Protection Agency ("EPA") Administrator under President Barack Obama, in a new role as White House National Climate Advisor. Additionally, President Biden secured the appointment of climate-ambitious people to head federal regulatory agencies.

President Biden's appointments include Interior Secretary Deb Haaland, a former New Mexico congresswoman who has strongly opposed oil and gas drilling; Securities and Exchange Commission ("SEC") Chair Gary Gensler, who plans to impose climate-focused disclosure requirements on public companies; and Treasury Secretary Janet Yellen, an advocate for carbon pricing. Secretary Yellen appeared at the G20 Finance Track summit in July, where she pledged U.S. support for efforts to mitigate the impacts of climate change in the developing world and urged international cooperation on carbon tariffs.

iv. Agency regulations

The Biden administration and congressional Democrats have taken steps to reinstate climate regulations rolled back by the Trump administration and have promised additional regulatory action this year. Of note:

- ***Restored methane regulations.*** Democrats invoked the Congressional Review Act to restore Obama administration regulations on methane emissions that were revoked by President Trump's EPA in 2020. The regulations place restrictions on methane emissions from all phases of oil and gas production and require energy companies to monitor for and address methane leaks in their infrastructure. Many U.S. energy companies have voiced support for reductions in methane emissions and have indicated they are investing significant sums in efforts to reduce their methane emissions.
- ***New power sector regulations remain a ways off.*** New power sector regulations are not expected in the near future. Both the Clean Power Plan, which was promulgated under President Obama, and the Affordable Clean Energy Rule, implemented by President Trump, have been suspended or invalidated by court order. The Supreme Court suspended the Clean Power Plan in 2016 amid legal claims that it overextended the EPA's regulatory authority over the power sector. On the other hand, a federal appeals court held the Affordable Clean Energy Rule construed the EPA's authority too narrowly. Any new regulatory scheme will have to be developed from scratch.
- ***A push for electric vehicles.*** President Biden's EPA is proposing to increase the corporate average fuel economy requirements for new vehicles from 43.3 miles per gallon to 52 miles per gallon by 2026. President Biden also issued an executive order calling for electric vehicles to comprise 50 percent of new auto sales by 2030. Nonetheless, Americans continue to purchase gas-powered vehicles en masse. Automakers have urged the administration that achieving these ambitious targets for emissions and electric vehicle sales will require heavy public investment in charging infrastructure and consumer tax incentives.
- ***SEC disclosure requirements.*** In March 2021, the SEC announced the launch of a Climate and ESG Task Force that will monitor for lapses in corporate disclosures on climate risk. The U.S. does not currently enforce climate-specific disclosure requirements, and a failure to disclose climate risks is only actionable to the extent a reasonable investor would consider it "material" information. SEC Chairman Gensler said the SEC plans to propose new, climate-focused disclosure requirements by the end of the year.

v. Legislation

U.S. voters (and the politicians they elect) are divided as to the best way to address the needs of the climate and of the economy.

In March, President Biden unveiled a $2.3 trillion infrastructure proposal, called the American Jobs Plan, that called for major investments in clean energy and measures to reduce the nation's carbon footprint. Since then, climate negotiations in Washington, D.C., have proceeded on two tracks. In August, the U.S. Senate passed a $1.2 trillion Bipartisan Infrastructure Bill, with President Biden's support. The bill allocates $5 billion for electric vehicle charging infrastructure, $73 billion to equip the nation's power grid to carry more renewable energy, and $30 billion for Amtrak's high-speed rail corridor, among other provisions. The U.S. House of Representatives has committed to vote on the bill by September 27.

In addition to the Bipartisan Infrastructure Bill, Congress passed a budget resolution that calls for $3.5 trillion in government spending on social welfare programs and climate change initiatives. The resolution includes clean energy tax incentives and a "clean electricity payment program," which would implement a version of the federal clean electricity standard that President Biden had proposed in his American Jobs Plan. The resolution sets out a "blueprint" for a final budget reconciliation package that will require a vote in both houses of Congress.

While it is not certain, House lawmakers may be able to achieve a consensus on the Bipartisan Infrastructure Bill. The budget legislation is more controversial. For example, Democrats are divided with the White House on the inclusion of a carbon tariff, which would tax imports based on the carbon emissions associated with their production. The Biden administration has previously indicated it would support a carbon tariff in order to protect U.S. industry from competition with foreign companies that are not subject to the same environmental controls. However, the White House has not endorsed that provision, reportedly because it could frustrate trade relations with U.S. allies and increase inflation. Additionally, some so-called centrist Democrats have signaled they may oppose the budget legislation or seek to strip out or water down climate-related provisions given their

high costs and potential negative effects on the U.S. economy. Republicans in Congress are largely unified in their opposition to this ambitious spending plan given its high costs and likely tax increases on U.S. consumers and businesses needed to pay for it.

