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Cap and Trade: Is It In Your Future?

Michael L. Faltischek

From the outset of his campaign, President Obama advocated for a strong government policy regulating air quality to impact climate change. This marked a departure from years of avoiding serious efforts to improve air quality at the national level, including refusal to support the Kyoto Accords, adopted by 140 nations and effective since 2005. While the final form of the Obama program is still taking shape, the core elements are now clear.

The cornerstone of pending legislation in Congress is to reduce harmful emissions in the atmosphere by placing a "cap" on what can legally be emitted. At the outset, the target would be companies that emit large amounts of greenhouse gases (primarily utilities, oil companies and other industrial manufacturers). The threshold for a company would be the emission of more than 25,000 tons of greenhouse gas annually. Over time, the "cap" would be reduced and extended to other industries. To the extent emissions of greenhouse gases exceed the cap, a company would need to secure "credits" for each ton emitted over the cap. These credits would be acquired either by a government allowance or through purchase at an auction sale. Industries that can establish reductions in emissions to levels below those which exist when the legislation becomes effective (now based on 2005 for measuring levels of greenhouse gas emitted) will be able to "earn" credits. Those credits can then be sold or "traded" with companies in need of credits not otherwise available to them. Thus, the description of the entire program as "cap and trade."

At the same time that legislation is being prepared, the Environmental Protection Agency is taking steps to make a "cap and trade" system workable. A rule making the reporting of greenhouse gas emissions mandatory has been proposed and, in some form, will likely be effective later this year. The reporting threshold, as in the legislation for mandatory caps, would be the emission of 25,000 tons annually. The information to be collected will require industries to effectively monitor emissions. Monitoring and accurate reporting is critical in order to make a cap and trade system workable.

The cap and trade system has many implications for the future and for businesses. There is a clear economic impact which will permeate business and personal economic interests. The most readily apparent impact would be in the utility industry – notorious for its significant amount of greenhouse gas emissions in the production of electricity, accounting for nearly 35% of all greenhouse gas emissions in the United States. This industry will need to either secure credits (at unknown cost) or make substantial capital investments to insure compliance with reduced emission standards (to be capped at over 80% by 2050 in some forms of the pending legislation). Either way, additional costs will be incurred – borne ultimately by ratepayers. Similar consequences are faced by all industries that emit greenhouse gases.

Cost is coupled with opportunity in an effective cap and trade system. Renewable, clean energy sources such as solar and geothermal are clear beneficiaries. Renewable energy affords opportunities to reduce emissions by implementing reliance on those alternatives – both on large and smaller scale projects. Incentives established in recent federal stimulus legislation enhances implementing these technologies at all levels.

"Green" industry ventures will also benefit by earning credits. Examples of the industries that can benefit by a cap and trade system are waste to energy, landfill gas capture, forestry (restoration creating offsets to carbon emissions), truck, bus or car fleet management and any other business concept which fosters confirmable benefits in reducing the level of greenhouse gas emissions – whether by reduction or offset. In each case, the amount of carbon emission avoided by the use of clean energy or items considered to be "green" would be translated into a monetary benefit by selling the credits earned in the marketplace.

A voluntary cap and trade system already exists. Many companies have elected to pursue emission reduction practices for a variety of reasons. By doing so, these companies earn credits available for sale on private exchanges, which then make those credits available to companies which are already subject to emission reduction obligations (or others, including speculators). The methodology for earning credits varies, but any consideration by a company to limit emissions or implement "green" strategies that are eligible for credits should consider the benefit of earning credits through the voluntary compliance programs.

Cap and trade represents a gateway to new opportunities, new business ventures and a need for analysis of older activities with a continuing impact on air quality. Eventually, cap and trade will be expanded to carbon emissions in many areas of our daily business and personal lives. Successfully navigating these new waters will present challenges and issues to be considered. The professionals in our Energy Practice Group are prepared to address those challenges and provide creative solutions.

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