

Carbon Market North America

PointCarbon
NEWS

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Cheaper oil to test US climate commitment

With the price of a barrel of crude oil sliding below \$40 this week and economic forecasts looking dim, observers have questioned whether the incoming presidential administration will stick to its plans to green the economy and put a cap on greenhouse gas emissions.

At a press conference early this week, President-elect Barack Obama said his administration will continue to prioritise climate change and energy security, even if the economic downturn worsens and oil prices stay low in the short term.

He warned that the US should not be "lulled into complacency," with the price of oil on the decline right now.

"There is not a contradiction between economic growth and sound environmental practices," Obama said, noting that making the US less dependent on foreign sources of energy could stimulate an economic recovery.

US government data published this week showed that energy-related carbon dioxide emissions will grow at a slower rate than previously thought.

Energy-related CO₂ emissions in the US, which accounted for about 82 per cent of the US total reported emissions in 2007, will increase at a rate of 0.3 per cent per year from 2007 to 2030, reaching a level of 6.41 billion tonnes in 2030, according to the Energy Information Administration's (EIA) Annual Energy Outlook 2009.

That's down six per cent from the agency's previous estimate of 6.85 billion tonnes of CO₂ in 2030.

The report's authors say that a weak economy, new efficiency policies and an eventual rebound in energy prices will slow demand for energy between now and 2030.

Although the report predicts slower growth, it does not anticipate an overall decline in CO₂ emissions compared to previous years.

President-elect Obama has called for total US greenhouse gas emissions to be reduced to 1990 levels by 2020.

But according to the report, CO₂ emissions alone (not including the other five greenhouse gases) will reach 5.99 billion tonnes in 2020, a 19 per cent increase over the 1990 baseline of 5.02 billion tonnes.

Many analysts believe energy prices will begin creeping upward sooner than later. In the longer term, the EIA predicts higher prices for crude oil due to growing demand and diminished access to new supplies.

RGGI emissions could rise

For now, however, low oil prices could lead to a significant rise in emissions from power plants in the 10 states in the Regional Greenhouse Gas Initiative (RGGI), according to a report released by Environment Northeast this week.

That's because lower oil prices will prompt a fuel switch from natural gas to dirtier, cheaper oil.

Derek Murrow, director of policy analysis at the non-profit environmental group, said it is not yet clear how much emissions will rise, but said oil-fired electricity generation is the primary driver behind the fluctuation in emissions in the RGGI region.

Up until recently, a spike in oil prices had led dual-fired power plants to switch to natural gas, which emits less carbon dioxide than oil.

Point Carbon estimates emissions in the RGGI region for 2008 will be around 162 million short tons, or 14 per cent below the cap.

The next issue of Carbon Market North America will be published 9 January 2009. Have a happy new year.

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Upcoming conferences 2009

Carbon Market Insights
2009

PointCarbon

17-19 March 2009, Copenhagen



Navigating
the American Carbon World

2-3 April 2009, San Diego

See www.pointcarbon.com for more information.

RGGI exchange snapshot (\$)

Exchange	Contract	Settle	Change
CCFE	Dec 08	3.27	-0.13
CCFE	Dec 09	3.33	-0.19
Nymex	Dec 09	3.30	-0.25

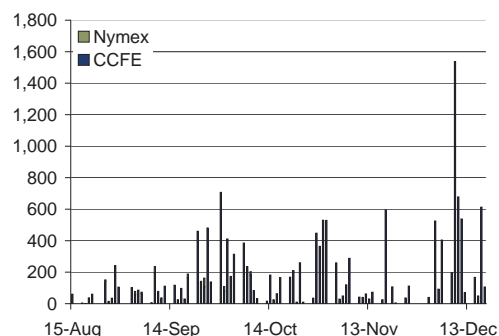
Point Carbon RGGI OTC assessment (\$)

Contract	Best bid	Best offer	Close	Change
Dec 08	3.25	3.30	3.26	-0.14
Dec 09	3.30	3.35	3.32	-0.18

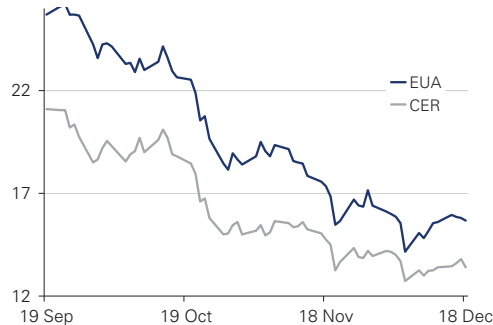
Source: Evolution Markets, Icap, TFS and Tullett Prebon.

