

Preserving Additionality of Complementary GHG-Reduction Actions under Waxman-Markey

Although the Waxman-Markey bill that is before the House of Representatives falls short of the “science-based” targets sought by climate scientists, complementary actions by states, cities, corporations and individuals could help move the nation closer to the goal of climate sustainability. But the House bill, as currently written, would perversely deter complementary GHG-reduction efforts because it does not provide adequate mechanisms for ensuring that such actions will actually lead to additional emission reductions. Instead, the reductions could simply result in a transfer of emission rights between regulated entities.

For example, the city of Berkeley, California has developed an innovative program (“Berkeley FIRST”) for financing residential solar installations with municipal bonds. Under Waxman-Markey’s cap-and-trade system any emission reductions resulting from Berkeley FIRST would reduce the number of allowances that the local power utility must surrender to meet its compliance obligation. The unneeded allowances could be sold or banked, and would allow correspondingly greater emissions elsewhere. The potential environmental benefits of Berkeley FIRST would be nullified by emission trading, and the only benefit that the program could claim would be reduced compliance costs for regulated entities.

Waxman-Markey contains strong protections for the rights of states and localities to regulate GHG emissions independently of the federal program. But unless states and cities are also granted rights to the surplus allowances resulting from their regulations, the federal protections would, in effect, merely authorize them to subsidize fossil-fuel industries.

There is one provision in Waxman-Markey (Sec. 334) that comes close to granting such rights. It authorizes a state to “require surrender to the State ... emission allowances ..., and require the use of such allowances ... as a means of demonstrating compliance with requirements established by a State ...”. But this provision is weak. It seems to be based on the implicit premise that state-regulated entities hold freely-allocated allowances that have become surplus as a result of state-mandated emission-reduction requirements. But the surplus allowances could be held by other entities, which might not even be within the state. For example, California plans to enact vehicle emission standards more stringent than federal standards. In this case, the regulated entities would be vehicle manufacturers, but the resulting surplus allowances would accrue to fuel refineries supplying the California market. Could Waxman-Markey constitutionally grant California authority to require refineries, including those operating out-of-state, to surrender surplus allowances resulting from the state’s vehicle regulations? Also, the surplus allowances might not be freely allocated. Could the state require surrender of allowances from an entity that is not entitled to free allowances? Furthermore, the objective of “demonstrating compliance with requirements ...” does not make a connection between the surrendered allowances and the surplus allowances resulting

from state requirements. State or local regulations might not even entail “requirements;” they could simply provide regulatory incentives or financing (as does Berkeley FIRST).

The surplus allowances could be captured more effectively by a process whereby the EPA would establish allowance set-asides for qualified state and local programs, including incentive-based and voluntary programs, that result in emission reductions additional to what federal regulations would achieve. This would help ensure that the cap-and-trade program does not discourage or deter early action pursuant to climate stabilization goals.

The set-asides for early action would somewhat resemble allowance offsets operating “in reverse”. Offsets result from additional emission reductions outside the capped sector, and regulated entities’ use of offset credits has the effect of injecting surplus allowances into the market. Early-action set-asides, by contrast, would result from additional emission reductions *within* capped sectors, and would take surplus allowances *out* of circulation. Some of the qualification criteria and administrative management procedures that apply to offsets could perhaps be adapted for application to allowance set-asides, but the qualification criteria need not be as stringent because set-asides would not affect the integrity of the cap – they would only affect allocation.

An allowance set-aside mechanism would only apply to emission reductions resulting from state or local policies that meet accredited accountability standards. But there is a more direct way of ensuring additionality of GHG-reduction actions of any kind, including individual and corporate actions that are outside the scope of any formalized regulatory program.

Waxman-Markey establishes a price floor of \$10/ton on auctioned emission allowances (increasing by 5% per year over inflation). If allowances are selling at the floor price, then surplus allowances resulting from complementary GHG-reduction actions will remain unsold because the number of allowances distributed would be determined by how many buyers are willing to pay \$10/ton; it would not be determined by the cap. A higher price floor would reduce the likelihood that the environmental benefits of complementary actions would be nullified by emission trading.

A higher price floor may be politically unviable unless it is accompanied by a sufficiently constraining price ceiling. (Waxman-Markey’s “strategic reserve” does not guarantee any predetermined price ceiling after 2015.) Emission trading systems such as the U.S. acid rain program, RGGI, and the EU-ETS have generally tended to be susceptible to long-term price erosion or collapse, so accepting a well-defined price ceiling in exchange for a higher price floor (at least in the early years of the program) could be a good compromise.

The Waxman-Markey bill will likely pass the House without much revision, so it will be the task of the Senate to ensure that the final legislation preserves additionality of complementary GHG-reduction actions. Otherwise, such actions would be tantamount to charity for fossil-fuel industries.

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