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Proposed U.S. Legislation and Carbon Leakage

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Andrew Shoyer
Washington, D.C.
ashoyer@sidley.com

Our Story So Far . . .

- Seeking to create **leverage** for US climate negotiators, and informed by Byrd-Hagel Resolution and international treaty rules, AEP and its trade union proposed (in February 2007) **imposing allowance requirements** on imports from countries failing to take action comparable to US
- Other US stakeholders, concerned largely with **loss of competitiveness**, proposed **free allowances** for carbon-intensive industries
 - Under scrutiny from environmental groups, changed to **carbon-based rebates** to secure US production and jobs
- In Waxman-Markey bill passed June 2009, House approved carbon-based rebates, supplemented by border measures, to address **carbon leakage**
- With health care debate in foreground, Senate might be forced to work within House framework, making changes at margins
 - Meanwhile, EPA continues to develop regulatory **standards** . . .

Why Should Emissions Traders Care?

- Because . . .
 - Politically, getting these cross-border issues right is **critical** (but not sufficient) to creation of US cap-and-trade system
 - **All** of the solutions introduce **some risk** of vulnerability under international trade treaty rules, and that risk might
 - Slow capital investment in new technology
 - Lower market prices for allowances and credits
 - The more **WTO-compliant** the solution, the **healthier** the long-term outlook for emissions trading