Quoted prices are US\$ per short ton of at close of market each Thursday as per Point Carbon's RGGI assessment methodology. Changes refer to the last issue of Carbon Market North America.

For methodology, see www.pointcarbon.com/news/methodology

Exchange volumes ('000) all RGGI contracts

Source: CCFE and Nymex

2008 European and CER prices (€)**Market comment**

The clearing price for RGGI allowances sold in the programme's second auction was revealed at \$3.38 Friday.

The December 2009 contract closed a few cents shy of Friday's clearing price Thursday at \$3.33 on the Chicago Climate Futures Exchange (CCFE), down 5 per cent from its close a week ago.

The contract's brokered closing bid and offer Thursday afternoon was \$3.30 and \$3.35, respectively.

The closing bid and offer for the December 2008 contract was \$3.25 and \$3.30.

All 31.5 million allowances that were available for sale were sold at the auction, which was held on 17 December.

Demand for allowances was 3.5 times higher than supply with 69 participants from the energy, financial and environmental sectors submitting bids.

Power companies constituted the majority of the bidders.

The benchmark December 2009 contract has fallen 24 per cent since the beginning of the month on market expectations the auction price would clear in the low \$3 range.

Some had even bet the auction would clear lower than the last auction's clearing price of \$3.07. One broker estimated it could clear as low as \$2.85.

Market participants expected the auction would clear in this range because demand for allowances might not be as robust as expected given lower-than-expected emissions forecasts in the RGGI region.

The credit crunch was also expected to discourage financial firms from participating.

Some market participants think prices will not increase anytime soon.

A large number of put option contracts at a \$3 strike price traded this week for January 2009 and March 2009 delivery, indicating some believe prices will stay in the \$3 range for at least the first quarter of next year.

One broker estimated approximately 1.5 million allowances traded in the form of \$3 put option contracts for January 2009 delivery in the over-the-counter market this week.

Meanwhile, spread trading between the December 2008 contract, which expires at the end of this month, and the December 2009 contract continued this week.

The spread between the two contracts has tightened to 6 cents, according to a trader.

Obama introduces green team

This week, President-elect Barack Obama formally announced the top members of his energy and environment team that will jointly tackle the issues of climate change and energy security.

Obama on Monday named Dr. Steven Chu as energy secretary, Lisa Jackson as administrator of the Environmental Protection Agency (EPA), Nancy Sutley as his White House environmental advisor and Carol Browner as a special climate and energy "coordinator."

Later in the week, he introduced former Iowa Governor Tom Vilsack as the secretary of agriculture and Colorado Senator Ken Salazar as secretary of the interior, who round out the president-elect's team of high-level energy and environmental advisors.

The Nobel prize-winning physicist Steven Chu, who will take the helm of the Department of Energy, has served as the director of the Lawrence Berkeley National Laboratory, a DOE lab, which Obama said was at the "cutting edge of our nation's efforts" to develop new sources of energy.

According to Vincent Devito, an attorney at Boston firm Bowditch & Dewey and former US assistant secretary of energy, the appointment of Chu is "right on target."

"Having someone from the lab puts the DOE where it should be," Devito said, noting its role as the country's promoter of research.

Obama also announced that Carol Browner, the former EPA administrator under the Clinton administration, will take on a new White House role as the coordinator of energy and environmental policy.

Browner will work closely with Obama, who pledged his "personal engagement" in these issues, and coordinate the work of the DOE, EPA, as well as the federal, state and local governments.

DOE and EPA have had a long history of not working in concert, leaving Browner with a significant task.

"The organisations bring different bents to an issue," said Richard Rosenswieg, COO of Natsource and former chief of staff to the energy secretary from 1993-1996.

"The agencies have not worked well together. Hopefully that will change," he added.

He added that Browner will bring her experience from the EPA of establishing the acid rain emissions trading programme.

Obama also announced his choices to lead the agriculture and interior departments, who will focus on a "rural agenda" that create green jobs and frees the US from energy dependence.

Obama has tapped former Iowa Governor Tom Vilsack to lead the US Department of Agriculture (USDA), a cabinet agency that will play a key role in developing an offset

programme in the US.

Vilsack was a vocal proponent of the development of biofuels and renewable energy to stimulate rural economies and reduce US energy dependence, and led a climate change task force at a think tank that recommended an overhaul of US domestic and foreign climate policy.

