

A SUMMARY AND ANALYSIS OF THE GREENHOUSE GAS REGULATION PROVISIONS CONTAINED IN THE WAXMAN-MARKEY DISCUSSION DRAFT – AMERICAN CLEAN ENERGY AND SECURITY ACT OF 2009

On March 31, 2009, Representatives Waxman and Markey released a discussion draft of the American Clean Energy and Security Act of 2009. Title III of that discussion draft is entitled “Reducing Global Warming Pollution.” This paper summarizes and analyzes that portion of the discussion draft.

DESIGNATION AND REGISTRATION OF GREENHOUSE GASES

The bill designates the following seven gases as greenhouse gases: carbon dioxide, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, perfluorocarbons, and nitrogen trifluoride. The first six gases are covered by the Kyoto Protocol, and are typically the six gases included in draft legislation that has been proposed in the past in the United States. Nitrogen trifluoride is the recent addition. The bill provides that the EPA may add additional gases. Also, any person is allowed to petition the EPA to have additional gases added to the list. The bill converts each of the greenhouse gases to their carbon dioxide equivalent quantity for purposes of regulation.

“Covered Entities” are required to report their emissions to a national registry that is created by the bill. The term “Covered Entity” is defined very broadly to include: (1) any electricity source; (2) producers and importers of petroleum-based or coal-based liquid fuel, petroleum coke, or natural gas liquid, the combustion of which would emit 25,000 tons of carbon dioxide equivalent greenhouse gases; (3) producers and importers of fossil fuel-based carbon dioxide, nitrous oxide, perfluorocarbons, sulfur hexafluoride, nitrogen trifluoride or any other fluorinated gas that is a greenhouse gas, the

combustion of which would emit 25,000 tons of carbon dioxide equivalent greenhouse gases; (4) any geological sequestration site; (5) any stationary source that refines petroleum or manufactures or produces adipic acid, aluminum, cement, hydrofluorocarbons, lime, nitric acid, phosphoric acid, silicon, carbon, soda ash, or coal-based liquid or gaseous fuel; (6) any stationary source in the chemical or petrochemical sector that manufactures acrylonitrile, carbon black, ethylene dichloride, ethylene oxide or methanol; (7) any stationary source in the chemical or petrochemical sector that manufactures a chemical or petrochemical not manufactured as of the date of enactment of the bill if such manufacturing results in annual process emissions of 25,000 tons or more of carbon dioxide equivalent greenhouse gases; (8) any stationary source that emits 25,000 or more tons of carbon dioxide equivalent greenhouse gases in a year and that is engaged in food processing or that produces or manufactures ethanol, ferroalloy, glass, hydrogen, iron and steel, lead, pulp and paper, or zinc; (9) any fossil fuel-fired combustion device that is part of any industrial source not specified in numbers 5 through 8 above and that emits in a year 25,000 or more tons of carbon dioxide equivalent greenhouse gases; and (10) any local distribution company that delivers in a year 460 million cubic feet of natural gas to customers that are not Covered Entities.

The reporting requirement also extends to entities other than Covered Entities. Specifically, the requirement extends to those entities that emit more than 10,000 tons of carbon dioxide equivalent greenhouse gases in a year, provided that the entity would be within the definition of a Covered Entity if the entity had emissions of more than 25,000 tons

of carbon dioxide equivalent greenhouse gases in a year. Finally, the reporting requirement also extends to any other entity where the EPA determines that reporting from that entity would help to achieve the purposes of the bill.

Entities are required to report data for 2007 through 2010 by March 11, 2011, although EPA may elect to waive this requirement for certain entities where adequate data is not available. Quarterly reporting of emissions begins in calendar year 2011, and reports must be submitted within 60 days after the end of each quarter.

PROGRAM RULES

The bill creates a certain number of Emission Allowances for each year beginning in 2012. The total number of Emission Allowances available each year declines from 2012 to 2050. Each Emission Allowance is equal to one ton of carbon dioxide equivalent greenhouse gas emissions. Beginning in 2013, each Covered Entity must hold a sufficient number of Emission Allowances to cover the previous year's emissions. Fuel and fluorinated gas producers and importers must hold sufficient Emission Allowances to cover the amount of fuel or gas produced or imported. The requirement to hold Emission Allowances is delayed until 2014 for industrial stationary sources, and until 2016 for local distribution companies. Compensatory Allowances may be issued later in situations where a producer or importer is required to retire Emission Allowances based on production or importation activities, but the subsequent combustion and emission of greenhouse gases does not actually occur.

Importantly, the bill does not provide for the disposition of Emission Allowances, other than to acknowledge that such allowances could be auctioned or allocated for free. Similarly, the bill does not provide for how the proceeds from any auction of Emission Allowances would be used. The resolution of this issue is highly controversial and appears to have been reserved for a later date.

A Covered Entity may meet its requirement to hold Emission Allowances by holding Offset Credits, International Emission Allowances or Compensatory Allowances. Offset Credits may be generated by actions taken to reduce, avoid or sequester emissions at non-regulated facilities. International Emission

Allowances are allowances generated through a foreign cap and trade program for greenhouse gases that has been approved by EPA as being at least as stringent as the United States program. The amount of the requirement that can be met by holding Offset Credits or International Emission Allowances is limited to a certain percentage of the total requirement for a Covered Entity. This limit is set forth by a formula contained in the bill. Further, not more than half of the limit for Offset Credits may be satisfied by holding Domestic Offset Credits, and not more than half may be satisfied by holding International Offset Credits.

