

**Money for Nothing, Chits for Free:
Excerpts from the Experts on
The Bush Administration's Greenhouse Gas Crediting Plan**

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I. Overview

This paper – a research aid for journalists, policymakers, and citizens – provides multiple glimpses into a key “inside baseball” debate on U.S. climate and energy policy.

The paper excerpts passages from comments submitted to the Department of Energy (DOE) on the Bush Administration's plan to revamp the Voluntary Reporting of Greenhouse Gases Program (VRGGP), established under Section 1605(b) of the 1992 Energy Policy Act. Those passages shed light on the most controversial and consequential feature of the Administration's initiative: President Bush's directive to DOE “to ensure that businesses and individuals that register reductions are not penalized under a future climate policy, and to give transferable credits to companies that can show real emission reductions.”

CEI has long warned that government-sanctioned transferable greenhouse gas (GHG) credits will: (a) create the institutional framework for a future Kyoto-style emissions cap-and-trade program, and (b) grow the “greenhouse lobby” of Enron-like companies seeking to profit from Kyoto and kindred energy rationing schemes.

Many of the comments submitted to DOE corroborate, illustrate, or supplement CEI's critique of GHG credit schemes. Excerpts presented in this paper provide evidence that:

- GHG credits are a first step towards energy rationing and serve no purpose apart from energy rationing
- The Administration has no legal authority to protect companies' emissions baselines and award credit for early action

- It is inappropriate to provide baseline protection or award credit for early action prior to enacting a cap-and-trade program
- GHG credits are not needed to protect companies' emissions baselines under a future climate policy
- Giving credits for "real" (tonnage) reductions conflicts with the President's goal of replacing Kyoto-style tonnage targets with an emissions intensity target
- GHG credits will provide windfall profits for "anyway tons" – monetary rewards to companies for doing (or not doing) what they would do (or not do) anyway
- GHG credits will transfer wealth from energy efficient firms to energy wastrels

II. Background

On February 14, 2002, President Bush directed the Secretary of Energy, working with other department and agency heads, to enhance the "accuracy, reliability and verifiability" of the Voluntary Reporting of Greenhouse Gases Program (VRGGP), established under Section 1605(b) of the 1992 Energy Policy Act. Mr. Bush also directed the Secretary to recommend reforms "to ensure that businesses and individuals that register reductions are not penalized under a future climate policy, and to give transferable credits to companies that can show real emission reductions."¹

To CEI and other free-market advocates, the President's call for penalty protection and transferable credits was *Déjà vu* all over again. During the 105th and 106th Congresses, Environmental Defense, the Pew Center on Global Climate Change, the Clinton-Gore Administration, and Senators John Chafee (R-RI) and Joe Lieberman (D-CT) devised and marketed "credit for early action" proposals and legislation. With one stroke of the Presidential pen, the Bush Administration on February 14th revived credit for early action – and did so without any public debate over the policy's economic implications, political risks, vulnerability to Enron-like asset manipulation, or consistency with the President's opposition to the Kyoto Protocol and support for increased energy production from coal and other hydrocarbon fuels.

In the *Federal Register* of May 6, 2002, the Department of Energy (DOE) published a Notice of Inquiry requesting comment on how to modify the VRGGP, in accordance with the President's February 14th directive. By the close of the comment period on June 5, 2002, individuals from the business, government, and non-profit sectors had submitted about 80 comments. The comments are available on DOE's Web site.²

On July 8, 2002, the Secretary of Energy together with three other agency heads sent a letter to President Bush updating him on actions taken in response to his February 14th

¹ "President Announces Clear Skies & Climate Change Initiatives," February 14, 2002, <http://www.whitehouse.gov/news/releases/2002/02/20020214-5.html>

² <http://www.pi.energy.gov/enhancingGHGregistry/>

directive. The letter outlined a plan to develop and issue new VRGGP reporting guidelines by January 2004. Pursuant to that plan, DOE has scheduled four workshops (Washington, D.C., November 18-19; Chicago, December 5-6; Houston, December 12-13). In addition, EPA will hold a meeting on November 20-22, and USDA will hold meetings on January 14-15 and January 23, 2003.

