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BORDER ADJUSTMENT MEASURES IN PROPOSED U.S. CLIMATE CHANGE LEGISLATION —

“A NEW CHAPTER IN AMERICA’S LEADERSHIP ON CLIMATE CHANGE?”¹

by Stephen Kho, Bernd G. Janzen & Holly M. Smith*

“Delay is no longer an option. Denial is no longer an acceptable response. The stakes are too high. The consequences, too serious.”²

—President Barack Obama

INTRODUCTION

All legislative proposals for a U.S. greenhouse gas (“GHG”) emissions cap-and-trade system released to date have recognized the need to safeguard the competitiveness of U.S. firms that may be required to bear emissions compliance burdens heavier than those borne by their foreign competitors. These legislative proposals have included “competitiveness measures” to ensure that emissions caps imposed on U.S. industries do not erode their competitiveness vis-à-vis imports from jurisdictions with no or lesser GHG emissions restrictions. The problem of “carbon leakage”—the incentive created by declining domestic emissions caps to move emissions-intensive production abroad—is particularly acute for manufacturing industries. Many such industries compete directly with imports, and most would not be able to pass on to their customers the increased costs of compliance or the acquisition of more efficient production technology. A properly designed U.S. climate change system should therefore legally safeguard the competitiveness of U.S. manufacturing industries, while also minimizing the incentive to move emissions-intensive production abroad.

Competitiveness measures can take a variety of forms. For instance, a “border adjustment” measure can impose costs on relevant goods at the time they are imported into the United States, assessed on the basis of either differences in the GHG emission restrictions in the country of origin as compared to the United States, or the emissions-intensity of the production process for the imported goods. Other forms of competitiveness measures include the free distribution of emissions allowances to industries particularly sensitive to foreign competition, the exemption of certain industries altogether from domestic emissions caps, the imposition of carbon taxes, and restrictions on

certain production methods or incentives to adopt cleaner production methods.

This article will focus on the use and consequences of a border adjustment measure, given that it is the competitiveness measure that is most consistently proposed in U.S. legislation, and that seemingly has the most significant exposure to challenges under the World Trade Organization (“WTO”) agreements. This article will first provide some background on the broader climate change discussion in the United States. It will then discuss the reasons for including competitiveness measures in U.S. climate change legislation, the border adjustment measures included in recent U.S. legislative proposals, and the viability of border adjustment measures under the WTO agreements. The article will conclude with a new proposal for an alternative to the border adjustment measures proposed to date.

BACKGROUND

The year 2009 promises to be an exciting year for proponents of strong action to combat GHG emissions in the United States and internationally. Over the past few years, broad political support for such legislation

has grown domestically, while international efforts have continued to progress, in large part without the participation of the United States. Given the recent inauguration of Barack Obama as President, and the goals of the international community to conclude a successor agreement to the Kyoto Protocol in Copenhagen in December of this year, real action is expected to be taken in 2009 to limit carbon emissions both in the United States and around the world.

Domestic competitiveness measures can ensure the equal distribution of costs in the absence of an international agreement limiting emissions.

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President Obama has made numerous statements to date expressing his commitment to addressing climate change. In spite of the uncertainty and turmoil caused by the ongoing financial crisis, he appears to be strongly committed to his original proposals. Specifically, President Obama has called for the implementation of an “economy-wide cap-and-trade program” that will aim to reduce GHG emissions eighty percent by 2050.³ President Obama’s plan is distinguished by his calls for the auction of *all* emissions credits, unlike other plans, under which a portion of credits would be provided at no cost to vulnerable industries as a form of transition assistance. His plan differs further due to his policy of using a portion of the proceeds from such emissions credit auctions (approximately \$15 billion a year) for investment in the “development of clean energy and energy-efficiency improvements, including clean vehicles.”⁴

Importantly, President Obama has also pledged to “re-engage”⁵ the international community through the UN Framework Convention on Climate Change (“UNFCCC”). Since early 2007, international efforts to combat climate change have been focused on developing a successor agreement to the Kyoto Protocol, which remains in effect until 2012. Rounds of negotiations have been held, both to address the future commitments of nations that have already been bound by emissions caps, as well as to reach developing nations and countries such as the United States that are not bound by the Kyoto Protocol. An important breakthrough came at the negotiations in Bali in December 2007, where it was decided that developing countries would not necessarily be excluded from future climate change control regimes.⁶ Other rounds of negotiations have taken place since, leading ultimately to the negotiation of a final agreement in Copenhagen at the 15th meeting of all Framework Convention parties in late 2009 that will replace the Kyoto Protocol.

Given the state of the economy, and previous difficulties in passing legislation to establish a cap-and-trade system, there are significant doubts over whether meaningful legislation curbing GHG emissions will be passed in the United States in 2009. Yet the concurrence of the Obama presidency, the pressure to have emissions limits in place domestically before concluding an international agreement on emissions caps in Copenhagen,⁷ and the increased presence of Democrats in the U.S. Congress, all indicate that the passage of climate change legislation is far more likely now than at any time in the past.

Currently, Senator Barbara Boxer, Chairman of the Senate Environment and Public Works Committee, and Representatives Henry Waxman and Ed Markey, Chairs of the House of Representatives Energy and Commerce Committee and the Energy and Environment Subcommittee respectively, are leading Congressional efforts to develop legislation addressing climate change. On March 31, 2009, Representatives Waxman and Markey issued a discussion draft of their climate change legislation entitled the American Clean Energy and Security Act of 2009 (the “Waxman-Markey draft”). While a draft has yet to come out of the Senate, on February 3, 2009, Senator Boxer and other committee members set out six basic principles for legislation on global warming.⁸ It is likely that the draft produced in the

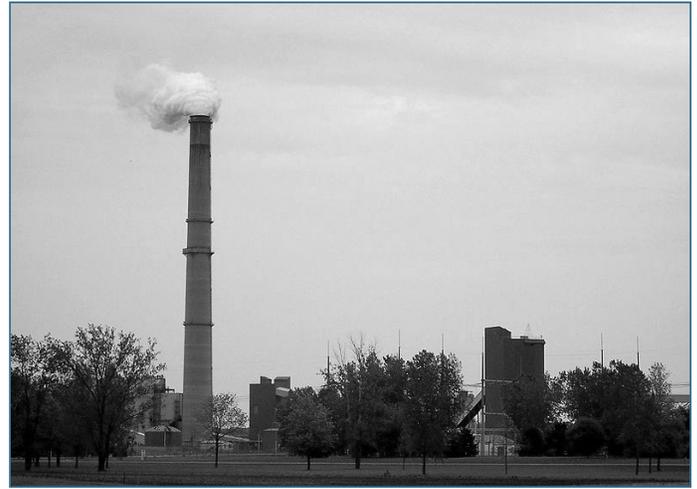


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Smokestack of a coal-fired power plant in New York.

Senate will rely heavily on the Boxer-Lieberman-Warner substitute amendment (the “Boxer Amendment”) to the Lieberman-Warner Climate Security Act of 2008 (“S.3036”), which was originally introduced on May 21, 2008.⁹ Although the Boxer Amendment has never been debated and considered in Congress to a significant extent,¹⁰ it represents the most advanced and comprehensive legislative effort on the Senate side to date addressing climate change.

Generally, both the Waxman-Markey draft and the Boxer Amendment propose the establishment of a cap-and-trade system to limit emissions domestically, along with a number of measures providing incentives for reduced emissions, and, in the case of the Waxman-Markey draft, the development of clean energy sources, clean technologies, and increased energy efficiency. Importantly, both bills provide for competitiveness measures in the form of a “border adjustment” requiring “covered goods” imported into the United States to be accompanied by purchases of emissions allowances.¹¹

RATIONALE FOR INCLUDING COMPETITIVENESS PROVISIONS

While commentators have expressed concern over the inclusion of certain competitiveness provisions in climate change legislation,¹² there are a number of reasons why such provisions are useful and should be included in any proposed legislation.