State action on climate change

State governments have taken action on climate change to supplement measures taken (or compensate for perceived inaction) by the federal government. These measures include local regulations and legislation and participating in regional carbon trading programs. Regional differences, however, mean the effect of state climate action is not always consistent.

A growing number of states have set targets, either through gubernatorial executive orders or state legislation, to achieve net-zero emissions across their economies by 2050 or earlier. These measures provoke the same public policy debate on the costs and benefits of a clean energy transition seen at the federal level. For example, in Massachusetts, Governor Charlie Baker and the state legislature negotiated heavily on the state's interim 2030 target for reducing carbon emissions. Lawmakers pushed for (and ultimately prevailed on) a 50 percent reduction in emissions from 1990 levels, but the governor's office cited concerns that an overly ambitious target would burden state taxpayers with the cost of retrofitting homes and taking other steps required to hit the target in less than ten years. Some states also use the power of their purse to drive a lower carbon future by directing state pension funds to withhold investment in companies perceived to be not doing enough to protect the climate.

Differences in regional economies and the political leanings of state residents can produce vast differences in the nature and scope of state climate legislation. For example, California, a largely progressive state with the nation's most stringent environmental controls, now requires all new residential construction to be equipped for electric utilities. Contrast that with Texas, a more conservative state with a heavy stake in Gulf Coast oil production, which recently passed a law that requires state pension funds and other investment vehicles to divest from companies that "boycott" the fossil fuels industry.

While states generally can only effectuate climate policy within their borders, regional carbon trading programs have allowed like-minded states to broaden the reach of their policies. For example, eleven East Coast states have joined the Regional Greenhouse Gas Initiative ("RGGI"), which sets a regional cap on carbon emissions from state power utilities. Each state participates in RGGI by implementing its own legislation, but utilities in participating states may trade carbon "credits" with one another at regional auctions in order to achieve compliance within their respective jurisdictions.

Changing consumer and corporate attitudes

The most powerful driver of climate action in the U.S. may not be the government but the court of public opinion. The same young Americans who vote in favor of progressive climate policies also wield enormous spending power. Their opinion of (and willingness to invest in and buy products from) companies can have a material effect on corporate stock performance. As a result, institutional investors continue to pressure companies to meet the expectations of America's new investor and consumer class by accounting for climate risk in their long-term financial planning and transforming their operations to better compete in a lower carbon economy. Additionally, financial institutions are making significant investments in renewable energy projects, and receiving pressure to justify funding of companies that do not have a robust plan for the transition to a lower carbon economy and/or to reduce their own carbon emissions.

Corporate America, in turn, is making a concerted effort to promote its commitment to sustainable business practices. For example, some of the nation's largest auto manufacturers, including Ford, General Motors, and Volkswagen, have pledged multibillion dollar investments in electric vehicles, with a view toward transitioning their product lineups to predominantly (or exclusively) zero-emissions vehicles within the next two decades. In addition, a growing number of corporations have taken up the "Climate Pledge" and promised to achieve net-zero emissions across their operations by 2040. Announcements like these reflect the increasing value that American consumers assign to climate impact when making purchase decisions and the impact this has on businesses serving these consumers to continue to develop plans to reduce emissions and transition to a lower carbon future.

Conclusion

As member nations prepare for COP26, the U.S. will face increased pressure, domestically and abroad, to establish itself as a leader in reducing carbon emissions and facilitating the migration of the global economy to a lower carbon future in a fair and equitable manner. This is especially true in the face of recent warnings from the Intergovernmental Panel on Climate Change ("IPCC") of an irreversible rise in global temperatures and sea levels unless world leaders take swift action. Secretary Kerry said the IPCC report underscores the "overwhelming urgency" of global action to reduce carbon emissions, and President Biden tweeted in response to the report that "the cost of inaction keeps mounting."

At the same time, U.S. lawmakers must continue to balance competing policy considerations with demands for climate action. Millions of Americans are employed in sectors of the economy that produce or rely on fossil fuels, and many U.S. taxpayers may be reluctant to make the economic sacrifices they perceive as necessary to produce dramatic and immediate reductions in the nation's carbon output—for example, by paying higher taxes or shouldering higher costs for the goods and services on which they rely.

Finally, other major political concerns, including the ongoing COVID-19 pandemic and the destabilization of power in Afghanistan, may impact what additional climate action officials in Washington have the bandwidth and political capital to take on in the lead up to COP26. Despite these political realities, it is clear that the U.S. has now put climate change front and center on its political agenda. Under the Biden administration, the U.S. intends to be a global leader in developing domestic and international policies to facilitate emissions reductions and the continued transition to a lower carbon future.

Key contacts

Benjamin Rubinstein
Partner
T +1 917 542 7818
benjamin.rubinstein@hsf.com

Maxwell Herman
Senior Associate
T +1 917 542 7848
maxwell.herman@hsf.com

Chris Emch
Associate
T +1 917 542 7838
chris.emch@hsf.com