CEI has long warned that transferable GHG credits will corrupt the politics of U.S. energy policy. GHG credits attain full market value only under a Kyoto-style cap-and-trade program. In effect, GHG credits are Kyoto stock – assets that mature and bear dividends only if the U.S. government ratifies the Kyoto Protocol or enacts a comparable regulatory system. Thus, if implemented, the Administration’s plan will expand and mobilize corporate lobbying for Kyoto and kindred energy rationing schemes.³

Comments excerpted in this paper corroborate, illustrate, or supplement CEI’s critique of credit for early reduction schemes.

III. Excerpts from the Experts

Bulleted paragraphs are direct quotations from comments submitted to DOE during the May 5-June 6, 2002 comment period. Where appropriate, I offer brief remarks (“Discussion”; “Translation”) to bring out the import of the quoted material.

Transferable credits are a first step towards energy rationing and serve no purpose apart from energy rationing

- A transferable credit system is a precursor to emissions trading (cap and trade) and such credits do not have monetary value without an emissions cap at the company level. An emissions cap at the company level would result in energy rationing, distorting energy markets, restraining economic growth, damaging competitiveness of U.S. manufacturing and accelerating the importation of energy containing products. Implementing transferable credits is a “defining climate, energy and economic policy issue” for this Administration and the U.S. economy long term. If the Administration does not intend to implement an emissions trading system (cap and trade), it should not establish a transferable credit system. **(Industrial Energy Consumers of America, Page 1; hereafter cited as IECA)**
- First, the NAM urges the DOE to make the GHG registry sufficiently credible so that a future Congress and Administration could be expected to recognize the emissions reported in the GHG Registry. The NAM urges, however, that the issue of transferable credits be separated from the voluntary GHG Registry in order to avoid the implication that the registry is a first step toward a mandatory emissions-reduction

³ CEI et al, “An Open Letter to President Bush About His Plan to Award Regulatory Credits for ‘Voluntary’ Greenhouse Gas Reductions,” October 2, 2002, <http://www.cei.org/gencon/027,03237.cfm>; Marlo Lewis, Jr., “If You Build It, They Will Come,” Tech Central Station, September 10, 2002, <http://www.cei.org/gencon/029,03195.cfm>; *CEI Comments on the Department of Energy’s Greenhouse Gas Reporting Proposal*, June 5, 2002, <http://www.cei.org/gencon/027,03046.cfm>.

(or energy-rationing) program. A formalized emission-trading program would create an inappropriate expectation of future credit value by implying that a future Congress will establish emission quotas. **National Association of Manufacturers [Page 2]**

- Transferable credits and baseline protection imply a mandatory cap and trade program. Without such a program, there is no need for either transferable credits or baseline protection. Also, absent a cap and trade program, transferable credits and baseline protection would serve no purpose. **Duke Energy [Page 5]**

The Administration has no legal authority to protect companies' emissions baselines and award credit for early action

- First, it is clear that section 1605(b) confers no authority on the administration to give credits against future global warming emissions limitations on companies that have made filings under that section. In fact, the 1992 EPACT legislation pointedly rejected proposals made at the time to confer credit status on reported reductions. **[Natural Resources Defense Council, et al, Page 9; hereafter cited as NRDC]⁴**
- This [the President's February 14, 2002 announcement] appears to be a request for legislative recommendations, because the administration has no authority under section 1605(b) or any other current law to ensure penalty protection or to give out transferable credits. **[NRDC, Page 7]**
- Congress has no more power than the president to resolve this issue [penalty protection and credit for early action] short of full cap and trade legislation. Neither the emissions reporting provisions in the Senate energy bill [H.R. 4, Title XI] nor the emissions reporting bill pending in the House (H.R. 4611) provides a "no-penalty" guarantee. **[NRDC, Footnote 6, Page 8]**
- We are skeptical of the authority to use 1605(b) to guarantee any future emission credits and strongly suggest that such a claim not be made without new legislation. **[Northeast States for Coordinated Air Use Management, et al, Page 1; hereafter cited as NESCAUM]⁵**
- 1605(b) was not designed for public recognition, baseline protection or the creation of early credits. Nor was it designed as the infrastructure for emissions trading...we are skeptical about how these [mandatory reporting and credit for early reductions] could be made legally binding without new legislation. **[NESCAUM, Attachment, Page 1]**

