

Under- standing Climate Change Legislation

An energy bill designed to reduce CO₂ emissions is working its way through Congress, and will likely be signed into law next year. If Congress fails to act, the EPA will, and the resulting statutes and regulations will affect the entire economy. This Executive Counsel special section examines the proposed legislation, how it might change, and what regulations will fill the gap if it doesn't pass.

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Jockeying for Position in the New Carbon Markets

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The U.S. Congress is now the center of climate change policy, but passage of legislation would not end the debate. The American Clean Energy and Security Act of 2009 establishes only a broad framework for the reduction of greenhouse gas emissions. Essential details are delegated for rulemaking to the Environmental Protection Agency, the Department of Energy, the Department of Agriculture, the Federal Energy Regulatory Commission, and the Commodity Futures Trading Commission.

As a result, EPA and other agencies will craft critical components of the bill's programs that will determine the obligations imposed on industry, and the outcome for the environment. It will be up to the regulator in many instances to decide who wins and who loses.

The bill contemplates no fewer than 22 agency rulemakings or major actions within the first year following

enactment. An additional 20 rulemakings or actions are required within two years. If history is any guide, few of these will be completed on time. Many rulemakings arising out of the Clean Air Act Amendments of 1990 took most of the decade to complete.

The first compliance deadline for emitters of greenhouse gases is slated for April 1, 2013. Questions loom as to whether EPA and other agencies will finalize critical regulations far enough in advance for the U.S. carbon market to get off the ground. At best, it appears that a skeleton version of cap-and-trade could commence on time, but without features designed to reduce compliance costs and provide regulatory certainty. At worst, regulatory gridlock could ensue, deterring investments in clean technology and disrupting efforts to reduce emissions.

For example, the bill provides for the distribution of "compensatory allowances" for certain "non-emissive" uses of greenhouse gases. The objective is to compensate businesses that would be forced to hold allowances for activities that do not result in emissions (i.e., use of petroleum-based fuel as a feedstock). The bill calls for creation and distribution of compensatory allowances within two years following enactment. This is just one of more than 40 rulemakings or major actions required in that time period.

The situation is similar with respect to the offsets program, but with far greater implications. Offsets arguably represent the only substantial cost containment mechanism in the bill. Although it provides substantial detail, the bill leaves some critical components of the program to EPA and the Department of Agriculture. For example, the bill does not provide a list of eli-

gible offset project types, instead requiring EPA and USDA to develop lists within one year of enactment. They would need to develop and finalize project methodologies in two years — complex, technical procedural requirements for an emission reduction project to be eligible to receive offset credits. The need to complete this process in two years raises concerns over when offset projects could begin generating offset credits, especially given that developing new offset projects could take years once the rules are finalized.

Of even greater concern is the two billion offset credits EPA and USDA would need to issue each year to maximize the bill's cost containment features. Existing offset programs have never come close to issuing two billion credits over their entire multi-year lifetimes. How many of those two billion would be available before the first compliance deadline in 2013 is an unanswered question.

Compensatory allowances and offsets are just two examples of key features that will depend heavily on rulemaking processes that historically have been anything but expeditious. Legal challenges could further delay the full implementation of many of the bill's most important provisions.

Equally if not more significant than the timing of agency rule makings is the extraordinary discretion the bill grants to EPA and other agencies to alter the cap-and-trade system. Under the offsets provisions, for example, EPA and USDA are required to revise key features of the program every five years. This is purportedly to ensure environmental integrity and efficient operation. While these are important, the unchecked nature of this authority could frustrate project developers and covered entities seeking to participate in the carbon market. Most emission reduction projects take a year or more to develop, then can operate for a decade or longer. The risk that projects could lose eligibility to generate credits as a result of a review could discourage investment and hinder the emergence of a robust offset credit market.

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Even features of cap-and-trade seemingly carved in stone are subject to change. No more obvious example exists than the number of emission allowances the bill requires EPA to establish each year. The precise numbers are listed in a table in the text of the bill, but EPA is authorized to change these numbers if it determines that the underlying data is inaccurate. EPA may make such a

change only once, but even a one-time change would effect the number of allowances allocated to covered entities, states, federal agencies and other groups. This in turn fosters uncertainty, raises compliance costs and could potentially destabilize the carbon market.

There also are instances where the bill delegates authority to entities outside the Executive Branch. For example, the bill requires EPA to report to Congress on U.S. and foreign efforts to reduce emissions, and to rec-

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ommend additional actions to address climate change. The bill then requires the National Academy of Sciences — a private entity whose members are not appointed by the President — to review the report and issue its own recommendations. The President is required to order agencies to implement these recommendations, and request additional legislative action where needed.

Although these provisions grant the National Academy and the President only a limited amount of discretion, they nevertheless raise potential constitutional issues, as this allows an entity untethered to the democratic process to force potentially unpalatable action.

In the end, what all this means is that as a comprehensive climate change regulatory regime inches closer to reality, its enactment will mark only the beginning of the jockeying between possible winners and losers in the new carbon markets.



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