electric light & power

benefit of counsel: new cap and trade programs target reductions in CO_2, mercury, SO_2, NO_x

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Recent developments in the regulation of air emissions from power generation facilities portend increased compliance costs coupled with market mechanisms designed to offset some of those costs. The regulatory approach known as "cap and trade" establishes an aggregate national, regional or state limit on the amount of annual emissions of a particular pollutant and allocates allowances—that is, permission to emit a given amount of a pollutant—to existing emissions sources. Simultaneously, a market is established to encourage trading of allowances at a market price that leads to the economically efficient achievement of the emissions cap. Compliance strategies that achieve reductions in emissions at a unit cost lower than the market price for allowances creates the potential for offsetting those costs by selling unneeded allowances on the market. Over time, the cap can be reduced and the price of allowances can increase accordingly. The 1990 amendments to the Clean Air Act established such a program to reduce sulfur dioxide (SO_2) emissions which is widely viewed as successfully achieving socially cost-effective reductions in overall emissions.

Three new cap and trade programs were recently finalized or will soon be implemented for a variety of air pollutants. The Environmental Protection Agency (EPA) finalized two new rules in March, one establishing a cap and trade program for mercury and another establishing a program for SO_2 and oxides of nitrogen (NO_x) in the Eastern half of the nation. Another proposed cap and trade program for states in the Northeast and mid-Atlantic states will be the first regional domestic program to regulate carbon dioxide (CO_2) emissions. Each new market is expected to take time to mature, and as they mature, so do opportunities for offsetting compliance costs with creative compliance strategies. Following is a brief overview of these new programs.

Clean Air Interstate Rule

On March 10, 2005, EPA finalized its Clean Air Interstate Rule, designed to create a cap and trade system for SO_2 and/or NO_x in 28 states and the District of Columbia. According to EPA's modeling, based upon assumptions regarding the performance of allowance markets and the full participation of affected jurisdictions, the interstate program will achieve significant reductions in SO_2 (45 percent reduction from 2003 levels by 2010) and NO_x (53 percent reduction from 2003 levels by 2009)—with greater reductions achieved by 2015. The program maintains some flexibility for state programs, and allows states to choose between participating in an allowance market overseen by EPA or implementing its own program to achieve the results expected from EPA's newly created market.

Mercury Rule

On March 15, 2005, EPA created an emissions trading program designed to cap mercury emissions from coal-fired power plants. National in scope, the rule hopes to achieve overall reductions in mercury emissions by nearly 70 percent from the current level of 48 tons per year. The rule establishes a two-step emissions cap: The first cap will be set at 38 tons, and in EPA's view can be achieved as a secondary benefit of the reductions in SO_2 and NO_x associated with the Clean Air Interstate Rule, and the second cap, not expected until 2018, will force emissions below 15 tons per year.

The mercury rule is controversial. Amid allegations that EPA intentionally ignored a study (that EPA sponsored and peer reviewed) which concluded sub-

stantially higher health benefits associated with reductions in mercury emissions, 10 states have filed suit arguing, among other things, that the installation of available technologies could result in mercury emissions of 5 tons per year, or about 11 percent of current levels. Congress already is considering legislation that would require similar reductions. A successful challenge to the rule (or new federal legislation) may result in a more traditional "command and control" approach to mercury emissions that requires specific emissions control technologies to achieve even greater reductions at greater cost to industry.

Regional Greenhouse Gas Initiative

On February 16, 2005, the Kyoto Protocol came into effect following Russia's ratification of the Protocol late last year, representing an international effort to mitigate climate change. The Protocol establishes a new international market for CO_2 emissions and requires participating countries to reduce greenhouse gas (GHG) emissions to 5 percent below 1990 levels. While the United States has not ratified the Protocol, and federal legislation for the domestic regulation of CO_2 emissions remains unlikely in the short-term, regional and state initiatives are well under way.

Nine states in the Northeast and mid-Atlantic region (Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont) have been collaborating on the Regional Greenhouse Gas Initiative, a program to develop a regional cap and trade program for GHGs. A final agreement on the program design is expected by summer 2005, and will initially target CO_2 emissions from power plants in member states by allocating allowances solely to such facilities. The program will be designed for multi-faceted expansion, with mechanisms in place to increase the number of member states, GHGs covered, and the types of industrial facilities subject to cap and trade requirements. The initiative is likely to become a model for implementation of similar CO_2 cap and trade programs around the country. Whether these domestic, regional markets for CO_2 emissions allowances prove more attractive to U.S. industry than the international market created by the Kyoto Protocol remains to be seen as these markets mature in the coming years.

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