When a Covered Entity does not hold the required allowances for a given year, it is subject to a civil penalty equal to the number of allowances that it is missing multiplied by twice the market value of Emission Allowances. Further, the Covered Entity must still offset its emissions by holding in the subsequent year the number of Emission Allowances required to make up the short fall of the previous year.

Emission Allowances may be sold, exchanged, transferred, held for compliance or retired. The trading of Emission Allowances is not limited to Covered Entities. Further, Emission Allowances may be banked indefinitely in order to meet obligations in future periods. A Covered Entity may also borrow Emission Allowances from up to five years in the future in order to meet up to 15% of its current requirements. There is an 8% interest charge for this borrowing.

The bill creates a Strategic Reserve and a certain percentage of the Emission Allowances are placed in the Strategic Reserve each year. This amount is 1% of total Emission Allowances from 2012 to 2019, 2% from 2020 to 2029, and 3% from 2030 forward. The Emission Allowances placed in the Strategic Reserve are auctioned off quarterly to Covered Entities. A Covered Entity may not purchase more than 10% of its total requirement to hold Emission Allowances. The proceeds from the sale of these allowances are to be used to purchase International Offset Credits for reduced deforestation. These International Offset Credits are then retired and Emission Allowances equal to 80% of the retired International Offset Credits are then issued and placed in the Strategic Reserve.

OFFSETS

The bill does not provide much detail on Offset Credits. Like the disposition of Emission Allowances, the issue of what projects qualify for Offset Credits is highly controversial. Rather than resolve the issue, the bill provides that EPA is to promulgate regulations regarding an offset program. The regulations are to provide for the issuance of Offset Credits for projects that result in the reduction, avoidance or sequestration of greenhouse gas emissions. The regulations are to include a list of eligible projects. The regulations must also set forth a methodology to: (1) ensure that any reductions are in addition to those that would have occurred anyway; (2) establish a baseline of business as usual emissions; (3) measure reductions and account for leakage and uncertainty; and (4) account for reversals of reductions, avoidances or sequestrations. The bill provides that offset projects must be pre-approved by EPA, and the project representative must submit an annual verification report prepared by an accredited third-party verifier that sets forth the amount of the reduction, avoidance or sequestration for the year. EPA is authorized to conduct random audits of offset projects.

The bill provides that Offset Credits may be sold, traded or transferred. In addition, there is a program that allows for the issuance of Offset Credits for projects that meet certain requirements and that have been approved by a state. The project must have been initiated after January 1, 2001. Offsets Credits will only be issued for reductions that occur after January 1, 2009, and before three years after the date of enactment of the bill.

EPA is also authorized to issue International Offset Credits based on projects that reduce, avoid or sequester emissions in a developing country. EPA may issue such credits only if (1) the United States is party to an agreement that includes the other country; (2) the country is a developing country; and (3) the agreement ensures that all of the requirements of this part of the bill apply to International Offset Credits issued under the bill. EPA is to identify those sectors where the issuance of credits on a sectoral basis is appropriate, and credits are to be issued only on a sectoral basis.

SUPPLEMENTAL EMISSION REDUCTIONS FROM REDUCED DEFORESTATION

The bill provides that EPA is to promulgate regulations establishing a program to use certain Emission Allowances to achieve reductions in greenhouse gas emissions from deforestation in developing countries. The EPA may distribute Emission Allowances to a country, private party, public group or international fund to achieve the objective of reducing emissions from deforestation. The bill sets forth a certain percentage of Emission Allowances each year that are to be distributed for this purpose. For example, from 2012 through 2025, the amount is to be 5% of total Emission Allowances each year.

CARBON MARKET ASSURANCE

The bill provides for the promulgation of regulations for the establishment, operation and oversight of markets for regulated allowances and allowance derivatives. Among other things, the regulations are to ensure transparency, prohibit fraud, market manipulation and excess speculation, and provide measures to limit unreasonable fluctuation in the prices of allowances.

ADDITIONAL GREENHOUSE GAS STANDARDS

The bill ends the debate about the applicability of certain Clean Air Act programs to greenhouse gas emissions. Specifically, the bill provides that (1) the new source review program does not apply to a greenhouse gas solely on the basis of its effect on climate change or its regulation under the cap and trade program; (2) no greenhouse gas may be added to the list of hazardous air pollutants unless the gas meets the listing criteria for reasons independent of its effect on climate change; (3) no greenhouse gas may be listed as a criteria pollutant on the basis of its effect on climate change; and (4) greenhouse gas emissions are not to be taken into account in determining the need for a permit under Title V of the Clean Air Act.

On the other hand, the bill directs EPA to publish a list of categories of stationary sources consisting of sources that individually had uncapped greenhouse gas emissions greater than 10,000 tons of carbon dioxide equivalent and that, in the aggregate, are

responsible for emitting at least 20% of the uncapped greenhouse gas emissions. EPA must include on the list each source category that is responsible for at least 10% of uncapped methane emissions. The list must include industrial sources the emissions from which, when added to the capped emissions from industrial sources, constitute at least 95% of the greenhouse gas emissions of the industrial sector. For each category listed, EPA is to promulgate standards of performance under Section 111 of the Clean Air Act for the uncapped emissions of greenhouse gases.

The bill also provides for the phase down in the production of hydrofluorocarbons, which are chemical products that are used in, among other things, refrigeration, air conditioning and insulation. The bill adds hydrofluorocarbons to the list of substances that EPA currently regulates because they deplete atmospheric level ozone. Finally, EPA is directed to use its authority under existing programs to reduce domestic emissions of black carbon.

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