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Waxman-Markey V. EU Emissions Trading Scheme

Law360, New York (June 11, 2009) -- Key differences exist between the cap-and-trade scheme proposed by the Waxman-Markey Bill and Phase II of the EU Emissions Trading Scheme (EU ETS), from 2008-2012, and Phase III of the EU ETS, from 2013-2020. The differences, particularly the different targets set by the Waxman-Markey Bill, may affect the EU ETS emissions reduction target.

On May 15, 2009, Chairman of the U.S. Energy and Commerce Committee, Henry A. Waxman, and Chairman of the U.S. Energy and Environment Subcommittee, Edward J. Markey, introduced a bill entitled, "The American Clean Energy and Security Act of 2009" (Waxman-Markey Bill).

The Waxman-Markey Bill proposes a federal cap-and-trade scheme in the United States to reduce greenhouse gas emissions. There are a number of key differences between the cap-and-trade scheme proposed by the Waxman-Markey Bill and Phase II of the EU Emissions Trading Scheme (EU ETS), from 2008-2012, and Phase III of the EU ETS, from 2013-2020.

These differences, particularly the different emissions reduction targets, may affect the EU ETS emissions reductions target. The Waxman-Markey Bill is at a relatively early stage in the legislative process and is, and will continue to be, the subject of significant debate amongst Democrats and Republicans alike. It is likely that both parties will offer amendments to the Waxman-Markey Bill as it progresses through the legislative process.

Coverage

The cap-and-trade scheme proposed by the Waxman-Markey Bill covers a wide range of entities, including electric utilities, oil companies, large industrial sources and other entities that are collectively responsible for 85 percent of the GHG emissions in the United States. Industrial sources emitting 25,000 tons or less per year of carbon dioxide equivalent are not subject to the restrictions imposed by the scheme.

Phase II of the EU ETS covers installations which perform certain activities above certain capacity thresholds. Generally, the installations covered emit large amounts of GHG emissions, for example, power stations and other combustion plants, oil refineries, coke ovens and iron and steel plants. The only GHG emissions covered by Phase II of the EU ETS are CO₂ emissions, with the exception of the Netherlands, which has opted in emissions from nitrous oxide.

It is intended that the coverage will be extended for Phase III of the EU ETS to include other sectors and GHG emissions, including CO₂ emissions from petrochemicals, ammonia and aluminum and nitrous oxide emissions from the production of perfluorocarbons from the aluminum sector.

The capture, transport and geological storage of all GHG emissions will also be covered. Starting in 2013, EU Member States may remove installations whose reported GHG emissions were lower than 25,000 tons of CO₂ equivalent in each of a three-year period under certain conditions.

Targets and Allocation of Allowances

The original target proposed by the Waxman-Markey Bill is a reduction of GHG emissions by three per cent below 2005 levels by 2012, followed by reductions of 17 percent below 2005 levels by 2020, 42 percent below 2005 levels by 2030 and 83 percent below 2005 levels by 2050.

To achieve the reductions, each of the covered entities will be allowed to emit GHG emissions, subject to a specified cap. That cap will be determined by the number of allowances that an entity has obtained. Each allowance will permit the holder of the allowance to emit one ton of CO₂ equivalent. Emissions allowances will be allocated free of charge to accomplish three goals:

- To protect consumers from energy price increases
- To assist industry in the transition to a clean energy economy
- To spur energy efficiency and the development and deployment of clean energy technology

For example, the electricity sector will receive 35 per cent of the allowances and local natural gas distribution companies, whose rates are set by the states, will receive nine per cent of the allowances.

The allowances allocated to local natural gas distribution companies must be used to protect consumers from natural gas price increases. A small number of allowances will be allocated to prevent deforestation and support national adaptation efforts and for other purposes. Some unallocated allowances will be auctioned to ensure budget neutrality.

The target for the EU ETS is a 20 percent reduction in GHG emissions compared to 1990 levels by 2020 and a 30 percent reduction provided other developed countries commit to comparable reduction targets. To achieve this target, the EU intends to increase energy efficiency by 20 percent and to increase the share of renewable energy in the EU's total energy consumption by 2020.

During Phase II of the EU ETS, each Member State is required to have a National Allocation Plan (NAP) in place that sets an emissions cap and determines the number of allowances to be allocated to each installation covered by the EU ETS. Most emission allowances will be issued free of charge during Phase II, however, each member state has been able to provide for emission allowances to be auctioned when developing its NAP.

There will be no requirement to have a NAP in place for Phase III. Instead, there will be an EU-wide emissions cap. During Phase III, the basic principle for the allocation of emission allowances will be that allowances will be auctioned. It is estimated that at least half of the available allowances as of 2013 will be auctioned.

Offsets

The Waxman-Markey Bill allows entities covered by the cap-and-trade programme to offset reductions by using emissions credits from other eligible domestic or international sources, where certain criteria are met. This may mean that credits from, for example, the Regional Greenhouse Gas Initiative (RGGI) may be used to offset an entity's reductions.

However, the total number of offsets allowed in any one year must not exceed two billion tons (split evenly between international and domestic offsets). From 2017, an entity must submit five tons of international offset credits for every four tons of GHG emissions being offset.

During Phase II of the EU ETS, each Member State may set a limit, in its NAP, on the number of credits from Joint Implementation (JI) and Clean Development Mechanism (CDM) projects that may be surrendered for compliance during Phase II of the EU ETS. The limit must be set at a level that ensures that a significant reduction of GHG emissions still takes place within the European Union and not outside of it.

During Phase III of the EU ETS, installations may continue to surrender credits from JI and CDM projects to satisfy their compliance obligations, subject to a limit.

In practice, the limit has the effect that existing operators will be able to use credits up to a minimum of 11 percent of their allocation during Phase II of the EU ETS, while a top-up is foreseen for operators with the lowest sum of free allocation and allowed use of credits during the same period.

Banking and Trading Periods

The Waxman-Markey Bill proposes that entities may bank allowances and use them to comply with their obligations in subsequent years; and a rolling two-year compliance period. The effect of which is that an entity may borrow an unlimited number of allowances from a year ahead without penalty.

Under the EU ETS, allowances remain valid throughout the relevant trading period, that is, Phase II or Phase III, and any surplus allowances can be "banked" for use in the subsequent trading periods.

Status of Waxman-Markey Bill

It is intended that the cap-and-trade legislation will be passed out of the Energy and Commerce Committee by May 25, 2009. There are a number of significant hurdles to doing so, including obtaining the agreement of the Democrat members of the committee to the Waxman-Markey Bill. Key parts of the Waxman-Markey Bill may be amended before it is passed out of the Committee.

Conclusion

The Waxman-Markey Bill proposes a cap-and-trade scheme with a number of fundamental similarities to the EU ETS. However, there are a number of differences proposed.

In particular, the emissions reduction targets have a different base year; the Waxman-Markey Bill proposes reductions compared to 2005 levels and the EU ETS reductions are compared to 1990 levels. The percentage reductions under the EU ETS are also greater during the only comparable year, that is, 2020.

The Waxman-Markey Bill proposes a reduction of 17 per cent below 2005 levels by 2020 and the target under the EU ETS is a reduction of 20 percent below 1990 levels by 2020, increasing to 30 percent provided that other developed countries commit to comparable reduction targets.

If the Waxman-Markey Bill is implemented in its current form, given the differences in the emissions reduction targets set by the two cap-and-trade schemes, along with the other differences between the schemes, a view may be formed in the European Union that the scheme proposed by the Waxman-Markey Bill is not a comparable scheme to the EU ETS.

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