⁴ NRDC submitted a joint comment with National Wildlife Federation, National Environmental Trust, Union of Concerned Scientists, U.S. Public Interest Research Group, World Wildlife Fund, and Minnesotans for an Energy Efficient Economy.

⁵ NESCAUM submitted a joint comment with the Air Resources Division of New Hampshire's Department of Environmental Services and the Air Quality Planning and Standards Division of Connecticut's Department of Environmental Protection.

- However, though we support giving some form of credit to those participants that can show real reductions, including the transfer of reduction certificates, we are concerned about 1605(b) making promises about the future value of transferable reductions without first receiving authority from Congress. Under the current 1605(b) legislation, there is no congressional mandate that emission reductions will be recognized under future regulations. [**NESCAUM, Attachment, Page 7**]
- Providing absolute assurances that companies will receive baseline protection and transferable credits may necessitate a federal statute authorizing DOE to enter into GHG mitigation agreements with participating companies or sectors. See *U.S. v. Winstar Corp.*, 116 S.Ct. 2432 (1996). [**Generators of Clean Air, Page 3; hereafter cited as GCA**]⁶
- The Pew Center’s review of existing statutory authorities indicates that the Executive Branch currently lacks authority to assure that current efforts to reduce GHG emissions receive credit under a future law. If a baseline protection program is to have binding effect, it must be authorized by law. [**Pew Center on Global Climate Change, Page 12; hereafter cited as Pew**]

Discussion: Pew, however, goes on to suggest that the Executive Branch could finesse the authority problem. In *U.S. v. Winstar Corp.*, (115 S.Ct 2432 (1996)), the Supreme Court held that a “properly drafted agreement” that surrenders future regulatory authority “could provide participants substantial comfort that the government’s commitment should be honored or, if not, the government would be liable for damages” [Pew, Page 12, Footnote 12]. In contrast, NRDC [Page 9, Footnote 7] denies that *Winstar* creates legal protection for credits not authorized by statute: “*Winstar* upheld a bank’s suit against the government for breaching a contract in unique circumstances that do not apply here.” NRDC observes: “It is also worth noting that during the previous administration, the Justice Department took the position that *Winstar* could not and should not be used as authority for an early credit program. The Department specifically warned that such an approach could expose the government to large financial liabilities.”

It is inappropriate to provide baseline protection or award credit for early action prior to enacting a cap-and-trade program

- Unwilling to address mandatory emission controls, the president is apparently suggesting that the penalty protection and early credit rules be legislated in advance, without knowing when and how the total quantity of global warming emissions will be capped. Instead of trying to legislate rules for rewarding early action in a policy vacuum, however, an effective global warming reporting program should confine itself simply to collecting credible, complete, and comprehensive emissions information. [**NRDC, Page 7**]

⁶ GCA members are American Electric Power, Cinergy, Detroit Edison, Public Service Company of New Mexico, and Wisconsin Energy.

