

Energy Law A Practice Focus

Kyoto Wasn't Last Gasp

Even without the protocol, greenhouse gas regulation is coming here.



BY MARY ANNE SULLIVAN

With the Bush administration's announcement in March 2001 that it would not seek ratification of the Kyoto Protocol, some in U.S. industry may have thought that, at least, for now, they did not have to worry about greenhouse gas regulation. Developments since suggest otherwise. Any U.S. company responsible for significant GHG emissions should be paying attention to this issue because, with every passing day, it seems clearer that GHG constraints are coming.

The most obvious way in which U.S. companies will be affected is through their international operations. But states are also hopping on the CO₂ regulation bandwagon with alacrity. Moreover, joining voluntary programs is becoming common among corporations in a wide variety of industrial sectors. And as the United States moves toward a more rigorous and comprehensive GHG registry, the pressure for federal regulation can only increase.

The Kyoto Protocol calls for developed countries to reduce their GHG emissions by an average of 5.2 percent from 1990 levels over the years 2008 to 2012. Developing countries that ratify have no such reduction targets during this Phase I, but they can participate by hosting so-called Clean Development Mechanisms, which are projects designed to reduce GHG emissions within their borders and earn credits transferable to countries with reduction obligations. Debate on what reduction obligations developing countries will assume

during Phase II (2013-2018) is scheduled to begin in 2005, before Phase I gets formally under way.

The Kyoto Protocol will enter into force only if at least 55 countries representing 55 percent of worldwide GHG emissions ratify it. The 55-country threshold has been crossed in the last two weeks with ratifications by the European Union member states and Japan. Yet the U.S. pullout means that ratification by Russia or Canada and Australia is critical to reaching the 55 percent emissions threshold. Russia stands to gain substantially from the sale of carbon credits, so its ratification seems likely, although it is seeking advance assurances from Europe and Japan that they will buy those carbon credits. Canada and Australia were originally thought sure to ratify, but they are becoming more concerned about the possible impact on their competitive position in world markets.

No country that fails to ratify, like the United States, may participate in buying or selling carbon credits, although subsidiaries of U.S.-based companies in ratifying countries will have that opportunity.

OVERSEAS ACTION

The EU and its member states are leading the charge not only on ratification but also on implementation. The EU has committed to achieve a collective reduction in GHG emissions of 8 percent, with member states facing targets ranging from reductions of 28 percent for Luxembourg and 21 percent for Germany to allowable increases of 27 percent for Portugal, 25 percent for Greece, and 15 percent for Spain. Individual countries are responsible for achieving compli-

ance, but several EU-wide mechanisms will provide a common framework.

The most significant of these is the carbon trading program proposed by the European Commission last October and recently endorsed, with amendments, by the Environment Committee of the European Parliament. It is intended to allow those who can achieve reductions at the lowest cost to generate credits for sale to those whose carbon-reduction efforts would be more costly. As proposed, the program, which will take effect in 2005, covers only CO₂ and focuses on the electric power, refining, and other selected sectors. It excludes chemical plants, transport, and agriculture. At the outset, each member state will have some discretion in determining the emissions allowances that will be issued to particular facilities, although it appears that, beginning in 2008, all emissions allowances will be auctioned.

Other state-sponsored carbon trading programs already exist in Europe, but the EU has said it expects all member states to adhere to the common program when it takes effect. EU-wide efforts are also likely to include renewable energy requirements, carbon taxes on transport fuels, and vehicle fuel efficiency standards.

Notwithstanding its vocal leadership on the issue of climate change, the EU may have difficulty achieving compliance. Electricity competition is being introduced in Europe, which tends to drive power suppliers toward coal and away from more-costly renewable energy sources. The German, Belgian, Dutch, and Swedish governments have committed to phase out carbon-emissions-free nuclear power. And in some countries,

carbon emissions in the transport sector are up sharply.

Meanwhile, the EU carbon trading program permits recognition of credits from outside the EU only upon negotiation of further agreements with countries that have robust GHG accounting and compliance programs in place. Those programs do not yet exist.

In Japan, the government has announced its intention to achieve only 0.5 percent of its 6 percent reduction target through voluntary programs at home. It plans to meet the remaining 5.5 percent reduction through international projects, particularly in the developing world. Again, that strategy depends on host countries developing reliable GHG accounting programs.

AMERICAN PLANS

The Bush administration has called for a voluntary program to reduce the “carbon intensity” of the U.S. economy—the rate of carbon emissions per unit of gross domestic product—by 18 percent over the next 10 years. The program also calls for renewable-energy tax credits, more research and development, and a registry that enhances measurement accuracy, reliability, and verifiability of GHG emissions reductions.