First, competitiveness measures can provide an even playing field for U.S. manufacturers and producers to compete in the domestic market against importers of goods from countries that lack emissions caps. Manufacturers in countries such as China and India, which are heavy polluters but currently are not subject to domestic or international limits on their emissions, would enjoy a significant production cost advantage over their counterparts in the United States under a U.S. cap-and-trade regime if no measures were taken to require these manufacturers to compensate for the emissions they created when producing products for import into the U.S. market. In particular, energy-intensive industries, such as cement, glass, paper, chemicals, fertilizer, and metals manufacturers, would be adversely affected by U.S.

declining emissions caps and their inability to compete with foreign producers who are not subject to such caps.¹³

The perceived need for protection of domestic manufacturers is so strong that it is highly unlikely that any climate change legislation could pass the U.S. Congress without competitiveness measures. One reason given for the U.S. refusal to adopt the Kyoto Protocol was the fact that it did not impose binding commitments on developing countries, which even then was perceived as a threat to the competitiveness of U.S. industries. Given the uncertainty over whether developing countries will commit to emissions limits in the successor agreement to the Kyoto Protocol, U.S. legislation will need to include competitiveness measures to compensate for non-participation by developing nations in future international climate change agreements.¹⁴

In fact, in a white paper produced by the U.S. House of Representatives Committee on Energy and Commerce and its Subcommittee on Energy and Air Quality (the “White Paper”), the drafters emphasized the need for competitiveness measures by linking them to the need to engage developing countries.¹⁵ They reasoned that, in the absence of an international agreement binding developing nations, domestic legislation needed to be structured in a way that would encourage developing nations to adopt similar limitations on GHG emissions domestically, and that such “encouragement” could include border adjustment measures, performance standards, and carbon market design conditions.¹⁶

The above emphasizes a second reason for competitiveness measures: they can also serve to encourage foreign countries to adopt their own domestic climate change measures. Foreign countries can be encouraged to adopt emissions limits by providing them with both positive and negative incentives to do so through U.S. legislation. Border adjustment measures could encourage the adoption of emissions limits in foreign countries in response to foreign manufacturers having to raise manufacturing costs by purchasing emissions credits. Alternatively, U.S. legislation could create positive incentives for foreign countries to adopt emissions caps by providing them with greater access to the U.S. emissions credit trading market, which is expected to be vast and lucrative for those able to sell credits on it.¹⁷

Third, the imposition of competitiveness measures can prevent “carbon leakage,” a situation where the benefits of reducing U.S. emissions would be “offset by increased emissions elsewhere by foreign competitors that are thriving as a result of higher costs in the United States.”¹⁸ They could also be used as export adjustments, i.e., by providing emissions credits for free

to U.S. manufacturers to allow them to compete equally in third-country markets with foreign competitors who are not subject to emissions caps.¹⁹

Finally, competitiveness measures would ensure that other countries share the cost of reducing GHG emissions on a worldwide basis, even if they are unwilling to adopt required limits on emissions themselves. Given that the ill effects of climate change are shared globally, the costs and burdens of eliminating emissions should also be shared globally. Domestic competitiveness measures can ensure the equal distribution of costs in the absence of an international agreement limiting emissions.²⁰

EXISTING BORDER ADJUSTMENT PROPOSALS

While a number of border adjustment proposals in draft legislation have been tabled to date, the Boxer Amendment represents the most comprehensive legislative effort to date. Although Senator Boxer currently is drafting new legislation, it is likely that her new proposals will reflect the proposals made in the original Boxer Amendment. While the Waxman-Markey draft and Representative Chris Van Hollen’s Cap and Dividend Act of 2009 represent efforts currently under consideration in the 111th Congress, neither is as specific as the Boxer Amendment on the border adjustment measures.

The border adjustment proposal in the Boxer Amendment essentially requires that, beginning from January 1, 2014, “covered goods”²¹ from countries that have not taken “comparable action”²² to the actions taken in

the United States to limit GHG emissions, must be accompanied by an appropriate number of emissions allowances in order to be imported into the United States.

Specifically, this proposal would be executed by first, establishing a bi-partisan “International Climate Change Commission” (the “Commission”) consisting of six commissioners appointed by the President in coordination with the Senate.²³ The Commission’s key role would be to determine annually which countries have or have not taken comparable action to combat greenhouse gas emissions and to publish those determinations. Countries that are found to have taken comparable action, or that meet certain exemptions,²⁴ are placed on an “excluded” list by the Commission.²⁵ Importers of covered goods from these countries would not be required to submit emissions allowances under these regulations. All other countries would be placed on the “covered” list, and covered goods would have to be accompanied by emissions allowances when imported into the United States.²⁶ The Commission would have enforcement powers

Carbon leakage is a real concern in light of the possibility of a post-Kyoto Protocol international climate change agreement without equivalent obligations undertaken by all heavy GHG emitters.

to penalize companies importing goods without the required emissions credits.²⁷ Such penalties could include payment of a penalty and even a prohibition on importing the goods in controversy for up to five years.²⁸

Under the Boxer Amendment, emissions allowances needed to accompany covered goods would come from a special reserve of allowances established by the Environmental Protection Agency (“EPA” or “Administrator”), which would also be responsible for establishing the pricing methodology²⁹ for these allowances. The Administrator additionally would be responsible for establishing a method for determining the number of allowances necessary for covered goods entirely manufactured and processed in one covered country, using a general formula³⁰ for calculating the number of allowances required “on a per unit basis for each category of covered goods that are entered into the United States from that foreign country during each compliance year.”³¹ The Administrator would further be responsible for establishing the methodology for determining the number of allowances to be applied to covered goods manufactured or processed in multiple foreign countries.³²

Finally, while most emissions allowances would come from the special reserve mentioned above, the Boxer Amendment also allows U.S. importers to submit allowances issued by foreign cap-and-trade programs that are deemed to constitute “comparable action.”³³ U.S. importers may also use credits from international offset projects authorized by the Administrator in lieu of international reserve allowances.³⁴ These international offsets would be authorized as part of Title XIII Subtitle B of the Boxer Amendment, which describes international partnership programs such as the reduction of deforestation.³⁵

The border adjustment measure of the Waxman-Markey draft differs from the Boxer Amendment in significant ways. The principal difference is that while the Boxer Amendment mandates that the border adjustment become effective from 2014, the Waxman-Markey draft gives the President the discretion to impose a border adjustment, after making a determination that compliance with the U.S. cap-and-trade system continues to cause significant reductions in domestic production or domestic jobs, or an increase in greenhouse gas emissions by foreign manufacturing facilities manufacturing covered goods in jurisdictions without “commensurate” GHG regulations.³⁶ This determination is expected to be made no later than June 30, 2017, as part of a reporting process by the President with the EPA.³⁷ If the President decides to impose a border adjustment, he must issue regulations no later than 24 months after the determination.³⁸ From that point on, covered goods may only be imported into the United States with the appropriate number of allowances.³⁹

The Waxman-Markey draft vaguely describes the parameters for the border adjustment program, with the result that there are only a few points of comparison with the Boxer Amendment provisions. One similarity is that both drafts specify exemptions permitted for least-developed countries and countries emitting less than 0.5% of total global GHG emissions (i.e., a *de minimis* rule).⁴⁰ The differences, however, are numerous. For instance,

the border adjustment in the Waxman-Markey draft clearly states its intent of addressing “competitive imbalance” as a result of “direct and indirect” costs of complying with both the U.S. cap-and-trade system and systems of other countries.⁴¹ Moreover, the definition of “covered goods” in the Waxman-Markey draft for purposes of the border adjustment measure does not broadly include imports of “manufactured items for consumption,” but only those designated as “primary products.”⁴²