Climate Change Regulation The Way It Should Work

Global Consensus



Federal Legislation



Federal Regulation



Regional and Local Implementation



Litigation

Climate Change Regulation

The Way It Is Working in the United States

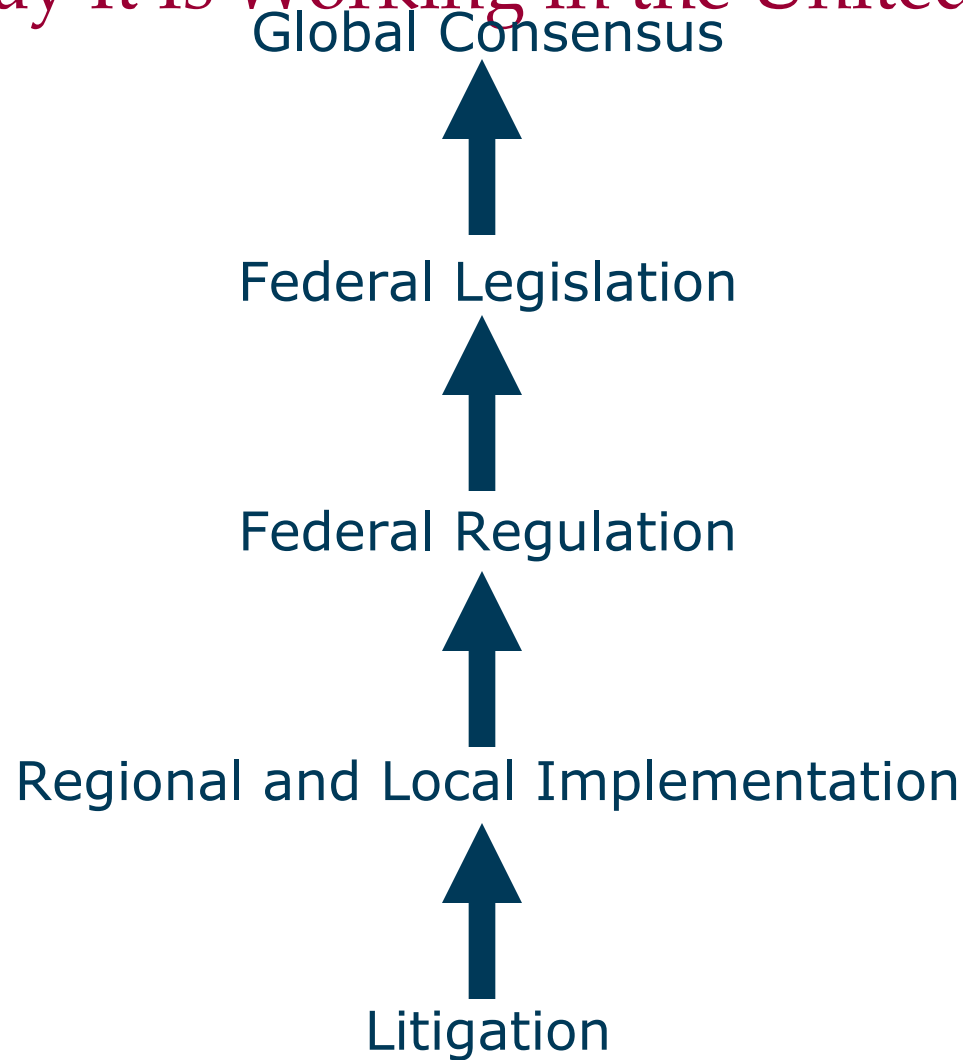
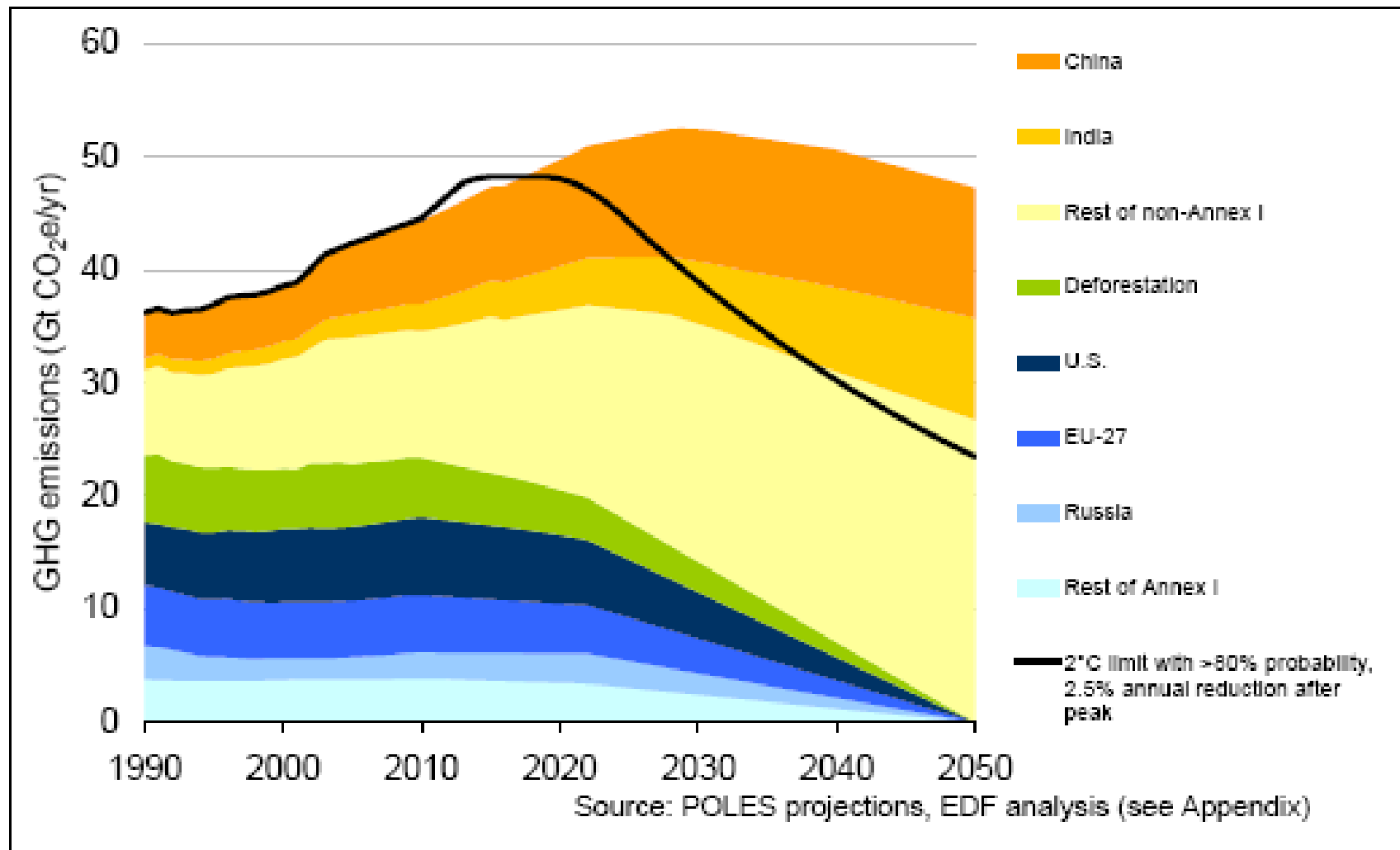


