

The Proposed EPA Mandatory GHG Reporting Rule Telegraphing Cap-and-Trade Points of Regulation

For those who doubt the impendency of GHG regulation, the EPA's proposed rule of March 10, 2009 should serve as a loud alarm that federal GHG regulation is coming and that many of the points of regulation for cap-and-trade compliance have been targeted. A "point of regulation" is any facility that will be required to pay the cost of obtaining allowances and offsets to cover their GHG emissions and remit them to the EPA for compliance under a cap-and-trade program's true-up process.

On March 10th the EPA released proposed rules for a mandatory greenhouse gas (GHG) registry that is intended to cover 85-90% of the nation's GHG emissions – requiring reporting from approximately 13,000 facilities. The proposed rule requires reporting from direct emitters, "upstream" suppliers of fossil fuels and GHG chemical products, industrial chemical plants, and vehicle & engine manufacturers among others.

The final rule will be put into action in the next few months, likely before the design of the cap-and-trade system / carbon market is finalized by Congress. It will telegraph where many of the carbon market's points of regulation are likely going to fall - providing insight into the future of carbon-compliance markets.

The rule delineates points of regulation and specifies reporting requirements to be used in understanding the flows of carbon through our economy. The rule reaches beyond points of regulation in an effort to gather information from other entities as well. For example, the draft rule would require gas pipeline companies to identify end consumer loads over a specific consumption threshold. This can be interpreted as a check and balance in GHG emissions reporting so the EPA can look at both suppliers (the proxy for the majority of end-users) and large end-users as distinct points of regulation.

The EPA rule suggests the following points of regulation:

Coal – downstream at the boiler / stack (power plants, industrials)

Gas – downstream at the burner tip (gas fired power plants, industrials, LDCs as the proxy for smaller users)

Petroleum – upstream at the rack for the carbon content of the fuel when the fuel enters the economy. Refineries would likely have another point of regulation, not on carbon content of product, but rather for the direct emissions resulting from process emissions and fuel consumption

Chemicals – importers of GHGs (as products) upstream when they enter the economy, manufacturers of chemicals that produce GHGs will have to account for both the direct emissions from manufacturing and the GHG content in the end-use products

Fuel Processing Facilities – direct emissions from fuel processing

"...federal GHG regulation is coming and the points of regulation for cap-and-trade compliance have been targeted."

The reporting rule has rigorous requirements that must be highlighted, independent of how it telegraphs the points of regulation for a future multitrillion dollar carbon market. The threshold level for most facilities that have been proposed as required to report is 25,000 metric tons of CO₂e (Carbon Dioxide equivalent). In energy consumption terms this is roughly equivalent to 11,000 tons of coal or 460,000 MMBtu's of gas burned in a calendar year. Exceeding the threshold emissions mark at a facility will trigger reporting / EPA registry requirements, while certain enumerated industries and fossil fuel suppliers will need to register irrespective of total GHG emissions. The chart below summarizes the specifically enumerated reporting-requirement thresholds.

The bottom line is that companies with operations on this list or that have facilities emitting at or above the threshold levels, have very little time to mobilize for reporting compliance. Under the draft rule reporting will be required for 2010 emissions, which means covered entities have a little over 8 months to develop procedures for inventorying, calculating, documenting, and reporting GHG emissions.

Furthermore, for those businesses that may be in the EPA's cross-hairs as a point of regulation, near-term preparation a pre-compliance carbon management strategy to plan for, and mitigate future compliance costs is prudent. Accounting for GHG emissions in a rigorous and programmatic manner will meet the requirements of the EPA and is the first step in managing and mitigating carbon's potential impact. Doing so well will improve your competitive position; those who are unprepared will find themselves in crisis management mode.

The following is a deeper dive into the EPA GHG emissions rule and highlights the implications for business:

Specific Industries and Fossil Fuel Suppliers Regulated "Upstream"

Specific industries (specifically industrial processes) and fossil fuel suppliers are regulated "upstream" at the supplier level. There is no threshold emission level that a facility will trigger in order to require registry. If an industrial is enumerated as a covered source within the rules, their GHG emissions report must include all sources in any source

category. Inherent in requiring "upstream" and "downstream" reporting, is double-reporting for some entities.