Another principal difference in the Waxman-Markey draft, which also has significant bearing on this discussion, is that—in order to avoid the problem of carbon leakage⁴³ while preserving the global competitiveness of industries affected by the carbon caps—the draft utilizes another competitiveness measure in the first instance to distribute “rebates” (essentially free credits) to the “owners and operators of entities in eligible industry sectors,” beginning in 2012.⁴⁴ Under this primary competitiveness mechanism, eligible industries would first be determined depending on whether they have an energy intensity or greenhouse gas intensity of at least five percent, and a trade intensity of at least fifteen percent, as calculated by the EPA Administrator according to methods described in the draft text.⁴⁵ According to the draft, the number of rebates given to each eligible entity would equal “the sum of the covered entity’s direct compliance factor and the covered entity’s indirect carbon factor.”⁴⁶ The draft further mandates an annual review of the rebate program, and allows for the EPA, beginning in 2021, to eliminate rebates if the Administrator determines that “more than 70 percent of the global output from a sector . . . is manufactured in countries subject to commensurate greenhouse gas regulation.”⁴⁷

Importantly, the Waxman-Markey draft, unlike a number of earlier proposals, particularly emphasizes the need for the adoption of clean technologies, clean energy sources, and energy efficiency. For example, the draft proposes the adoption of a “smart grid” to improve energy efficiency; the adoption of technologies such as carbon capture and sequestration to reduce emissions in the air; and the provision of U.S. assistance to the developing world to encourage them to adopt clean technologies.⁴⁸

The Cap and Dividend Act of 2009⁴⁹ is the most recent legislation to be introduced imposing a border adjustment measure. The measure differs radically from the Boxer Amendment and Waxman-Markey draft provisions, in that it requires the imposition of “carbon equivalency fees” on all imports of “carbon-intensive goods.”⁵⁰ The carbon equivalency fee would equal the dollar value amounts domestic producers have to pay to acquire carbon permits for the production of their goods, and any carbon equivalency fees paid by importers for carbon-intensive goods used in the production of their final manufactured items.⁵¹ This carbon equivalency fee would in turn be paid out to domestic producers of carbon intensive goods, to make up for the costs they incur.⁵² This provision will be terminated in the event that an international agreement is reached requiring carbon-emitting countries to adopt similar measures, or when carbon-emitting countries unilaterally adopt equivalent measures to those of the United States.⁵³

Prior and subsequent to the Boxer Amendment last year, both the Senate and the House of Representatives had introduced a number of bills containing border adjustment measures, which differed more or less substantially from the Boxer Amendment. S.3036, which the Boxer Amendment replaced, for example, contained significant differences in the timing of implementation, structure of oversight and implementation bodies, and the definition of certain terms.⁵⁴

Two pieces of legislation proposed in the House of Representatives also included border adjustment measures: H.R.6186, the Investing in Climate Action and Protection Act (“H.R.6186”),⁵⁵ introduced by Representative Markey, and H.R.6316, the Climate, Market, Auction, Trust & Trade Emissions Reduction System Act of 2008 (“H.R.6316”),⁵⁶ introduced by Representative Lloyd Doggett.

The terms of the border adjustment measures under H.R.6186 are very similar to, if more simplistic than, S.3036. If H.R.6186 is the House’s counterpart to S.3036, then H.R.6316 serves as the House’s counterpart to the Boxer Amendment. Much of the terms and structure of H.R.6316 replicates the proposals in the Boxer Amendment. The fact that H.R.6316 was the latest piece of climate change legislation introduced into the House, and that it so closely echoes the direction and details of the Boxer Amendment, again reinforces the notion that these pieces of legislation will likely form the basis of some of the future legislative efforts to regulate GHG emissions, particularly on the Senate side.⁵⁷

ARE THE EXISTING BORDER ADJUSTMENT PROPOSALS CONSISTENT WITH WORLD TRADE ORGANIZATION RULES?

This section provides a brief overview of WTO rules that could be implicated by the border adjustment proposals described in the previous section, and discusses whether the proposals would survive scrutiny under those rules. Because the proposals for U.S. legislation are incomplete and likely to be substantially revised prior to passage, it is difficult to reach definitive conclusions about the outcome of any future WTO challenge. However, notwithstanding this uncertainty, it is already quite clear which WTO rules would be implicated in such a challenge, and these rules provide an important roadmap for legislators hoping to “appeal-proof” a final bill.

At least three distinct WTO agreements could come into play in a challenge to U.S. border adjustment measures. The first is the General Agreement on Tariffs and Trade (“GATT”).⁵⁸ The relevant GATT provisions can be divided into two groups—first, the fundamental trade principles that WTO Members must uphold, and second, defenses that may be asserted to justify a breach. Thus, a finding of a violation of one or more of the fundamental principles may not necessarily lead to termination of a challenged measure if a legitimate defense is available.

One fundamental trade principle likely to come into play if legislation like the Boxer Amendment enters into force is the most-favored nation (“MFN”) clause of GATT Article I. The MFN clause at Article I:1 provides, writ large, that if a WTO

Member gives advantageous treatment to imports of a given product from one WTO Member, it must provide the same advantageous treatment to imports of the “like product” from all the other Members as well. In short, a WTO Member may not discriminate by providing better treatment to imports from some countries than to imports from other countries. The obligation set forth in Article I:1 is broad, applying “with respect to all rules and formalities in connection with imports.” Yet, the Boxer Amendment at Section 1316(b)(3) would seem to *require* this very mode of prohibited discrimination by imposing the importer allowance requirement on imports from countries deemed not to have taken “comparable action” to the United States to combat climate change, while relieving imports from other countries of this obligation. The MFN clause would thus seem to present a significant hurdle under the WTO rules for border adjustment mechanisms like the Boxer Amendment that treat imports from different countries differently.

Another GATT principle potentially implicated by border measures is set forth in Article II, pursuant to which WTO Members have agreed to “bind,” or fix, their customs duties on imports at levels laid out in national schedules of concessions. Under Article II:1(b), WTO Members have committed not to impose customs duties in excess of their bound levels. Notably, this obligation extends to “all other duties or charges of any kind.” The terms “all” and “of any kind” in this provision appear to encompass an importer allowance requirement of the sort proposed by the Boxer Amendment.

The GATT contains another important prohibition on trade-discriminatory treatment—the national treatment provisions of Article III. The general thrust of these provisions is that a WTO Member must accord treatment to goods imported from other WTO Members that is no worse than the treatment accorded to domestically produced “like” goods. Any border adjustment measure that imposes higher compliance burdens on imported goods than it imposes on domestically produced goods could run afoul of this national treatment requirement. Two elements of Article III are most likely to come into play in challenges to border adjustment measures. The first is the requirement of Article III:2 that imports shall not be subject to “internal taxes or other internal charges” that exceed those applied to the “like” domestic products. The second is the requirement of Article III:4 that imports shall be subject to regulatory treatment that is no less favorable than that accorded to “like” products of domestic origin. A considerable body of WTO jurisprudence helps define the scope of these obligations—including the perpetually tricky question of how to define a “like” product.⁵⁹ Unlike the vulnerability of an importer allowance program under the above-mentioned GATT provisions, it seems possible for lawmakers to craft a program that would impose comparable burdens on imported and domestically produced goods alike. However, there is no broad guarantee that such an effort would succeed; if challenged, compliance with national treatment principles may have to be assessed on a product-by-product basis, and any incremental increase in the compliance burden imposed on importers could render the program vulnerable.

Yet another GATT provision that may be implicated by border measures is Article XI:1, pursuant to which WTO Members may impose “no prohibitions or restrictions [on imports] other than duties, taxes, or other charges.” This proscription could readily be seen as applying to border measures intended to deter carbon leakage such as importer allowance requirements—particularly if the market price for allowances were to rise to a level rendering importation cost-prohibitive.

As noted, a WTO Member may violate one of these fundamental principles, but still be able to justify the violation. Doing so would require invocation of one or more of the “General Exceptions” set forth in GATT Article XX. Two of the enumerated exceptions are generally understood as providing possible cover for border adjustment provisions in a GHG emissions cap-and-trade scheme. The first is sub-article (b), for measures “necessary to protect human, animal or plant life or health,” and the second is sub-article (g), for measures “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.” Both of these exceptions appear sufficiently broad for lawmakers to craft border measures to fit within their parameters. Further, as a matter of intent, the GATT appears to leave room for WTO Members to pursue their own environmental policies and does not attempt to harmonize national policies.