FIGURE 1: Projection of developing countries' GHG emissions through 2050, with "Two-Degree Emissions Pathway", and industrialized nations' emissions and emissions from deforestation declining to zero by 2050



Major Concerns

The cross-border policy concerns associated with the regulation of greenhouse gas emissions range across a spectrum, from the purely economic to the purely environmental

Economic

Environmental



Loss of

Carbon

Loss of

Competitiveness

Leakage

Effectiveness

Policy Options

- Internal measures
 - Free allowances
 - Output-based rebates
- External measures
 - Border tax
 - Allowance requirement
 - Sectoral carbon-intensity standard

Treaty Rules - UNFCCC

- “Measures taken to combat climate change, including unilateral ones, **should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.**”
 - Article 3 (Principles), paragraph 5, UN Framework Convention on Climate Change (1992)
 - Highlighted text is taken from Article XX, WTO General Agreement on Tariffs and Trade 1994
- “All Parties, taking into account their **common but differentiated responsibilities** and their specific national and regional development priorities, objectives and circumstances, shall”
 - Article 4 (Commitments), paragraph 1, UNFCCC

Treaty rules – WTO

Internal regulation or import measure?

- If it is considered an internal regulation (affecting domestic and imported goods), then
 - GATT Article III – Generally permitted if “applies to an imported product and the like domestic product”
 - WTO-UNEP Report (2009) -- Border tax adjustments permitted, under certain conditions, on imports and exports goods
 - Distinction between indirect taxes (e.g., on products or value added) and direct taxes (e.g., on income)
 - GATT Article III:4 -- A government may not treat imported goods less favorably than like domestic goods, so as to afford protection to domestic production.
 - Emphasis on conditions of competition
 - But are goods made with different levels of GHG emissions “like products” – process or production method (PPM)?

Treaty rules – WTO

Internal regulation or import measure? (2)

- If it is a border measure (affecting imports), then
 - GATT Article II: A government may not impose customs duties or other duties or charges on imports in excess of its scheduled tariff concessions.
 - GATT Article XI: A government may not impose restrictions, other than duties, taxes or other charges, on imports.
- BUT either way, if the measure distinguishes between the goods of different countries (e.g., based on their GHG emissions), then
 - GATT Article I: Most-favored-nation treatment

Treaty rules – WTO

General exceptions

- Even if a measure violates a GATT rule, a government may impose it anyway if
 - GATT Article XX(b): necessary to protect human, animal or plant life or health, OR
 - GATT Article XX(g): relating to the conservation of exhaustible natural resources, taken in conjunction with restrictions on domestic production or consumption, AND
 - GATT Article XX chapeau: not applied in a manner that would constitute
 - Means of arbitrary or unjustifiable discrimination between countries where same conditions prevail, or
 - Disguised restriction on international trade

Treaty rules – WTO

Free allowances - Subsidies

- A measure is actionable as a subsidy if -
 - SCM Article 1: a government provides a financial contribution, e.g., revenue is foregone, and confers a benefit
 - SCM Article 2: it is specific to certain enterprises
 - SCM Article 5: it creates adverse effects to the interests of another Member government, including injury to a domestic industry, or
 - SCM Article 6: serious prejudice, which could include price suppression in a third country market
- A subsidy could be challenged –
 - in a countervailing measure proceeding or
 - in a WTO dispute settlement proceeding

IBEW-AEP Proposal

(February 2007 – Senate June 2008)

- Upon passage of US legislation, US would make good faith effort to negotiate with all significant emitters to achieve real reductions in GHG emissions comparable to that achieved in US
- Importers of “covered” goods produced in countries that failed to take comparable action would be required to hold international reserve allowances
 - Covered goods = primary goods, i.e., corresponding to US goods most impacted by US cap-and-trade, but could extend to manufactured goods if practicable
 - International reserve allowances = sold by US at same price as regular US cap-and-trade allowances, but from separate, unlimited pool; could satisfy with other (EU) allowances also
- To ensure even-handedness, requirement on importers adjusted to reflect free allowances given to domestic industries

Waxman-Markey Bill American Clean Energy and Security Act of 2009



“A legislative
Susan Boyle”

Chairman Waxman

Waxman-Markey Bill

Main Elements

- Renewable Energy Standards
- Energy Efficiency
- Emissions Trading Scheme (“cap-and-trade” regime)
- Transition to a Clean Energy Economy (including competitiveness and adaptation provisions)

Waxman-Markey Bill

Rebates to address carbon leakage

- Specifies distribution of emission allowances to key sectors or for certain key purposes; rest auctioned off
- Carbon-based rebates (i.e., free allowances)
 - Available to eligible industrial sectors with
 - 5 percent – energy or GHG intensity
 - 15 percent - trade intensity
 - Which sectors? Determined by 2011
 - Rebate calculated based on sum of
 - direct carbon factor
 - indirect carbon factor
- Designed to cover compliance costs from 2012 through 2025, then rebates will phase out from 2025 until 2035.