- If such credits were to be considered by a future Congress, it would be necessary to decide many questions, including whether they are to be drawn from within a pre-established cap, or whether they expand the cap. In our view, these are fundamental questions that should be decided part-and-parcel with determining that cap. These questions cannot and should not be addressed piecemeal by an administration unwilling to address the question of a cap. **[NRDC, Page 8]**
- A future Congress will determine the size of a cap on global warming pollutants and the timetable for meeting that cap. The Congress will decide on the basis for allocating emissions allowances under that cap. It will decide whether to encourage any specific activities, past or then-contemporaneous, with specific allocations of allowances, and it will decide whether any such allocations will come out of the cap or on top of it. The administration cannot and should not prejudice these issues. **[NRDC, Page 10]**
- While these program elements [“baseline protection,” “transferable credits”] might indeed be appropriate, even essential, in the design and implementation of a mandatory greenhouse gas emissions reduction program, definition of these elements prior to specification of a mandatory program only serves to encourage development of a mandatory regime and to prejudge its design. In a more ideal world, voluntary programs to provide transferable credits and baseline protection would be developed in conjunction with the mandatory regime....This is really the only way to assure that these program elements would actually be consistent with the chosen regulatory approach. **[Duke Energy, Page 2]**

GHG credits are not needed to protect companies’ emissions “baselines” under a future climate policy

- The fear that companies may be penalized for early action in the allocation of emissions allowances in a future climate program arises primarily from an unwarranted assumption as to how such a program will allocate allowances. Most options for allocating allowances under a cap present absolutely no risk of penalizing early movers. Such a risk arises at all only if it assumed that a future system will grandfather allowances to firms based on their emissions at a particular moment. The simplest way to avoid the risk of penalizing early movers is to choose an allocation approach other than grandfathering. **[NRDC, Page 8]**
- There are at least two other ways to allocate emissions allowances under a cap. One is through an output-based allocation subject to periodic updating. For example, electricity producers could be allocated emissions allowances in proportion to their output (e.g., kilowatt-hrs of electricity production) in the previous year. A second approach is to allocate allowances to members of the public (e.g., electricity consumers) and provide for electricity generators to acquire those allowances from the public (through auctions, brokers, or other means). In neither case is a firm’s allocation dependent on its emissions level in 2002 or any other base year before the first compliance deadline. **[NRDC, Page 8]**

Discussion: These remarks go to the pivot point of the whole debate. The claim that early movers must have credits to avoid penalty under a future climate policy is the central rationale for President Bush’s initiative and all previous early action crediting proposals. If NRDC is correct, it has just knocked the props out from under early credit lobbyists.

Giving credits for “real” (tonnage) reductions conflicts with the President’s goal of replacing Kyoto-style tonnage targets with an emissions intensity target

- In examining the various issues that the NOI [Notice of Inquiry] seeks input on, we struggle to see how the concepts of transferable credits and protection against penalty under future climate policy (hereafter referred to as “baseline protection”) align with a program that calls for voluntary actions to reduce the greenhouse gas intensity of the economy....Historically, virtually all discussion and thinking regarding the concepts of transferable credits and baseline protection have focused on their role in facilitating a cap and trade approach to reducing greenhouse gas emissions. We note, however, that an emissions intensity of the economy approach ties program objectives to the state of the economy and requires metrics and approaches that are significantly different from cap and trade programs which ignore economic performance. [**Duke Energy, Page 2**]
- The President’s directive is that DOE develop a registry program that will provide for “real” reductions of GHG....Unfortunately, as we understand at this time, the federal administration’s stated goal of reducing energy intensity (as a ratio to GNP growth) is not in any clear way directly linked to real emissions reductions. [**Massachusetts Department of Environmental Protection, Page 2**]
- IECA does not recommend implementation of transferable credits. However, if this Administration moves forward, it must change the conventional definition of “transferable credit” from “absolute tons” of reduced GHG emissions to “GHG intensity per unit of output.” This is complex, but to measure absolute reductions is not fair to the manufacturing sector and will lead to competitiveness problems. If manufacturing is to show economic growth, it must produce more “widgets” per input of energy. This does not result in absolute GHG emissions reductions (without significant new technology). It means less GHGs are produced per widget. [**IECA, Page 6**]

Discussion: The President wants to award transferable credits for “real” reductions. “Real” reductions are tonnage reductions – the kind required by Kyoto. Yet the President wants to replace Kyoto’s tonnage targets, which restrict growth, with emission intensity targets, which accommodate growth. These goals are incompatible. Awarding credits for tonnage reductions ratifies rather than replaces the Kyoto framework. Credits for “real” reductions are applicable to, and build political support for, cap-and-trade schemes. If, on the other hand, credits are for “intensity” reductions, they will have little if any value as an offset under an emissions cap, because decreases in emissions intensity often go hand in hand with increases in aggregate emissions.

