

# 2009 Climate Policy Landscape

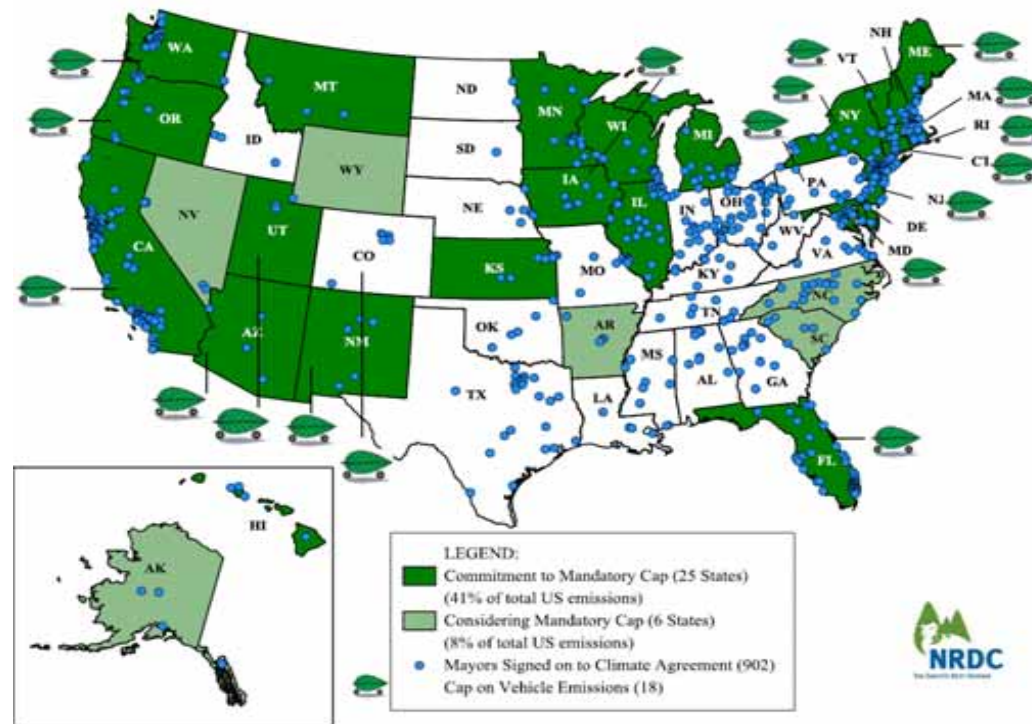


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## 2009 Climate Policy Landscape

- Growing political consensus and momentum for mandatory federal carbon caps.
- Well designed carbon cap legislation – with large “invest” and “dividend” components -- can ensure a rapid and smooth transition to an efficient low-carbon economy.
- Passing climate legislation in the US opens the possibility of rapid progress towards an international climate containment regime.

## State actions build momentum for federal solution



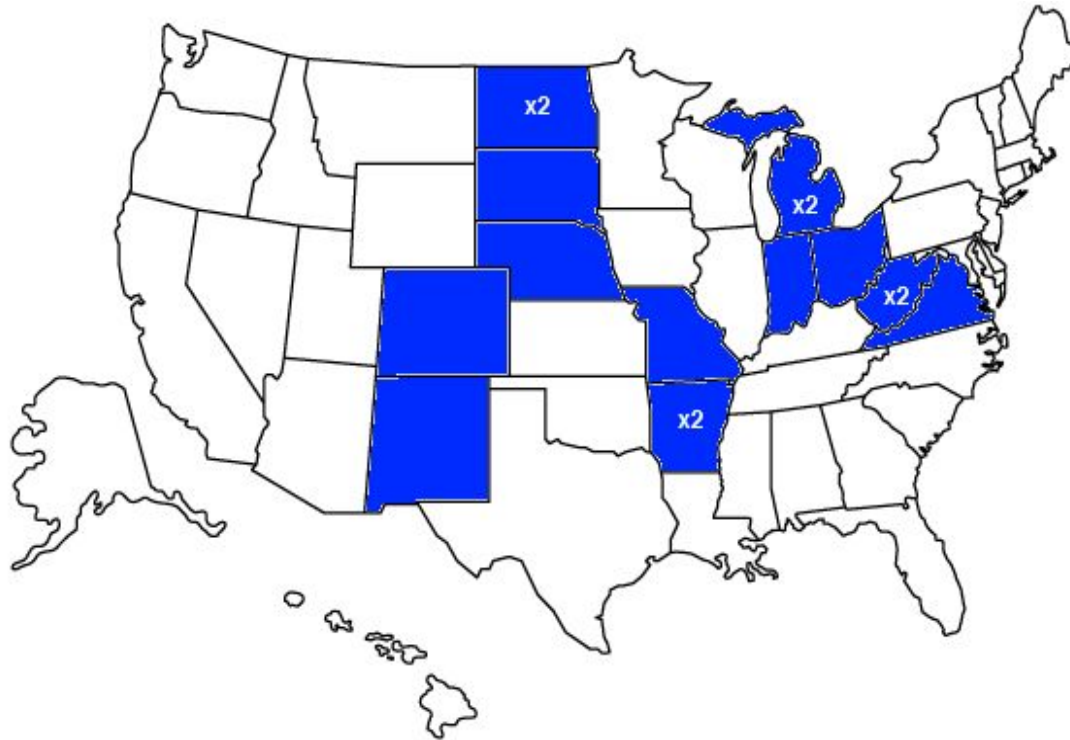
- 15 states have committed to adopting California's GHG standards for new vehicles, 40% of U.S. car market.
- 25 states have committed to GHG emission reduction targets and/or regional climate policy initiatives.
- Over 800 mayors have signed onto US Mayors Climate Agreement.