However, fitting a measure within one of the Article XX sub-articles is not the end of the inquiry. Any defense of a measure under Article XX must also survive the test laid out in the chapeau of that Article itself, which provides that the measure may not be applied “in a manner which would constitute a means of arbitrary or unjustifiable discrimination,” or a “disguised restriction on international trade.” In short, Article XX does not shield protectionism masquerading as environmentalism. Would border adjustment measures that are, on their face, intended to safeguard U.S. industries from foreign competitors deemed to have an unfair cost advantage survive scrutiny under the Article XX chapeau? Opinions on this question vary, and the answer would ultimately depend both on the final wording of U.S. legislation as well as how it is implemented.

Further, a considerable body of WTO jurisprudence now exists on the Article XX chapeau, and provides some considerations likely to be applied in any challenge to U.S. border adjustment measures. For example, in the recent *Brazil-Tyres* case, the WTO Appellate Body struck down a Brazilian import ban on retreaded tires that exempted imports from MERCOSUR⁶⁰ countries. In a key passage in its holding, the Appellate Body reasoned that the trade discrimination (i.e., imports were generally prohibited, but not if originating in MERCOSUR countries) at issue was not “rationally related” to the environmental objective of the import ban.⁶¹ Another consideration likely to arise in any challenge to final U.S. border adjustment measures stems from the much-cited *U.S.-Shrimp* case, in which the WTO Appellate Body explained that the legitimacy of an environmental measure with a trade-discriminatory impact may be shown through earnest attempts by the importing country to negotiate an international agreement that would ensure equal treatment of

all affected trading partners. Under this test, a “serious, good faith effort” to discuss a global climate change mitigation regime may be sufficient.⁶²

A second WTO agreement that may be invoked to challenge U.S. border adjustment measures in cap-and-trade legislation is the Agreement on Technical Barriers to Trade (“TBT Agreement”). The TBT Agreement guides the application of technical regulations and standards in order to avoid unnecessary obstructions to trade. Technical regulations are defined in Annex 1 of the TBT Agreement as “document[s] which [lay] down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory.”⁶³ This definition may extend to requirements dealing with packaging, labeling, and marking. In the context of border adjustment measures, if the measures require that products be produced in accordance with certain emissions control criteria in order to be imported freely into the United States, for instance, this could trigger a TBT Agreement challenge. Although none of the current proposals contain criteria that could be defined as a “technical regulation” for purposes of the TBT Agreement, the alternative proposal described at the end of this paper—as well as other proposals by commentators⁶⁴—could trigger a challenge under these provisions.

There are four possible ways in which a challenge may be raised against border adjustment measures under the TBT Agreement. First, like the MFN and national treatment clauses described in the GATT discussion above, TBT Agreement Article 2.1 requires that technical regulations must apply “no less favorably” to “like products” of WTO Members than to “like products” of national origin or of other countries.⁶⁵

Second, under Article 2.2 of the TBT Agreement, technical regulations must not be drafted or applied in a way that creates an “unnecessary obstacle to trade,” or more specifically, must not be “more trade-restrictive than necessary to fulfill a legitimate objective.”⁶⁶ However, under Article 2.2, legitimate objectives may include protection of the environment. Therefore, if the U.S. Government were able to prove adequately that its technical regulations were designed to fulfill the objective of protecting the environment, and did not do so in an overly-restrictive manner, then the technical regulations could survive a challenge under this provision.

Third, the TBT Agreement mandates under Article 2.4 that, where international standards exist, they must be used as a standard for WTO Members’ technical regulations.⁶⁷ In this case, no such global standards exist, but if new standards were adopted pursuant to the UN climate change negotiations, then these would necessarily have to serve as the basis of any technical regulations adopted in the United States, and if not, U.S. regulations could be subject to a challenge under this provision of the Agreement.

Finally, TBT Article 12 requires that WTO Members take into account developing countries in applying technical regulations, particularly to ensure that such technical regulations do not impose unnecessary obstacles to trade with these developing countries.⁶⁸ Although most border adjustment measures

proposed so far specifically exempt countries designated by the UN as “least developed” countries, any legislation imposing technical regulations should take this requirement into account as well.⁶⁹

The third WTO agreement that may come into play in a challenge to a U.S. competitiveness provision more generally is the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”).⁷⁰ Exposure to claims under the SCM Agreement could arise in several ways. One possibility, applicable to a competitiveness measure that allocates emissions allowances to some domestic manufacturing industries (but not others) at no charge, would be a claim that the provision of free allowances under such circumstances constitutes an actionable subsidy.⁷¹ Such a claim could be premised on a definition of “subsidy,” at Article 1.1(a)(ii), which covers government decisions to forego revenue that is otherwise due.⁷² However, for such a claim to succeed, the alleged subsidy would also have to be “specific” for purposes of Article 2—i.e., limited by law or in fact to certain enterprises or industries. Further, a complaining WTO Member could only prevail in such a case by demonstrating, under Article 5, that the alleged subsidy is causing “adverse effects” to its interests.⁷³ The obstacles to success in such a challenge would be relatively high.

While not directly related to the adoption of competitiveness measures, a second way in which the SCM Agreement might be implicated in relation to a national cap-and-trade program is through the government’s use of proceeds from the sale of emissions permits. As noted earlier, President Obama’s climate change agenda calls for substantial government investment in a range of clean energy technologies. It seems feasible that such expenditures might be challenged by foreign governments seeking to nurture competing industries as impermissible or actionable subsidies under the SCM Agreement. Notably, the SCM Agreement at its inception contained provisions insulating certain “green box” subsidies described in Article 8.2(c) from challenge.⁷⁴ However, these exceptions were of limited duration, and expired in 2000 when the WTO Members could not agree on their continuation.⁷⁵ The expiration of these provisions injects further uncertainty into the WTO risk analysis for any national cap-and-trade system designed to promote clean energy technologies.

Finally, the prospect of a WTO challenge to any competitiveness provisions that might ultimately be adopted raises litigation risk questions entirely apart from the application of the above-mentioned rules. One of the worst-case scenarios would be the imposition of different types of competitiveness provisions by different jurisdictions, spawning multiple and overlapping WTO challenges. The Director-General of the WTO, Pascal Lamy, has referred to such a scenario as a “spaghetti bowl,” and described the institutional problems it could raise for the WTO.⁷⁶ In this scenario, the WTO’s dispute settlement process may well be overwhelmed, both by the magnitude and complexity of the legal issues as well as the unprecedented trade values affected by the challenged measures. Further, regardless of the results of any WTO challenge to climate competitiveness measures, the

imposition of the measures themselves may poison the ongoing UN negotiations towards a new global accord and invite retaliatory action.

These fears, even if speculative, point to the need for an international climate change agreement in which all countries—developed and developing—accept responsibility for reducing worldwide GHG emissions. Indeed, this is the only viable solution to the climate change problem, and the only “exit strategy” for countries that have or will unilaterally implement cap-and-trade systems domestically. Even if competitiveness measures pass WTO muster, they are only temporary measures until a global solution on climate change is achieved. In the meantime, domestic political reality in the United States (and in other advanced economies) dictates that no domestic GHG cap-and-trade scheme can achieve adequate political support if it does not ensure the competitiveness of domestic manufacturing industries in light of the developing countries’ current stance on prioritizing “development” over carbon reduction. Thus, designing competitiveness measures—and specifically border adjustment measures—to maximize their chances of surviving a WTO challenge, to the extent permitted by domestic political reality, remains the task at hand.

MINIMIZING THE RISK THAT A BORDER ADJUSTMENT MEASURE WILL RUN AFOUL OF WTO RULES

The preceding sections show that robust border adjustment measures are a *sine qua non* of any final U.S. cap-and-trade system that may be enacted, but also that any such measure could be subjected to a dizzying array of claims under WTO rules. How, then, might the risk of reversal in WTO dispute settlement proceedings be reduced?