Salazar, a former head of the Colorado Department of Natural Resources and member of the Senate energy committee, would make key decisions on providing access for oil and natural gas drilling on US public land.

"This is a big opportunity for agriculture to have the kind of leadership it needs at USDA on this issue," said Laura Sands, an agricultural offsets expert at consultancy the Clark Group.

Sands said the USDA is the federal agency with the most experience and knowledge about agricultural production systems, giving it the expertise and systems in place to enable a domestic offsets programme to work.

Land-use and forestry offsets are likely to be central to a domestic offset programme if Congress passes a cap-and-trade bill.

"Agriculture will play a strong role in the offset supply of an American cap-and-trade system, especially with regards to waste methane," said Justin Felt, a senior analyst at Point Carbon.

New Jersey sets GHG plan

New Jersey officials released a plan this week to help the state cut emissions 80 per cent by 2050.

The draft proposal sets out a list of recommendations to guide the state toward reducing greenhouse gas emissions to 1990 levels by 2020, and to 80 per cent below 2006 levels by 2050.

These reduction targets became legally binding when Governor Jon Corzine signed the state's Global Warming Response Act on 6 July 2007.

Key recommendations are:

- Promote clean, efficient vehicles – including zero emissions electric cars – to eliminate fossil fuels from transportation
- Ban new coal-fired power plants
- Expand the rail network
- Increase renewable energy to ensure all electricity sources are carbon-free by 2050
- Require new buildings to meet energy efficiency standards
- Establish the Garden State Climate Fund to identify and promote offset projects

The recommendations build on several initiatives the state has already undertaken to reduce emissions.

Among these is New Jersey's energy master plan, which sets a goal of producing 30 per cent of the state's electricity through renewable energy by 2020.

The plan projects that by 2020, New Jersey's renewable electricity supply will consist of 900 MW of biomass capacity, at least 3,000 MW of offshore wind capacity, 200 MW of onshore wind capacity and 1,800 MW of solar.

California to begin heavy-lifting to implement GHG cuts

California last week adopted a major plan to cut GHGs, but now needs to iron out key details. On 11 December, the California Air Resources Board (Carb) unanimously approved a plan to reduce the state's emissions to 1990 levels by 2020.

The plan commits California to participation in a regional, economy-wide cap-and-trade system, and requires the state's utility companies to produce a third of their electricity from renewable energy by 2020.

But the board's vote marks just the beginning of the rulemaking process, leaving many of the tricky details to be hammered out.

Chief among the decisions to be made will be how the state, the nation's most populous, will allocate its allowances under the cap-and-trade programme.

Utility companies and manufacturers plan to lobby hard to receive free allowances, and will use the state's already weakened economy to convince rulemakers to give the allowances away. They will also push for a broad use of carbon offsets to contain compliance costs.

Environmentalists, however, will be pushing in the opposite direction, arguing for a full auction of allowances and limited use of offsets.

The new implementation rules will be decided by 1 January 2011 and go into effect by 1 January 2012, the date the cap-and-trade programme is expected to begin.

"We're looking forward to an intense two years of developing the rules and regulations that will get us to our goal with full public input," said Stanley Young, a spokesman for Carb.

He said that while some of the rulemaking will be farmed out to other state agencies, Carb officials will design key features of the cap-and-trade programme.

"The real meaningful and important decisions, the ones that will affect whole industries and individual companies, have yet to be made," said Josh Margolis, co-chief executive officer of environmental broker CantorCO2e in San Francisco. "You haven't seen anything yet if you

thought getting here is a big deal."

Opponents of cap and trade are digging in for a fight. Their line of argument is bolstered by a weak economy, and conflicting economic reports on what impact the cap-and-trade system will have on California businesses.

"Without a realistic assessment of the impact that the (plan) will have on existing jobs in California, the California Chamber of Commerce is certain that the state is headed down a path that will slow economic recovery and delay a long-term solution to the budget crisis," said Amisha Patel, a policy advocate at the Chamber.

Virginia shouldn't join regional trading systems: report

Virginia shouldn't join US regional emissions trading programmes, state climate advisors said.

Instead, the state's governor should advocate for a national cap-and-trade programme, according to the final report by the state's Climate Change Commission, which was released Monday.

The commission was created by Virginia Governor Tim Kaine in 2007 to prepare recommendations to help him shape his climate change policy.

"The governor should ask Congress to act as soon as possible to pass comprehensive climate change legislation," the report says.