Waxman-Markey Bill

Allowance requirements on imports

- Soon after enactment, the President must
 - notify other countries that it is US policy to address climate change through international agreements,
 - request that other countries take appropriate measures to limit their GHG emissions, and
 - indicate that imported goods may be subject to international reserve allowance requirements beginning in 2020.
- The President will report to Congress by 2017 on the effectiveness of rebates in preventing carbon leakage and the usefulness of imposing an international allowance requirement on imports of covered goods, defined as
 - industrial goods that are energy- and trade-intensive, or
 - manufactured goods if EPA determines they should be covered.

Waxman-Markey Bill

Purpose of international allowance requirement

- What is the stated purpose of the program?
 - “To induce foreign countries, and in particular, fast-growing developing countries, to take substantial action with respect to their greenhouse gas emissions consistent with the Bali Action Plan” under the UNFCCC, and
 - “to ensure measures . . . are designed and implemented in a manner consistent with applicable international agreements.”
 - “Congress finds that the purposes . . . can be most effectively addressed and achieved through [negotiated] agreements.”
 - “Work proactively under the [UNFCCC] and other fora to establish binding agreements, including sectoral agreements, committing all major [GHG]-emitting nations to contribute equitably to the reduction of [GHG] emissions.”

Waxman-Markey Bill

Establishment of allowance requirement

- If by 2018 the United States has not entered into an international climate change agreement, then the President shall establish an international reserve allowance program
 - UNLESS the President determines it would not be in the national interest AND
 - Congress passes an affirmative joint resolution within 90 days.
- EPA would create a pool of international reserve allowances separate from the allowances that domestic entities must use to comply with their cap-and-trade obligations
- EPA would sell the international reserve allowances at the same price at which the domestic allowances are offered for sale

Waxman-Markey Bill

Sectoral coverage of international allowances

To identify the industrial sectors subject to the international reserve allowance requirement, the President shall by July 2018 determine whether, for any carbon-intensive sector, more than 85 percent of imports come from countries that meet one of three criteria:

- (1) the country has taken in an international agreement a nationally enforceable, economy-wide emissions reduction commitment at least as stringent as the US commitment;
- (2) the country and the US are parties to a sectoral international agreement; or
- (3) the energy or carbon intensity of the sector is equal or less than in the US

Waxman-Markey Bill

Sectoral coverage of international allowances (2)

- If the President identifies an eligible sector where the percentage/criteria are not met, then he must extend rebates and impose an international reserve allowance requirement.
 - But EPA must adjust to as low as zero the international reserve allowance requirement for a sector to account for the benefit to that sector of free allowances to electricity providers and rebates to industrial sectors.
- If, on the other hand, the President identifies a sector for which the percentage/criteria are met, then the President is prohibited from applying an international allowance requirement.

Waxman-Markey Bill

Country exemptions from international allowances

- The goods of a country would be exempt from an international reserve allowance requirement if it -
 - meets any of the three criteria on slide 21 (for a sector);
 - is listed by the UN as a least developed developing country; or
 - is responsible for less than 0.5 percent of global emissions and 5 percent of imports of covered goods with respect to the eligible sector.
- SO . . . this creates strong incentive for a country to –
 - enter into a post-Kyoto multilateral climate change agreement AND take a carbon reduction commitment, OR
 - enter into agreements (at least bilateral) with the US on its key sectors

US climate change legislation

Support and next steps

- Support for both types of measures!
 - Output-based rebates had broad House support
 - More than 10 Senate votes depend on “border measures”
- Further steps:
 - Boxer, Kerry (EPW Committee) produces draft bill
 - Mark-up in Finance (Baucus), others
 - Consideration and vote by Senate
 - Conference between House and Senate to resolve differences
 - Passage by House and Senate
 - Signature by President