As noted in the previous section, one of the key design challenges for border adjustment measures from a WTO risk reduction perspective is how to avoid overt—and unlawful—trade discrimination. One way to avoid at least the surface appearance of discriminatory treatment would be to design a measure so that it does not apply at the border at all, but at the point of consumption within the U.S. economy, for all emissions-intensive goods deemed to be vulnerable to carbon leakage.

Ideally, such a mechanism—which could take the form of a requirement to submit certain standardized amounts of GHG emissions allowances or offsets per quantity of the products at issue⁷⁷—would apply to all GHG-intensive products, regardless of country of manufacture. Refunds or rebates would then be provided to suppliers able to certify that the products were produced subject to a requirement to submit such allowances or offsets (regardless of jurisdiction of submission).⁷⁸ In other words, this adjustment measure would be geared to an objective emissions standard that is not, on its face, based on the country of manufacture of the product. The difficulty, of course, would be in the determination of the amount of allowances or offsets required per product, which could raise concerns under the TBT Agreement as previously noted.

The appearance of discriminatory treatment could be further reduced if suppliers would be permitted to satisfy the standard

based on the emissions intensity of the manufacturer of the product at issue, as opposed to average emissions intensity for the sector in the country of manufacture, as currently envisioned under the Waxman-Markey draft. This would have the added benefit of encouraging the adoption of more efficient manufacturing technologies—*regardless* of the country in which they are deployed.

The above approach, while reducing the chances of being found to violate the GATT's non-discrimination principles and border requirements, could also help buttress a defense under GATT Article XX. As noted in the previous section, a GATT Article XX defense can succeed only where the challenged measure does not constitute a means of arbitrary or unjustifiable discrimination or a disguised trade restriction. Succeeding with such a defense is more difficult where the measure at issue, on its face, distinguishes between products based on their country of manufacture. In such cases, the measure would likely have at least the appearance of unwarranted trade discrimination—especially if the ostensible purpose of the provision is to safeguard the competitiveness of domestic manufacturing industries. However, if the operation of the competitiveness measure can be moved from the border to the point of consumption in the U.S.

economy, as proposed above, and where it operates based on an objective standard of manufacturing emissions intensity, it should be easier to demonstrate that the measure truly advances an environmental goal covered by one of the Article XX exceptions, and does not constitute a disguised trade restriction.

CONCLUSION

It is our hope that this article generates additional thought and discussion as part of the U.S. legislative process in 2009 to craft an effective domestic cap-and-trade system, including the ability to successfully safeguard the competitiveness of U.S. firms that would likely have to bear heavier emissions compliance burdens than most of their foreign competitors. Carbon leakage is a real concern in light of the possibility of a post-Kyoto Protocol international climate change agreement without equivalent obligations undertaken by all heavy GHG emitters. An effective and WTO-consistent adjustment measure (whether applied at the border or at the point of consumption)—among all of the competitiveness measures—appears to stand the best chance of encouraging developing countries to meaningfully participate in a global solution to a global problem. 

Endnotes: Border Adjustment Measures in Proposed U.S. Climate Change Legislation

¹ Bryan Walsh, *Despite the Economy, Obama Vows to Press Green Agenda*, TIME MAGAZINE, NOV. 19, 2008, <http://www.time.com/time/health/article/0,8599,1860431,00.html> (quoting President Barack Obama, Taped Remarks at the Governors' Global Climate Summit (Nov. 18, 2008)).

² *Id.*
³ WhiteHouse.gov, *The Agenda – Energy and Environment*, http://www.whitehouse.gov/agenda/energy_and_environment/ (last visited Apr. 20, 2009).
⁴ Barack Obama: New Energy for America: Reduce our Greenhouse Gas Emissions 80 Percent by 2050, http://my.barackobama.com/page/content/new-energy_more (last visited Dec. 9, 2008).
⁵ *Id.*
⁶ The Bali Action Plan states that countries will act to enable the full implementation of the UNFCCC, through “measurable, reportable and verifiable nationally appropriate mitigation commitments or actions . . . by all developed country Parties” and through “nationally appropriate mitigation actions by developing country Parties. . . .” Conference of the Parties, Report of the Conference of the Parties on its thirteenth session, held in Bali from Dec. 3–15, 2007, *Addendum, Part Two: Action taken by the Conference of the Parties at its thirteenth session*, ¶¶ 1.(b)(i)-(ii), U.N. Doc. FCCC/CP/2007/6/Add.1* (Mar. 18, 2008), available at <http://unfccc.int/resource/docs/2007/cop13/eng/06a01.pdf#page=3>.

⁷ See Kent Garber, *On Climate Change, Environmental Groups Want Obama to Reverse Troubled Bush Legacy*, U.S. NEWS AND WORLD REPORT, NOV. 19, 2008, <http://www.usnews.com/articles/news/national/2008/11/19/on-climate-change-environmental-groups-want-obama-to-reverse-troubled-bush-legacy.html>.

⁸ The six principles are:
1. Reduce emissions to levels guided by science to avoid dangerous global warming. 2. Set short and long term emissions targets that are certain and enforceable, with periodic review of the climate science and adjustments to targets and policies as necessary to meet emissions reduction targets. 3. Ensure that state and local entities continue pioneering efforts to address global warming. 4. Establish a transparent and accountable market-based system that efficiently

reduces carbon emissions. 5. Use revenues from the carbon market to: Keep consumers whole as our nation transitions to clean energy; Invest in clean energy technologies and energy efficiency measures; Assist states, localities and tribes in addressing and adapting to global warming impacts; Assist workers, businesses and communities, including manufacturing states, in the transition to a clean energy economy; Support efforts to conserve wildlife and natural systems threatened by global warming; and Work with the international community, including faith leaders, to provide support to developing nations in responding and adapting to global warming. In addition to other benefits, these actions will help avoid the threats to international stability and national security posed by global warming. 6. Ensure a level global playing field, by providing incentives for emission reductions and effective deterrents so that countries contribute their fair share to the international effort to combat global warming.

Senator Barbara Boxer, *Principles of Global Warming Legislation* (Feb. 3, 2009), http://epw.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=14dc734d-74c9-4fb3-8bf2-6d5d539226d1.

⁹ The Boxer Amendment was proposed as a substitute to S.3036, a piece of legislation which was originally introduced into the Senate in October 2007 as S.2191, the Lieberman-Warner Climate Security Act of 2008. S.2191 was considered, and a revised version later reported to the Senate on May 20, 2008, by the Senate Environment and Public Works Committee. On the same day, a nearly identical version of S.2191 was reported by Senator Boxer, containing a slight amendment to render the legislation budget-neutral. This version was renumbered from S.2191, becoming S.3036. Brent D. Yacobucci & Larry Parker, *Climate Change: Comparison of S.2191 as Reported (now S.3036) with Proposed Boxer Amendment* (Congressional Research Service Report for Congress No. RL34513, 2008), available at <http://ncseonline.org/NLE/CRS/abstract.cfm?NLEid=2127>.

Endnotes: Border Adjustment Measures in Proposed U.S. Climate Change Legislation *continued on page 59*

ENDNOTES: BORDER ADJUSTMENT MEASURES IN PROPOSED U.S. CLIMATE CHANGE LEGISLATION *continued from page 19*

¹⁰ The Boxer Amendment died in a 48-36 vote against cloture on June 2, 2008. No further action has been reported on the Boxer Amendment to date. An article published one day before the cloture vote on the Boxer Amendment stated that “several senators are questioning why they are being asked to vote on a lengthy substitute version of the bill that Boxer and her allies just introduced a week and a half ago.” Juliet Eilperin and Steven Mufson, *Climate Bill Underlines Obstacles to Capping Greenhouse Gases*, WASHINGTON POST, June 1, 2008, at A12, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/05/31/AR2008053102471.html>.

