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BLOG

CSAPR's Emission Allowance Trading Program

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EPA's recently finalized Cross State Air Pollution Rule (CSAPR) requires upwind states to reduce the portion of their state-wide nitrogen oxides and sulfur dioxide emissions that contribute significantly to nonattainment or interfere with maintenance in another state with the annual fine particle matter, 24-hour fine particle matter, and ozone NAAQS. To achieve these reductions, CSAPR establishes nitrogen oxides and sulfur dioxide budgets for each of the covered states and then allocates nitrogen oxides and sulfur dioxide allowances to each of the covered (power plant) units in those states consistent with those budgets. CSAPR also assigns each state a yearly variability limit, which allows a state to exceed its nitrogen oxides and sulfur dioxide emissions budgets by a certain percentage. CSAPR marshals this process through the imposition of an "assurance provision" that prohibits each covered state from exceeding its budget for nitrogen oxides and sulfur dioxide plus the variability limit. Each covered unit in the state whose emissions exceed its allocation plus its share of the variability limit must surrender an assurance penalty of two allowances in addition to the allowance already submitted for compliance, even if the unit held sufficient allowances to cover it's all of its emissions.

CSAPR's assurance provision and its penalties are a vital consideration for sources as they conduct emissions trading under CSAPR. CSAPR establishes four interstate trading programs that begin in 2012: (1) Sulfur Dioxide Group 1 (a group of states required to make deeper cuts in sulfur dioxide emissions); (2) Sulfur Dioxide Group 2; (3) annual nitrogen oxides; and (4) ozone-season nitrogen oxides. These trading programs mirror the 4-tier allocation scheme under CSAPR, and they are separate and distinct programs. While EPA envisions robust allowance trading programs under CSAPR, other industry observers have expressed concerns. Those concerns are generally summarized as follows:

- The stove-piped nature of the four separate trading programs might decrease the general availability of the allowances needed for robust trading. For example, covered sources may only trade sulfur dioxide allowances within their respective sulfur dioxide groups (i.e. Group 1 states may only trade with other Group 1 states). Thus, even if additional sulfur dioxide allowances are available from Group 2 sources, Group 1 sources will not be able to acquire them and Group 2 sources will not be able to realize their value.
- Even where allowances are available for trading, the assurance penalty might deter sources from acquiring them. Bringing additional emission allowances into the state may cause statewide emissions to exceed the assurance threshold, resulting in severe penalties. In some states, (i.e. New Jersey and Maryland) the variability limit is

narrow, and it may be difficult for sources in those states to acquire and use additional allowances without exceeding the assurance threshold.

- The final rule eliminated the “opt-in” provision that would have allowed non-covered sources to participate in the CSAPR’s trading programs. This may result in a less dynamic trading program and reduce the number of allowances available for trading.

Some observers fear that the stove-piped nature of the CSAPR allowance trading markets, the scarcity of allowances available for trade, and the disincentives to trade caused by the assurance penalties will culminate in an ineffective allowance trading market. It remains to be seen whether the practical challenges involved in implementing CSAPR’s trading programs will stifle a robust emission allowance trading program.

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