Kaine supports a national cap-and-trade system, and is trying to focus other southern states, who have so far avoided adopting climate legislation, on the potential impacts of climate change on the region.

Southern states like Virginia are heavily dependent on coal to generate electricity.

An advisor to Kaine said Virginia will not join the Regional Greenhouse Gas Initiative because it is not an economy wide programme.

He added that the members of the Western Climate Initiative have a different energy mix than Virginia, so that group would not be a good fit for the state.

The commission anticipates that Congress will enact a cap-and-trade programme within the "next four years," according to the report.

The national programme should establish a mandatory economy-wide cap-and-trade programme that achieves at least a 25 per cent reduction in greenhouse gases by 2020, and an 80 per cent reduction below 1990 levels by 2050.

The commission says Virginia should cut its fast-growing emissions 30 per cent below business as usual by 2025, a reduction of 69 million tonnes of CO2 equivalent.

Canada needs to prove tar sands not dirty: report

Canada must convince the US that its energy is clean before a climate deal can be signed.

Canada's tar sands could prove the biggest challenge to reaching an agreement between the two countries, according to a new report by the Conference Board of Canada, a not-for-profit research organisation.

Canada has said it wants to form a continental North American cap-and-trade programme with the US, but it has given few details of what kind of scheme it has in mind. Obama's transition team has not formally responded to the proposal.

Obama's advisors have condemned tar sands petroleum as "dirty oil," and Obama himself has said the US must move away from its reliance on oil as an energy source.

In June, Obama energy advisor Jason Grumet said that it was an "open question" as to whether Canadian tar sands fits in with Obama's clean energy strategy.

But for environmental groups like Greenpeace, the case is closed. They have called the tar sands the "biggest environmental crime" in history.

"Against this background, Canada will need to make a strong case to convince the US that Canada is the foremost secure source of clean energy," the report said.

Canada is most likely to do this by showing that the oil sands emit no more carbon dioxide than Venezuelan or Middle Eastern oil, the report said.

Canada also needs to show it is committed to investing in clean energy through technologies such as carbon capture and sequestration technology.

Canada's best argument might be that the two countries enjoy such a positive trading relationship. The US will need to consider balancing its energy security concerns with its worries about the large amount of carbon dioxide emitted by the oil sands, the report said.

While the US imports more oil from Canada than any other country, it is also reliant on oil from the Middle East, including countries that are hostile to US foreign policy.

Canada's Prime Minister Stephen Harper's move to propose a common cap-and-trade scheme was inspired by a desire to protect Alberta's oil sands from potential measures the Obama administration might enact on energy and climate change, the report said.

It added that Canada's federal government will need "political magic" to satisfy the US and the province of Alberta, where most of the oil sands are located, in a joint climate change pact. Alberta's Premier Ed Stelmach said he does not support a deal that would disturb investment in Alberta's energy projects, and has insisted that Alberta play a role in negotiating any climate change deal.

RECENT GLOBAL CARBON POLITICS

Members of the **EU parliament** on Wednesday approved all six parts of the bloc's **climate package**. All 785 elected members of the parliament voted on the package, which outlines how the 27-nation bloc will meet its commitments to cut its greenhouse gas emissions by 20 per cent under 1990 levels by 2020.

The MEPs approved amendments to proposals on energy from renewables, a review to the **EU's emissions trading scheme**, how to distribute reduction efforts in the non-traded sector, reducing emissions from new cars, geographical storage of carbon dioxide, and transport fuel quality.

A revision of the EU emissions trading scheme could increase demand for UN carbon credits. New installations and sectors joining the cap-and-trade market from 2013 will increase the volume of **UN-backed offset credits** that can be imported to at least 1.7

billion from 2008 through 2020, Point Carbon analysts said in a report this week. In addition, new rules on how many credits each member state can use could increase demand by a further 670 million over the same period.

Steel giant **ArcelorMittal's** challenge against the legality of the EU carbon market failed this week. The European Court of Justice found the directive did not violate the principle of equality by exempting aluminium or plastic-producing chemical companies from being required to participate.