¹¹ See Boxer Amendment to S.3036, 110th Cong. Title XIII, Subtitle A and American Clean Energy and Security Act of 2009, Discussion Draft, 111th Cong. Title IV, Subtitle A, Part 2. It should be noted that the Waxman-Markey bill utilizes the border adjustment measure as a “backstop” to a more comprehensive free allowance mechanism for trade-sensitive, energy-intensive industries. In other words, under this bill, free allowances would first be provided to such industries to ensure their global competitiveness. Should these allowances not meet this stated goal, border adjustment measures would then be used.

¹² See, PEW CENTER ON GLOBAL CLIMATE CHANGE, RESPONSE OF THE PEW CENTER ON GLOBAL CLIMATE CHANGE TO THE COMMITTEE ON ENERGY AND COMMERCE AND ITS SUBCOMMITTEE ON ENERGY AND AIR QUALITY, U.S. HOUSE OF REPRESENTATIVES, ON THE CLIMATE CHANGE LEGISLATION DESIGN WHITE PAPER: COMPETITIVENESS CONCERNS/ENGAGING DEVELOPING COUNTRIES 2 (2008), available at <http://www.pewclimate.org/docUploads/Pew%20Center%20on%20Competitiveness-Developing%20Countries-FINAL.pdf>.

¹³ NIGEL PURVIS, RES. FOR THE FUTURE, MIND THE GAP: THE CASE FOR CLIMATE

AND COMPETITIVENESS PROTECTION AUTHORITY 2 (2008), available at <http://www.rff.org/RFF/Documents/RFF-IB-08-03.pdf>.

¹⁴ See ELLIOT DIRINGER, PEW CTR. ON GLOBAL CLIMATE CHANGE, THE U.S. ELECTION AND PROSPECTS FOR A NEW CLIMATE AGREEMENT 4 (2008), available at <http://www.boell.de/climate-transatlantic/index-117.html>. (“There is now an emerging consensus in Washington that the United States should proceed with mandatory action at home, with or without developing country commitments, provided the legislation includes trade provisions to protect U.S. industry from competitive harm by imposing like costs on energy-intensive imports from countries like China.”).

¹⁵ STAFF OF H.R. COMMITTEE ON ENERGY AND COMMERCE, 110TH CONG., CLIMATE CHANGE LEGISLATION DESIGN WHITE PAPER: COMPETITIVENESS CONCERNS/ENGAGING DEVELOPING COUNTRIES 1 (Comm. Print 2008) (“If the U.S. were to cap its own GHG emissions without corresponding action by developing nations that compete in global trade markets, the cost of producing some American products would increase relative to those manufactured in countries without emissions limits. As a result, U.S. industry might relocate to (or expand operations in) countries that do not limit the emissions of their industries, causing both the environment and the U.S. economy to suffer.”).

¹⁶ *Id.* at 2, 8.

¹⁷ *Id.* at 12.

¹⁸ *Issues in Designing a Cap-and-Trade Program for Carbon Dioxide Emissions, Before the H. Comm. on Ways and Means*, 110th Cong. 16 (2008) (statement of Peter R. Orzag, Director, Congressional Budget Office), available at <http://waysandmeans.house.gov/media/pdf/110/orszag.pdf>.

¹⁹ *Id.*

²⁰ See Joost Pauwelyn, *U.S. Federal Climate Policy and Competitiveness Concerns: The Limits and Options of International Trade Law 4* (Nicholas Inst., Working Paper no. 07-02, 2007), available at <http://www.nicholas.duke.edu/institute/internationaltradelaw.pdf>.

²¹ A “covered good” is defined as:

[A] good that (as identified by the EPA Administrator by rule (A) is a primary product or manufactured item for consumption; (B) generates, in the course of the manufacture of the good, a substantial quantity of direct greenhouse gas emissions and indirect greenhouse gas emissions; and (C) is closely related to a good the cost of production of which in the United States is affected by a requirement of [the Boxer Amendment].

Boxer Amendment to S.3036, 110th Cong. § 1311(7). In § 1311(16), “primary product” is defined as:

(A) iron, steel, steel mill products (including pipe and tube), aluminum, cement, glass (including flat, container, and specialty glass, and fiberglass), pulp, paper, chemicals, or industrial ceramics; or (B) any other manufactured product that—(i) is sold in bulk for purposes of further manufacture or inclusion in a finished product; and (ii) generates, in the course of the manufacture of the product, direct greenhouse gas emissions or indirect greenhouse gas emissions that are comparable (on an emissions-per-output basis) to emissions generated in the manufacture of products by covered entities in the industrial sector.

Id. § 1311(16).

²² “Comparable action” is defined in the Boxer Amendment as “greenhouse gas regulatory programs, requirements and other measures adopted by a foreign country that, in combination, are comparable in effect to actions carried out by the United States through federal, state and local measures to limit greenhouse gas emissions, as determined by the Commission.” The determination of whether a country has taken comparable action will be based on the following requirements, in compliance with applicable international agreements:

(i) A foreign country is deemed to have taken comparable action if the Commission determines that (I) the percentage change in greenhouse gas emissions in the foreign country during the relevant period is equal to, or better than, (II) the percentage change in greenhouse gas emissions in the United States during the same period. The Commission will develop rules for taking into account net transfers to and from the United States and other foreign countries of greenhouse gas allowances and other emission credits.

(ii) If a foreign country is not deemed to have taken comparable action under clause (i), the Commission will take into consideration, the extent to which all of the following actions that have the effect of limiting greenhouse gas emissions in the foreign country have been taken during the relevant period, and that these actions have been fully implemented, verified and enforced: (I) the deployment and use of state of the art technologies in industrial processes, equipment manufacturing facilities, power generation and other energy facilities, consumer goods (such as automobiles and appliances) and implementation of other techniques or actions that have the effect of limiting greenhouse gas emissions in the foreign country during the relevant period; and (II) any regulatory programs, requirements, and other measures that the foreign country has implemented to limit greenhouse gas emissions during the relevant period.

Id. § 1311(4).

²³ *Id.* § 1314.

²⁴ Exemptions include foreign countries (i) that have been classified as a least-developed developing country by the United Nations, or (ii) whose share of total global greenhouse gas emissions is below the *de minimis* percentage defined in the Boxer Amendment as “0.5% of total global greenhouse gas emissions for the most recent calendar year for which relevant data is available, taking into consideration the annual average deforestation rate during a representative period for a developing foreign country.” *Id.* § 1316(b)(2).

²⁵ *Id.* § 1316(b)(2).

²⁶ *Id.* § 1316(b)(3).

²⁷ Boxer Amendment to S.3036, 110th Cong. § 1314.

²⁸ *Id.* §§ 1314(d)(1)-(2).

²⁹ *Id.* § 1316(a)(3).

³⁰ The “general formula” is defined as:

[T]he international reserve allowance requirement, as described in paragraph (1), for a compliance year is equal to the product obtained

by multiplying (A) the national greenhouse gas intensity rate for each category of covered goods of each covered foreign country for the compliance year, as determined by the Administrator under paragraph (3); by (B) the allowance adjustment factor for the industry sector in the foreign country that manufactured the covered goods entered into the United States, as determined by the Administrator under paragraph (4); by (C) the economic adjustment ratio for the foreign country, as determined by the Commission under paragraph (5).

Id. § 1316(d)(2).

The “national greenhouse gas intensity rate” is calculated by the Administrator:

[F]or a particular foreign country under subparagraph (2)(A), on a per unit basis, in an amount equal to the quotient obtained by dividing (A) the total amount of direct greenhouse gas emissions and indirect greenhouse gas emissions that are attributable to a category of covered goods of a covered foreign country during the most calendar year (as adjusted to exclude those emissions that would not be subject to the allowance submission requirements of section 202 for the category of covered goods if manufactured in the United States); by (B) total number of units of the particular covered good that are produced in the covered foreign country during the same calendar year.

Id.