Production / Direct Emitters Regulated at the Facility Level

With exception of enumerated industrial chemical and fossil fuel suppliers (product based), the proposed rules place registry requirements at the facility level. Owners and operators of facilities that have source emissions greater than 25,000 metric tons of CO2 will be required to register. The threshold amount will take into account aggregate emissions from all units at a facility. If a facility triggers the threshold, they must report all emissions from all source categories. The rules do not currently require reporting of mobile source emissions; however that may change for large onsite mobile fleets.

The Impendency of GHG regulation

The EPA states the purpose of the reporting rules as a two-fold framework. First, reporting allows for a better understanding of the relative emissions for various industries and the distribution of emissions from facility to facility within each industry. Second, reporting rules will act as a supplement to both existing and future climate change policy. Make no mistake about it: the purpose of these rules is to lay the foundation for carbon cap and trade. It is reasonable to anticipate that there will be transition assistance via an allowance set-aside or other mechanism to mitigate the carbon-based electricity cost increases borne by energy

Industrial Suppliers	Fossil Fuel Suppliers	Production / Direct Emitters	Stationary fuel combustion (Catch-all)*
<i>No Threshold</i>	<i>Minimal / No Threshold*</i>	<i>25k metric ton CO2e threshold</i>	<i>25k metric ton CO2e threshold</i>
Adipic acid Aluminum Ammonia Cement HFCF-23 Lime Nitric acid Petrochemical Petroleum Phosphoric acid Silicon carbide Soda ash Titanium dioxide Underground Coal Mines Electronics (LCD, MEMs, Semiconductor manufacturing	Coal Coal-based liquid fuels Petroleum Natural gas Liquid Natural Gas Industrial GHGs (producers) *Importers and exporters of industrial GHGs must register if imports or exports exceed 25K metric tons CO2e per year	Electricity Generation Electronics - PV Ethanol Ferroalloy Fluorinated GHG Glass Iron & Steel Lead Magnesium Oil & Gas Systems Pulp & Paper Manufacturing Zinc Industrials Landfills Wastewater Treatment Municipal Landfills Manure Management Vehicle & Engine Manufacturer	Encompasses all facilities who have stationary combustion sources that emit 25k metric tons CO2e per year and have a heat input capacity for all units at the facility of 30 MMBtu/hr or greater *Requires most facilities who combust fossil fuel on site and exceed the threshold amount to register.

Source: Pace

intensive industrials. In order to administer the mechanism, the EPA could very well include indirect emissions from electricity in a facility's emissions report. Thus, even though it is not yet a part of the proposed rule, do not be surprised if indirect emissions are a part of the final rule.

The Proposed Reporting Rule's Penalties Under the Clean Air Act

The proposed reporting rule draws authority from the Clean Air Act (CAA). Failure to report, collect the necessary data, continuously monitor and test, retain records, and calculate GHG emissions following one of the prescribed methodologies will result in violations under the CAA. Penalties range from civil and administrative penalties to criminal charges depending on the severity of the violation and can be cascading. Under the CAA, the EPA is entitled to fine a non-complying facilities as much as \$32,500 a day for each violation. The maximum civil penalty for non-complying facilities will increase every four years under the Federal Civil Penalties Inflation Adjustment Act.

Within each enumerated sector, of which there are over 35, there are specific calculation methods and reporting requirements tailored to that industry and associated processes. Inaccurate reporting will lead to civil or administrative penalties. Submission of a report that is found to be intentionally misrepresented may lead to criminal charges.

Future Perspective

Under the draft rule reporting will be required for 2010 emissions, which means covered entities have a little over 8 months to develop procedures for inventorying, calculating, and documenting GHG emissions. The truth is that today there is support in this Congress for carbon regulation – support we believe will translate into enactment of legislation between Q3 2009 and Q3 2011. The Obama administration has also said explicitly that it will act under the authority of the Clean Air Act if Congress does not. Predictions aside, any business that holds off on preparations for compliance reporting or business planning for carbon management is increasing the risk that they will be unprepared and at a competitive disadvantage. To be clear there is no certainty with respect to Congress, the Obama administration and the provisions of carbon regulation, but there is a heightened expectation of management prudence. Prudent companies should interpret the EPA's draft reporting rule as a clear signal of what should be planned for and what has to be managed in the very near future. Delay and avoidance is not a strategy that will serve business well; the probability of occurrence and the potential impact from carbon regulation is far too great for those companies that are in EPA's crosshairs.

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