# USCAP consensus jumpstarts 111<sup>th</sup> Congress on domestic legislation



- **Targets:** 14-20% reduction by 2020, 42% by 2030, **80% by 2050**
- **Allowances:** distribution to LDCs, technology deployment, consumers
- **Cost Containment:** offsets (2-3 bln tons), reserve pool (2 bln tons)
- **Complementary Measures:** coal, transportation, energy efficiency

...but major political hurdles remain



### Senate

- “Mod Squad” of 16 Senators express key concerns after 2008 vote
- Multiple committees exert jurisdiction for drafting legislation: EPW, Energy, Finance
- Likelihood of energy legislation first, then climate

### House

- Waxman takes over Energy & Commerce, Dingell still influential
- Announces Committee action by Memorial Day
- Likelihood of integrated climate and energy legislation

## Existing law can help leverage Congressional action.

- 1970: Clean Air Act authorizes and obligates EPA to regulate any air pollutant that “endangers public health or welfare.” Definition of “effects on welfare” expressly includes effects on “weather” or “climate.”
- 1990: Clean Air Act amendments require CO<sub>2</sub> monitoring at power plants.
- Early 2000’s: Faced with federal inaction, States start regulating global warming pollution. States and environmentalists join in litigation to overturn Bush administration decision that CO<sub>2</sub> is not an “air pollutant” under the Clean Air Act.
- 2007: US Supreme Court decision affirms that the Clean Air Act does authorize EPA to regulate global warming pollution and remands Agency to reassess endangerment finding.
- 2008: Bush stalls on implementing Supreme Court decision, denies California waiver for landmark vehicle emission standards.
- 2009: Obama sets new course: California waiver likely to be approved, EPA nearing “endangerment” finding that will lead to regulations for cars, power plants and other sources, new administration pushing climate legislation.

## Cap, Invest Now and Recover: Ensure economic recovery through immediate and multi-decade infrastructure investment

### Growing support for low-carbon investment

*"My presidency will mark a new chapter in America's leadership on climate change that will strengthen our security and create millions of new jobs in the process"*  
-**Barack Obama**, 11/18/2008

*"The usual argument against public works as economic stimulus is that they take too long...well, that argument has no force now, since the chances that this slump will be over anytime soon are virtually nil."*  
-**Paul Krugman**, winner of 2008 Nobel prize in economics, NYT 10/17/08

*"The U.S. government must stimulate demand...the next administration should direct any stimulus plan toward energy savings, developing alternative energy sources and building green infrastructure. This stimulus can be the new motor for the world economy."*  
-**George Soros**, 10/12/2008

### Climate policy *is* economic recovery policy

- Cap and associated energy price impacts will be delayed to 2012 at earliest
- Recycling auction revenues into technology innovation and deployment will drive economic growth, accelerate reductions, lower long-term abatement costs/carbon prices
- Climate legislation can ramp up efficiency and low-carbon energy investment incentives during 2009-2011 pre-cap period
- Early incentives and anticipation of 2012 carbon price motivates industry to proceed now with "high multiplier" clean energy investment (e.g. using future allowance allocations as collateral based on price floor)
- Big dividend component to protect consumers, especially the poor.

## Getting Carbon Trading Right: Addressing the confidence gap in the creation of the U.S. allowance trading market

**Risk 1: Spot Price Manipulation** - the ability of individual market participants to control sufficient trading volumes to manipulate commodity prices. While offsets will limit some of the upward bias of the market, the issue of scarcity inherent in the market due to the fixed and declining supply of carbon allowances creates opportunities for speculation that should be regulated explicitly.