The “allowance adjustment factor” is calculated by the Administrator:

[F]or a particular foreign country under subparagraph (2)(B) in an amount that is equal to 1 minus the ratio that (i) the number of allowances, as determined by the Administrator under subparagraph (4)(B), that an entire industry sector in the foreign country would have received at no cost if such allowances were allocated in the same manner that allowances are allocated at no cost under Titles V through XI to the same industry sector in the United States; bears to (ii) the total amount of direct greenhouse gas emissions and indirect greenhouse gas emissions that are attributable to a category of covered goods of a covered foreign country during a particular compliance year.

Id.

“Allowances allocated at no cost” are calculated by the Administrator:

[I]n an amount equal to the product obtained by multiplying—(i) the baseline emissions level that the Commission has attributed to a category of covered goods of a foreign country; by (ii) the ratio that—(I) the quantity of allowances that are allocated at no cost under Titles V through XI to entities within the industry sector that manufactures the covered goods for the compliance year during which the covered goods were entered into the United States; bears to (II) the total amount of direct greenhouse gas emissions and indirect greenhouse gas emissions of that sector during the same compliance year.

Finally:

[T]he Administrator shall apply an economic adjustment ratio of 1 for a particular foreign country under subparagraph (2)(C) unless the Commission makes an affirmative decision to lower the ratio in order to take into account all of the following actions that the foreign country has taken during the relevant period, and that these actions have been fully implemented, verified, and enforced—(A) the deployment and use of state of the art technologies in industrial processes, equipment manufacturing facilities, power generation and other energy facilities, consumer goods (such as automobiles and appliances) and implementation of other techniques or actions that have the effect of limiting greenhouse gas emissions in the foreign country during the relevant period; and (B) any regulatory programs, requirements, and other measures that the foreign country has implemented to limit greenhouse gas emissions during the relevant period.

Boxer Amendment to S.3036, 110th Cong. § 1316(d)(2).

³¹ *Id.* § 1316(d)(1)(B).

³² Under this methodology, each importer would (i) determine for each covered foreign country the number of allowances that apply to the category of covered goods manufactured and processed entirely in that covered foreign country for that compliance year; and (ii) of the allowance requirements identified for particular covered foreign countries, apply the requirement that imposes the highest number of allowances for the category of covered goods. The Administrator may allow importers to apply an alternate method for establishing this requirement, but only if the importer demonstrates in an administrative hearing by a preponderance of evidence that the alternate method will establish

an international reserve allowance requirement that is more representative than the applicable requirement. *Id.* § 1316(d)(8).

³³ Such programs represent a “comparable action” if the Administrator certifies that the program (i) places a quantitative limitation on the total quantity of greenhouse gas emissions of the covered foreign country in terms of tons emitted per year and achieves that limitation through an allowance trading system; (ii) satisfies criteria established by the Administrator for requirements relating to the enforceability of the cap and trade program, including requirements for monitoring, reporting, verification procedures, and allowance tracking; and (iii) is a comparable action. *Id.* § 1316(e)(1).

³⁴ *Id.* § 1316(e)(2).

³⁵ *Id.* § 1316(e)(2)(A).

³⁶ American Clean Energy and Security Act of 2009, Discussion Draft, 111th Cong. § 414(b) [hereinafter American Clean Energy and Security Act of 2009]. Furthermore, a country will be determined to have:

[C]ommensurate greenhouse gas regulation if (1) the country’s annual greenhouse gas intensity or energy intensity (as described in section 403(b)) for a sector or sub-sector is equal to or less than the greenhouse gas intensity or energy intensity for such sector or sub-sector in the United States in the most recent calendar year for which reliable data are available; or (2) the country has implemented policies, including sectoral caps, export tariffs, or production fees, that individually or collectively place a price on greenhouse gas emissions from a sector or sub-sector that is at least 60 percent of the cost of complying with title VII of the Clean Air Act in the United States for such sector or sub-sector, averaged over a two-year period.

American Clean Energy and Security Act of 2009, § 405(b)(2).

³⁷ *Id.* § 414(a).

³⁸ *Id.* § 416(a).

³⁹ *Id.* § 415.

⁴⁰ *Id.* § 416(a)(1)(C).

⁴¹ *Id.* § 416(a)(2).

⁴² American Clean Energy and Security Act of 2009, *supra* note 36, § 411(1). This section specifies “iron, steel, steel mill products (including pipe and tube), aluminum, cement, glass (including flat, container, and specialty glass and fiberglass), pulp, paper, chemicals, and industrial ceramics” as “primary products.” It also provides a “catch-all” sub-provision covering

[A]ny other manufactured product that (i) is sold in bulk for purposes of further manufacture or inclusion in a finished product; and (ii) generates, in the course of the manufacture of the product, direct greenhouse gas emissions or indirect greenhouse gas emissions that are comparable (on an emissions-per-output basis) to emissions generated in the manufacture of products [that were specifically listed earlier].

Id.

⁴³ *Id.* § 402(b)(1). Carbon leakage is defined as “any substantial increase (as determined by the Administrator) in [GHG] emissions by manufacturing entities located in countries without commensurate [GHG] regulation, provided that such increase is caused by an incremental cost of production increase in the United States resulting from the implementation of title VII of the Clean Air Act.”

⁴⁴ *Id.* § 403(a).

⁴⁵ *Id.* § 403(b).

⁴⁶ *Id.* § 403(c). The direct compliance factor is equal to the “product of (i) the output of the covered entity; and (ii) 85 percent of the average [GHG] emissions (expressed in tons of carbon dioxide equivalent) per unit of output for all covered entities in the sector or sub-sector, as determined by the Administrator based on reports provided under subparagraph (C).” The “indirect carbon factor for an entity for a calendar year is the product obtained by multiplying the output of the covered entity by both the emissions intensity factor determined pursuant to clause (i) and the electricity efficiency factor determined pursuant to clause (ii) for the year concerned.” The “emissions intensity factor” in a regulated electricity market is “the average [GHG] emissions (expressed in tons of carbon dioxide equivalents) per kilowatt hour of the electricity purchased by the covered entity, as determined by the Administrator based on reports provided under subparagraph (D).” “In a wholesale competitive electricity market, the emissions intensity factor is the average [GHG] emissions (expressed in tons of carbon dioxide equivalents) per kilowatt hour of the marginal source of supply of electricity purchased by the covered entity, as determined by the Administrator based on reports provided under subparagraph (D).” “The electricity efficiency factor is 85 percent of the average amount of electricity (in kilowatt

hours) used per unit of output for all covered entities in the relevant sector or sub-sector, as determined by the Administrator based on reports provided under subparagraph (C).”

⁴⁷ American Clean Energy and Security Act of 2009, *supra* note 36, § 405(b).

⁴⁸ *See id.* Titles I and IV.

⁴⁹ Also known as H.R. 1862, the bill was introduced on April 1, 2009 and was referred to the Committees on Ways and Means and Energy and Commerce. H.R. 1862, 111th Cong. (1st Sess. 2009).

⁵⁰ *Id.* § 2.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ S.3036, 110th Cong. § 6006 (2008). An important difference between the Boxer Amendment and S.3036 is that the requirement for U.S. importers to submit emissions allowances for the covered goods imported would have gone into effect from January 1, 2020 under S.3036, meaning that there would have been an eight-year delay between requiring emissions allowances from domestic manufacturers (which would commence in 2012) and from importers. In contrast, the Boxer Amendment incorporates only a two-year delay between domestic and international requirements, requiring importers to purchase and produce emissions allowances beginning from January 1, 2014. A further difference concerns how key terms in the border adjustment measures are defined, thus having an impact on how these measures will be implemented and enforced. Baseline emissions level used to calculate emissions attributable to covered goods, and to determine whether comparable actions have been taken, would be calculated as of 2005 levels in the Boxer Amendment, but as of the period from January 1, 2012 to December 31, 2014 under S.3036. While the Boxer Amendment specifically addresses the calculation of allowances for goods from multiple covered countries, S.3036 does not. Further, under the Boxer Amendment, the definitions of comparable action and the formulas to be used by the EPA are far more developed and fully conceptualized than in S.3036. For example, in contrast to the methodology described above in the section on the Boxer Amendment, the methodology for calculating the international allowance requirements under S.3036 only covers the initial compliance year, and is defined as “for each category of covered goods of each covered foreign country” it is “equal to the quotient obtained by dividing (i) the excess, if any, of the total emissions from the covered foreign country that are attributable to the category of covered goods produced during the most recent year for which data are available, over the baseline emission level of the covered foreign country for that category; and (ii) the total quantity of the covered good produced in the covered foreign country during the most recent calendar year.” *Id.* § 6006(d)(2)(A). The legislation is designed so that the allowance requirements would be adjusted later:

(i) in accordance with the ratio that (I) the quantity of allowances that were allocated at no cost to entities within the industry sector manufacturing the covered goods for the compliance year during which the covered goods were imported into the United States, bears to (II) the greenhouse gas emissions of that industry sectors; and (ii) to take into account the level of economic development of the covered foreign country in which the covered goods were produced.