GHG credits will provide windfall profits for “anyway tons” – monetary rewards to companies for doing (or not doing) what they would do (or not do) anyway

- As detailed in the enclosed report by the Natural Resources Defense Council, electric power companies – responsible for two-thirds of the “reductions” claimed under the current DOE reporting system – used inflated baselines and other dubious accounting practices to claim large emission reductions when in fact they did little or nothing to change emissions trends. Emissions rose at about the same rate that power generation increased. For example, seventy percent of pollution “reductions” the utilities claimed were based on the routine operation of nuclear plants. Companies simply credited themselves for avoiding emissions that would have occurred only if that power had been generated by purely hypothetical coal-fired plants instead of nuclear plants. **[NRDC, Page 1]**
- Creating a robust reporting system, under which nuclear power plants can register emissions avoided and receive transferable credits for those tons avoided, is important to capture the full potential of nuclear energy – both increased output from existing new plants and construction of new nuclear power plants. **[Nuclear Energy Institute, Page 2; hereafter cited as NEI]**
- Nuclear power plants represent approximately 20 percent of U.S. electricity supply, and approximately three-quarters of emission-free electricity production. Since 1973, America’s nuclear power plants have avoided the emission of 2.8 billion metric tons of carbon equivalent by producing electricity that would otherwise have been produced by fossil fuels. In 2000, the last year for which data exists, U.S. nuclear power plants avoided the emissions of 174.4 million metric tons of carbon. **[NEI, Page 3]**
- As the data show, higher output, higher reliability and capacity uprates at nuclear power plants are the largest single source of tons reported under the existing 1605(b) program. In fact, improved performance at existing nuclear power plants represented 43.3 percent of all tons reported and approximately 60 percent of the tons reported by the U.S. electric sector. **[NEI, Page 4]**
- In the future, whether or not nuclear generating companies uprate existing plants and, eventually, build new nuclear units will depend, to some extent, on the nuclear companies’ ability to capture the economic value associated with avoiding emissions of greenhouse gases....The industry also believes that a robust reporting program and a system of transferable credits is necessary to capitalize fully on nuclear power’s significant potential. **[NEI, Page 5]**

Discussion: How might NEI member companies benefit from the Administration’s early credit plan? The U.S. average annual reduction target under the Kyoto Protocol is 558

million metric tons carbon equivalent.⁷ If the Administration decides to count “avoided” emissions as reductions, and if NEI member companies continue to “avoid” 174.4 million metric tons of carbon equivalent emissions per year, then NEI members would be entitled to hold 31 percent of total U.S. emission credits under the Kyoto Protocol. What if, in addition, the Administration decides to award credits for past “avoided” emissions? Let’s conservatively assume that NEI member companies “avoid” 100 million metric tons carbon equivalent per year from 1990, the Kyoto Protocol baseline year, through 2012, the end of the Kyoto Protocol compliance period. In that case, NEI member companies would be entitled to 2.2 billion metric tons worth of credits – or about three-quarters of the entire U.S. Kyoto budget. Clearly, an early credit system has the potential to transfer enormous wealth from non-nuclear generators and other industry sectors to NEI member companies.

- A significant portion of Exelon’s reported emission reductions resulted from avoided emissions associated with efficiency and capacity addition projects at zero emission generating units, such as occurred during the mid-1990s at the Corporation’s Limerick and Peach Bottom nuclear power plants, as well as at our Conowingo Hydroelectric Dam....We have estimated that each of these unit uprates is avoiding between 300,000 and 500,000 tons of CO2 emissions per year, based on increased zero emission generation resulting from these projects....We believe that an enhanced VRGGP that includes baseline protection and transferable credits (including credits for avoided emissions) would be very useful in terms of supporting the economics, and extent of, future projects to increase output from existing, zero emission generation sources. [Exelon, Page 2]

Translation: Give us credits because we split atoms for a living. We will thereby gain a competitive edge over non-nuclear generation, enabling us to grow and, well, earn more credits!