**Risk 2: Forward Price/Offshore Manipulation** - While trading volumes for short-term futures contracts for any given commodity are generally high enough to make market manipulation difficult, the same cannot be said for futures contracts that have longer terms or trade on overseas markets. Poor liquidity and insufficient regulatory co-operation can give rise to unwanted market volatility.

**Risk 3: Investment Class Risk** - As commodities have become an investment class in their own right, there is now considerable risk of market activity that has nothing to do with current supply/demand considerations. For example, investments by pension funds, endowments, and index funds that are betting on the long-term out-performance of commodities as an asset class can be disruptive

**Risk 4: Counterparty Risk** - Counterparty risk is the risk that the bank or business in a contract will default on their obligation prior to the expiring date of the contract. The current case of the credit default swap (CDS) market highlights the importance of counterparty risk in unregulated markets.

➤ **Contract limits must be set down as mandatory requirements**, not just "where necessary and appropriate." Each participant exposure should be limited to no more than 5% of the market capitalization of carbon markets above requirements and failure to stay within these limits should be met with significant penalties.

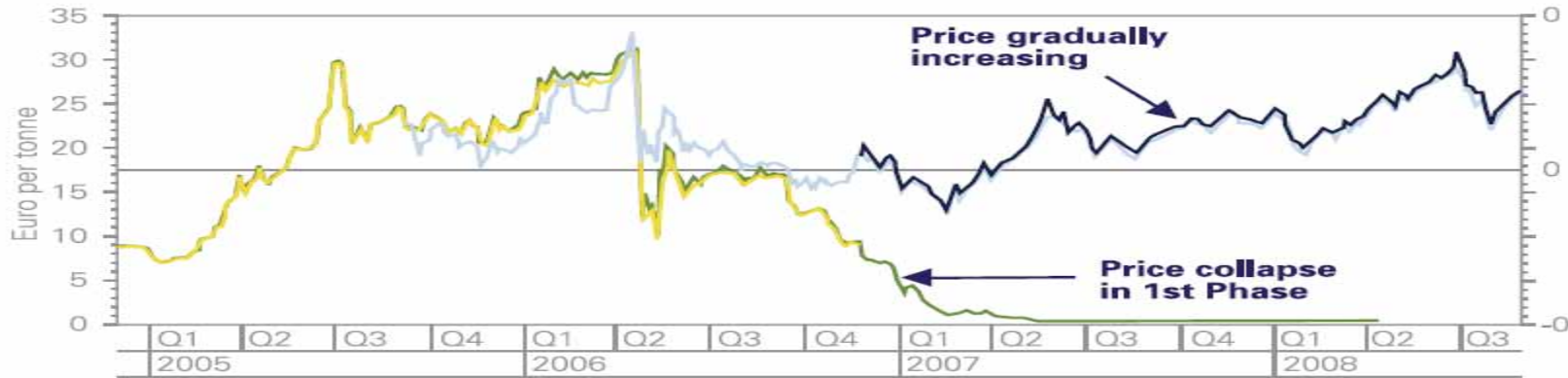
➤ **Margin requirements sufficient to discourage price manipulation** by potential speculators should be established. Further, efforts should be made to ensure that markets are not established overseas in a way that undermine the authority of the US carbon markets regulator.

➤ **The Enron Loophole should be closed for carbon trading.** Market manipulation can occur through off-balance-sheet trades, and should be prohibited to ensure a stable transparent carbon market.

➤ **Well staffed regulatory oversight is needed** to monitor trading under either the Commodity Futures Trading Commission (CFTC) or the Federal Energy Regulatory Committee (FERC) to ensure all trading is done through exchanges or under agreed upon collateral arrangements.

# The EU launched a cap and trade system in 2005 (source Point Carbon)

After significant growing pains...



...the market is now functioning well



Latest prices in €-10 range following slowdown with 2013 Phase three allowances trading higher

## Goals for Copenhagen Agreement (December 2009)

- **“Domestic Effort”** - Developing countries undertake emissions reductions on their own (without assistance from developed countries)
- **“Stretch Target”** - Developing countries are provided with a package of incentives to “enhance” and/or “complement” their actions
- **“Incentive Package”** - Developed countries provide a package of incentives to assist developing countries in reaching a “stretch” target

## Leveraging US Legislation in Post-Kyoto Negotiations

- Get key incentives for international agreement in domestic legislation
- Lay groundwork for U.S. adoption of international agreement
- Avoided deforestation, adaptation assistance and technology support are critical issues.