Id. § 6006(d)(2)(B). While the Boxer Amendment’s methodology is more detailed and complex, its basic principles are roughly the same as in S.3036.

⁵⁵ H.R.6186 was introduced in the House of Representatives on June 4, 2008, and referred to the House Subcommittee on Energy and the Environment on June 12, 2008. No further action has been taken on this bill. H.R. 6186, 110th Cong. (2d Sess. 2008).

⁵⁶ H.R.6316 was introduced into the House of Representatives on June 19, 2008 and referred to the House Subcommittee on Conservation, Credit, Energy and Research on November 19, 2008. No further action has been taken on this bill. H.R. 6316, 110th Cong. (2d Sess. 2008).

⁵⁷ However, there are some significant differences between the Boxer Amendment and H.R.6316 that are worth noting. Perhaps the most significant difference between the two is that, unlike the Boxer Amendment, which requires imports from any foreign country not on the exempted list to submit emissions allowances, H.R.6316 applies only to countries that are members, or observant governments of, the WTO, defined in the bill as “WTO participants.” Imports from countries that are not WTO participants are not regulated under this legislation, and therefore efforts to limit GHG emissions and spread the cost of regulation among nations do not extend to countries outside of the WTO. Another significant difference is H.R.6316’s inclusion of provisions for negotiating agreements with WTO participants who are developing countries to secure comparable action on GHG emissions, including offering countries will-

ing to negotiate such agreements preferential access to the domestic U.S. carbon market. H.R.6316 § 115(b)(1). The preferential agreements could include incentives such as the ability of the WTO participant to choose its base year or its maximum GHG emissions limits for its system, rather than requiring it to match the U.S. limitations in order to access the U.S. carbon market. *Id.* The negotiated agreements would only be available on a “first-come, first-served” basis, and would not be negotiated in a way that would breach this emissions budget. *Id.* Finally, the requirement for importers to provide emissions allowances on imports from covered countries would begin from January 1, 2015 under H.R.6316, rather than on January 1, 2014 under the Boxer Amendment. Therefore, H.R.6316 allows for a three-year implementation gap before implementing the border adjustment measure, rather than a two-year gap indicated under the Boxer Amendment. H.R.6316. § 111(d)(1).

⁵⁸ The GATT is incorporated into the set of agreements known collectively as the Marrakesh Agreement Establishing the World Trade Organization, which entered into effect on January 1, 2005.

⁵⁹ For instance, one line of cases suggests that the definition of “like” is broader under Article III.4 than it is under Article III.2. *See* World Trade Organization, Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products (“EC – Asbestos”)*, ¶¶ 87-154, WT/DS135/AB/R (March 12, 2001).

⁶⁰ The Mercado Común del Sur (“MERCUSOR”), is a regional trade agreement in South America.

⁶¹ World Trade Organization, Appellate Body Report, *Brazil – Measures Affecting Imports of Retreated Tyres (“Brazil – Tyres”)*, ¶ 232, WT/DS332/AB/R (Dec. 3, 2007).

⁶² World Trade Organization, Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products (“U.S. – Shrimp”)*, ¶¶ 122-24, WT/DS58/AB/R (Oct. 22, 2001).

⁶³ Agreement on Technical Barriers to Trade, Dec. 15, 1993, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. (1994) [hereinafter TBT Agreement].

⁶⁴ *See e.g.*, Statement of Joost Pauwelyn, “Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means,” March 24, 2009. On page 13 of his written statement, Professor Pauwelyn refers to “a carbon assessment on a product-specific basis by, for example, allowing an importer to demonstrate the actual carbon-footprint of a specific batch of imports.” (Emphasis in the original.)

⁶⁵ TBT Agreement, *supra* note 63, art. 2.1.

⁶⁶ *Id.* art. 2.2.

⁶⁷ *Id.* art. 2.4.

⁶⁸ *Id.* art. 12.

⁶⁹ The Emission Migration Prevention with Long-term Output Yields Act (“H.R. 1759”), introduced by Representatives Jay Inslee and Mike Doyle on March 26, 2009, provides an example of the adoption of technical standards in legislation designed to address GHG emissions. H.R. 1759, 111th Cong. (2009). Although this legislation does not apply to imported goods, it does apply to domestic industries in a way intended to defend against carbon leakage. Under the proposal, emission allowances would be distributed to industries vulnerable to external competition as a result of the imposition of a cap-and-trade program. The allowances would be subject to a declining cap, which

would force industries either to adopt clean technologies and become more efficient, or, alternatively, to move operations offshore to avoid U.S. restrictions. Given that the adoption of such technical standards to determine distribution of emissions allowances could force less efficient manufacturers to relocate operations offshore, rather than adopt expensive, cleaner technologies, it is possible that eventually, only the most efficient operators would remain in the United States. The most efficient operators then would have to both increase expenses to maintain efficiency and defend against competition from manufacturers who have moved offshore and are able to produce at lower cost. In short, technical standards, when not carefully applied, can have unintended consequences, and when applied to imported goods they can trigger a TBT Agreement challenge.

⁷⁰ Agreement on Subsidies and Countervailing Measures, Dec. 15, 1993, Marrakesh Agreement Establishing the World Trade Organization, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. (1994) [hereinafter SCM Agreement].

⁷¹ The SCM Agreement permits WTO Members to take action against foreign governments’ subsidies in two distinct ways. The first method is through direct challenges that WTO Members may pursue before WTO dispute settlement panels pursuant to Part III of the SCM Agreement, which may, if successful, result in a WTO ruling requiring that the subsidizing WTO Member terminate the subsidy program. *Id.* pt. III. The second method, authorized in Part V of the SCM Agreement, is through the imposition of countervailing duties (“CVDs”) on imported products benefiting from alleged subsidies. *Id.* pt. V.

⁷² Such a theory of subsidization would posit that the system norm is the government sale of emissions allowances to manufacturing industries. Thus, the provision of allowances to some industries or entities would arguably constitute a government decision to forego government revenue otherwise due. *Id.* art. 1.1(a)(ii).

⁷³ This observation applies to challenges brought pursuant to Part III of the SCM Agreement, for non-export contingent, actionable subsidies. *Id.* art. 5.

⁷⁴ The Article 8.2(c) exception covered “assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms,” subject to certain specified limitations. *Id.* art. 8.2(c). It seems this exception might have covered a range of emerging clean energy technologies useful in mitigating climate change.

⁷⁵ *See id.* at Art. 31, concerning period of applicability of SCM Agreement Article 8.

⁷⁶ Pascal Lamy, WTO Director-General, Speech before a European Parliament panel (May 29, 2008), available at http://www.wto.org/english/news_e/spl_e/spl191_e.htm.

⁷⁷ While the levy of an internal consumption tax is also a possibility, it is likely that a requirement to submit allowances would optically appear more permissible under the WTO.

⁷⁸ So, for example, all suppliers of corrosion-resistant or stainless steel sheet to a U.S. manufacturer of kitchen appliances would be required to submit emissions allowances for the steel products supplied to the manufacturer. However, the suppliers would be able to obtain allowance refunds if they can certify that the same amount of allowances were submitted at the point of production. Alternatively, a prospective system utilizing a certification process may also be considered.