The president’s program has been criticized on the ground that an 18 percent reduction in carbon intensity merely leaves this country on the trajectory of improved energy efficiency that it is already on. Some view it as nothing more than “business as usual.”

Others point out, however, that even when the United States was expected to ratify Kyoto, a substantial portion of its compliance was anticipated to come through tradable credits from projects elsewhere in the world, rather than from domestic reductions. The projected reductions in carbon intensity achievable through voluntary programs at home, they argue, is comparable to what would have been domestically achieved under Kyoto.

To date, Congress has been cautious as well. The House energy bill offers fairly modest research, efficiency, and incentive programs. The main Senate bill includes provisions for a more robust GHG registry, although reporting remains voluntary for at least five years. The Senate bill also calls for the development of a “National Climate Strategy.” The only mandate is for utilities to increase the percentage of their electricity sales from renewable sources to 10 percent over nearly 20 years. The “four

pollutant” legislation of Sen. Jim Jeffords (I-Vt.) calls for limits on carbon emissions, but that bill appears to be stalled.

OUTSIDE WASHINGTON

Oddly for an issue referred to as “global” climate change, the locus of most threatened regulatory action in the United States is the states. The New England states have agreed with the eastern Canadian provinces to reduce carbon emissions to 1990 levels in 10 years. The New Hampshire Legislature is close to final approval of a bill to regulate CO₂ emissions from that state’s power plants.

Farther west, the California Senate has passed a bill to require reduced carbon emissions from automobiles. Sharply opposed by the auto industry, which is not well-equipped to produce a separate product line for just one state, its fate is not clear. The Colorado Senate has approved a bill mandating that 10 percent of the state’s electricity come from renewable sources by 2010, 10 years earlier than provided for in the U.S. Senate bill. And more than a dozen states already have renewable portfolio standards in place.

Even as governments worldwide struggle with the issue of GHG emissions, there is, not surprisingly, no outcry from private industry for mandatory controls. Nevertheless, many companies seem to recognize the risk of (or need to be ready for) a carbon-constrained future. Every day it seems that a new corporate initiative to limit GHG emissions is announced.

For example, DuPont has publicly committed to a 20 percent reduction. PSEG recently reached a “voluntary agreement” with regulators to reduce CO₂ emissions from its power plants by 15 percent. General Motors has committed to a 10 percent reduction at its North American facilities between 2000 and 2005. Miller Brewing is seeking an 18 percent reduction over five years. And Alcoa is committed to a 25 percent reduction between 1990 and 2010.

Separately, several groups of large utilities have pointed out the need for regulatory certainty on the carbon issue. Others have joined either a business leadership council at the Pew Center on Global Climate Change or the GHG Protocol Initiative of the World Resources Institute, signaling their view that the question is no longer whether to control GHG emissions, but how and when.

This growing corporate move to limit GHG emissions makes it more difficult for others to argue that GHG regulation is “too hard” or “too costly.” Of course, many of those moving forward are multi-

nationals who face direct GHG regulation outside the United States. U.S. participation in Kyoto might give them more flexibility to reduce compliance costs by trading credits internally.

DOWN THE ROAD

Subsidiaries of U.S. companies in ratifying countries will be subject to GHG emissions limits and able to earn and sell carbon credits. But neither the levels of emissions that will be permitted nor the terms under which trades will be recognized have been established yet. A modest level of trading has already begun, but it is based largely on educated guesses about what will qualify.

In Europe, the current disposition is to take a very hard line on recognizing carbon credits from outside the EU. That is likely to change only when developing countries put in place sufficient accounting and monitoring systems to demonstrate that particular projects are in fact responsible for reducing carbon emissions. And that may be a tall order.

For those in the United States with substantial export business, threats to use international trade treaties and conventions to attack U.S. products because of the U.S. failure to ratify Kyoto represent an additional worry. Established trade law principles suggest that such efforts should fail, but there could be substantial costs associated with defending against that kind of challenge.

For operations within the United States, the two principal areas of concern are whether piecemeal state efforts will proliferate and whether actions taken now to reduce GHG emissions will receive appropriate credit in the event a mandatory federal program is developed. The effort currently under way to enhance the Department of Energy’s GHG registry may prove critical to ensuring that early reductions are fully credited. On the other hand, for those who want to forestall federal action, it cannot be ignored that a good accounting system today will make it easier to move to a full-fledged regulatory program tomorrow.

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