- ... we believe that reporters need the option to continue reporting on specific projects, to supplement their entity reporting. For example, the majority of Exelon’s fossil emissions take place in the PJM power pool, while the majority of our nuclear uprate projects are, and could take place, in MAIN. We have virtually no fossil assets in MAIN so increased nuclear generation in MAIN does not necessarily offset Exelon fossil emissions that are taking place in another power pool (PJM) to serve another load area. In this sense, entity reporting, without project reporting, potentially fails to provide us with credit for avoided emissions since avoidance projects we complete in MAIN have little effect on the dispatch/emissions of our fossil assets in PJM that are operating to serve another load area. [Exelon, Page 4]

Translation: Give us credits for expanding nuclear capacity in a power pool “with virtually no fossil assets” even though this in no way reduces emissions in our other power pool with significant fossil assets.

⁷ Energy Information Administration, *International Energy Outlook 2001*, p. 14.

- This document [*Sector Specific Issues and Reporting Methodologies*] should be updated and expanded to quantify entity emissions reductions associated with increased recycling and material reuse. From our studies, the recycling of materials such as aluminum products can provide significant holistic emissions reductions advantages because aluminum and other metals consume less energy to produce than from virgin materials and these recovered metals are durable and can be recycled and reused over and over again. [**Alcoa, Page 3**]
- We believe that the 1605(b) inventory should also include provision for facilities to take credit for recycling efforts that save energy, reduce emissions and help to protect the climate. [**The Aluminum Association, Page 2**]

Translation: Give us credits because we recycle aluminum for a living.

- For example, through recycling aluminum, energy use and GHG emissions are reduced by 95%. Also, for each ton of aluminum that displaces the use of steel in a mid-size sedan, over the life cycle of that automobile there is a net reduction of 20 tons of GHG emissions. These reductions need to be recognized. [**Alcan, Page 2**]

Translation: Give us credits because we recycle aluminum for a living. And, while you're at it, reward us (not automakers or auto buyers) for the avoided emissions from automobiles built with aluminum components.

- Waste-to-energy reduces greenhouse gas emissions in two ways. First, combustion diverts municipal solid waste from landfills where the trash would otherwise produce CH₄ as it decomposes. Second, electricity energy resulting from waste combustion displaces electricity generated by fossil fuel-fired power generators (and associated greenhouse gas emissions)...Finally, the IWSA strongly believes that credits should be owned by the entity owning a waste-to-energy facility. [**Integrated Waste Service Association, Pages 2, 3**]

Translation: Give us credits because we burn trash for a living.

- In many cases, a requirement to identify the specific emission reduction would mean having to prove a negative. For example, solid waste that is combusted by a WTE facility over several years would otherwise have been sent to a landfill, where it would eventually produce methane gas. In addition, the need for fossil fuel generation capacity is reduced by the use of WTE. However, the WTE entity can not usually identify the specific landfill that is not built to receive that waste, and can not identify the fossil fuel capacity that is not built due to decreased demand, and can therefore not show specific reductions. [**Ref-Fuel, Page 2**]

Translation: We can't really prove that we avoid emissions, but give us credits anyway.

Discussion: Ref-Fuel argues as if waste-to-energy production were the only way to avoid methane emissions from landfill waste. Not so. Landfill methane gas can be captured and

(a) “flared” or (b) burned to generate electric power. To make good its claim, Ref-Fuel must not only identify the specific landfill that is not built to receive the waste. It must also identify the methane recovery and landfill generation facilities that would not be built even if Ref-Fuel were not in the business of burning trash!

- The methane generated in a landfill has a much greater greenhouse gas warming factor – in fact, CH₄ has a CO₂ equivalence of 21. This means that one pound of CH₄ is equivalent to 21 pounds of CO₂ when considering how it affects greenhouse warming. If a facility manages to avoid this secondary pollutant, the avoided GHG should be recognized as a transferable credit with the quantity of credits being proportional to the CO₂ equivalence. [Covanta, Page 3]

Translation: Pound for pound, give us 21 times the credits a manufacturer gets for energy-related CO₂ reductions, because we burn trash for a living.

- There are two different baseline scenarios to be considered when considering an existing facility. The first baseline is used to determine the quantity of GHG credits. The second baseline is to determine when a facility first commenced generation of the credits. Covanta proposes that the first baseline for WTE and landfill gas facilities should be 1974. 1974 is referenced because it is the oldest available data for MSW practices and it provides for a clear comparison of how current MSW management technologies reduce greenhouse gases. [Covanta, Page 3]

Translation: Give us credits for burning trash as far back as 1974, before global warming was even a gleam in Al Gore’s eye.

Discussion: Whatever one’s views on global warming, awarding credits for past actions does nothing to spur new investment in energy efficiency or environmental performance. As one commentator observes: “Any policy that creates tradable emissions credits or a promise for future credits should be offered only for emissions reductions that take place after the revised program is announced. The goal of such a program is to offer financial incentives to those with the ability to reduce emissions. Giving credits away for past actions that require no further incentive would be counter to such goals.” [NESCAUM, Page 3]

- When utilized as an ingredient in concrete, fly ash can replace a portion of the cement that is used. Cement production is a significant contributor to greenhouse gas emissions. Therefore, for every ton of cement that is not produced because it is displaced by fly ash use, approximately 1.1 tons of carbon dioxide are not emitted. In the United States in 2000, approximately 10 million tons of fly ash was utilized in cement replacement applications – meaning that more than 10 million tons of CO₂ emissions were displaced. Industry goals call for doubling or even tripling that utilization volume by 2020, representing the easiest, most cost effective single step available for the United States to dramatically reduce CO₂ emissions....If an industry is able to take measurable actions that displace production of CO₂ in an unrelated

industry, that displaced production should be considered as a valid emissions reduction. [ISG Resources, Inc., Page 2]

Translation: Give us credits because we sell coal combustion products for a living.

- The forest products industry leads all other manufacturing sectors in onsite electricity generation, meeting more than half of its own energy needs through highly efficient co-generation processes using biomass fuels derived from wood waste products. By recycling these wood wastes into a renewable energy source, the forest products industry is able to divert waste from landfills and, at the same time, reduce reliance on fossil fuels and offset greenhouse gas emissions by substituting renewable biomass-based carbon for carbon from fossil fuels....Appropriately documented reports to the registry of emissions reduction, emissions avoidance and carbon sequestration projects should be eligible for transferable credits and protection against penalty under future climate policy. [American Forest and Paper Association, Pages 1, 5; hereafter cited as AFPA]

Translation: Give us credits because we grow trees and burn wood waste for a living.

- The current program does not require a demonstration that the emissions reduction project “goes beyond business as usual” or require a certain level of financial commitment. This is an important feature to maintain. For the forest products industry, certain projects, such as the use of renewable energy, have been under way for many years. [AFPA, Page 8]

Translation: Give us credits for being the forest and paper kinda guys we are.

- The company that owns the source should have a first claim on reductions. In many cases, multiple companies could have competing claims for credit from the same reduction, e.g., where a downstream energy user implements an energy efficiency project that results in a reduction in the power plant’s GHG emissions. The reporting program under Tier Two [guidelines for transferable credits] needs a default rule to resolve the question of ownership in such cases. The GCA recommends that the program award the credit to the company owning the emitting source. This approach is the most straightforward for purposes of measurement and administration. Moreover, the approach will neither preclude nor discourage energy efficiency projects or other such projects because it always will be possible to contract around the default ownership rule. [GCA, Page 4]

Discussion: So, if a manufacturer installs a combined heat and power system, and reduces Cinergy’s or AEP’s electricity production and emissions, the credit “defaults” to AEP or Cinergy. The only way “around” this “default rule” is to negotiate a “contract.” Guess who will hold the whip hand in any such negotiation? Compare Cinergy/AEP’s position with that of Wisconsin’s Department of Natural Resources: “One way to avoid double counting of indirect emission reductions is to require that the emission reduction be reported only by the entity taking the action to reduce energy use and emissions, and

to prohibit any claims to emission reductions by the electric utility whose direct emissions decreased because of actions taken by others.” [Department of Natural Resources-Wisconsin, Page 2]

- The reporting of transferable GHG emission reductions should not be subjected to independent third party review. [Cinergy, Page 4]

Discussion: How convenient for a utility that considers it appropriate for utilities to take credit for other companies’ energy efficiency investments!

GHG credits will transfer wealth from energy efficient firms to energy wastrels

- Global competition forces manufacturing to constantly reduce its costs, especially energy costs per unit of manufactured product. From 1977 to year 2000, manufacturing reduced its energy intensity per shipment by 49.53 percent, according to the Pacific Northwest National Laboratory. [IECA, Page 2]
- The manufacturing sector can and will continue to reduce its GHG intensity per unit of output, but most are incapable of reducing absolute quantities of greenhouse gases. [IECA, Page 3]
- Should we reward companies who have been abusively wasteful with energy, reward them with transferable credits that the manufacturing sector will be required to buy in the future?...Should we reward utilities with transferable credits when many of the costs are automatically recovered from consumers and manufacturers’ costs are not? The conventional utility generation plant is only half as energy efficient as a typical industrial CHP plant. Should we reward utilities for improving energy efficiency given they have done so little all these years? Should we reward utilities whose plants have been exempt from many provisions of the Clean Air Act? Should we reward companies for venting or flaring methane? Should historically more energy efficient manufacturers be required to buy credits generated by historically inefficient entities if they want to grow? [IECA, 5]

Discussion: GHG credits will enable two types of companies to make out like bandits under a future cap-and-trade system: (a) companies who receive credits for “anyway tons” (emissions they would have reduced or avoided anyway in the normal course of doing business); and (b) companies who can easily and cheaply reduce emissions because they have historically invested little to improve energy efficiency.

IV. Conclusion

Duke Energy’s observation is worth repeating: “Transferable credits and baseline protection imply a mandatory cap and trade program. Without such a program, there is no need for either transferable credits or baseline protection. Also, absent a cap and trade program, transferable credits and baseline protection would serve no purpose.” The Administration officially opposes setting a cap on energy-related greenhouse gas

emissions. Why then is the Administration putting in place the precursor to a GHG cap-and-trade program, and creating incentives for companies to lobby for such regulation?

Financial reporting is an age-old discipline. Nonetheless, generally accepted accounting practices, “independent” auditing, and SEC oversight failed to stop Enron from cooking its books, creating billions of dollars in phony assets, and inflicting enormous losses on employees and shareholders. How much confidence should we place in greenhouse gas reporting, auditing, and certification – disciplines in their comparative infancy – when a company might “reduce” its emissions and “earn” credits by not producing things, outsourcing production, shifting operations overseas, “avoiding” hypothetical future emissions, or “displacing” hypothetical emissions elsewhere in the economy?

Accounting systems do not evolve in a political and economic vacuum. Reporting rules tend to reflect the desires of the reporting parties.⁸ Much of the push for GHG credits comes from:

- Companies who seek monetary rewards for “anyway tons”;
- Companies who face cheap emission reduction opportunities because they are relatively *inefficient* in their use of energy; and
- Companies who expect to gain competitive advantage under Kyoto-style energy rationing.

It is not hard to understand why some companies want a money-for-nothing, chits-for-free climate initiative. But why on earth should the Bush Administration promote this recipe for corporate scheming, artful accounting, and pro-Kyoto regulation?

⁸ Lawrence Revsine, “Enron: sad but inevitable,” *Journal of Accounting and Public Policy* 21 (2002), p. 138.