The Australian government proposed rules for its emissions trading scheme this week. Guided by an emission reduction target of bringing greenhouse gas output to 5-15 per cent below 2000 levels, **Australia** said it will implement its carbon pollution reduction scheme on 1 July 2010. The scheme features include: a cap for participants to be set after the UN climate meeting in

Copenhagen in December 2009; 1,000 facilities to be covered; a price cap of A\$40 (US\$26.66) from the start, to be increased by 5 per cent annually and phased out after five years; indefinite banking of allowances, 5 per cent borrowing from future vintages allowed each year; a ban on export of Australia emissions units; unlimited use of project-based Kyoto credits; lowered threshold for free allocation to trade-exposed industries; and 31.2 million free AEU's per year to the most inefficient coal generators.

Japan's industrial electricity demand fell at its fastest pace in nearly seven years in November. The deteriorating state of the economy saw power demand fall 5.2 per cent compared to November 2007 to about 23.4 billion kWh, according to preliminary figures from the Federation of Electric Power Companies of Japan.

GUEST COMMENTARY

Legislating the highway act of 1956: Lessons for climate change legislation

By Roel Hammerschlag, Stockholm Environment Institute US

Under the pressure of the economic crisis, President-elect Obama is issuing calls for massive public works projects: in separate addresses he has both invoked images of the Interstate System megaproject, and cast climate regulation as jobs creation. In 2009 the new, 111th Congress will likely be faced with passing climate legislation that is also a clean energy megaproject.

As a crude measure of scale for the Clean Energy Project, if allowances covering all US fossil energy-related emissions were to be auctioned at \$10/MgCO_{2e}, the annual revenue would be roughly \$60 billion, or 0.5 per cent of US GDP. The only other federal megaproject this large funded by a dedicated revenue mechanism was in fact the Federal-Aid Highway Act of 1956, which directed about 0.4 per cent of US GDP to constructing the Interstate System with a collection of gas, tire and vehicle taxes.

The Highway Act passed the 84th Congress after two attempts: a failure in the 1955 session followed by success in the 1956 session. The history of the Highway Act is like a laboratory experiment under controlled conditions, offering lessons for the future: how did the same set of actors learn to pass megaproject legislation after it failed the first time?

Lesson 1: Move the debate away from conservative-vs-liberal polarisation

During the first attempt to pass the Highway Act, conservatives believing in states' rights and small federal government blocked a federal highway program on principle. But by 1956 an intense debate had developed around the question whether the highway system should be funded with bonds

or taxes. The heated discussion around financing mechanism drew attention away from the values-laden question of federal vs. state leadership, removing the ideological blockade.

In American climate policy development, the values-laden resistance to "going first" before developing nations is counterbalanced by a less ideological question: cap-and-trade or taxes? Some economists have made convincing arguments that taxes are likely the more efficient tool, while environmentalists appreciate the quantitative certainty of cap-and-trade. I suggest that making much more of this debate in Congress will,

“ The Clean Energy Project is a commitment to develop a collection of as-yet undetermined technologies.

appropriately, put the focus on how to pay for the Clean Energy Project, not whether to do so.

Lesson 2: Start in the House

The Constitution requires that revenue legislation be introduced in the House rather than the Senate. Yet, of the 13 climate bills introduced in the 110th Congress only four originated in the House. In the 1950s Senator Al Gore Sr. was the sponsor of most highway bills. Though the 1955 highway bill eventually made it to the House Public Works committee, members of the Ways and Means committee were offended that a revenue bill was being discussed elsewhere, resulting in a turf war.

But by 1956 the inflamed bonds vs. taxes question caused Congress to face the fact that the Highway Act

required a revenue bill. In the second session a complementary pair of bills was introduced in the House, with Public Works considering just highway authorisations and Ways and Means considering just funding mechanisms. This time the bills passed out of committee in the House, and subsequently through the Senate, easily.

Lesson 3: Propose a trust fund

The 1955 bill's failure was driven in part by intense lobbying from the commercial interests most affected by the proposed taxes. Lawmakers observed that the lobbyists' main complaint was not per se the choice to spend money on the Interstate System but rather their mistrust of the federal government: they believed the feds would co-opt the collected taxes for other purposes. So the 1956 bill proposed a Highway Trust Fund, ensuring that all taxes collected could go nowhere else. The Trust Fund was an enormous legislative success and exists to this day.

One of the biggest differences between the Interstate System and the Clean Energy Project is that the Interstate System was well-defined: 40,000 pre-planned miles of pavement. The Clean Energy Project, in contrast, is a commitment to develop a collection of as-yet undetermined technologies.

This makes a Clean Energy Trust Fund even more important, for it doubles as a proxy for the vision of our energy future.

Point Carbon is happy to consider your proposals for commentaries in Carbon Market North America. Please submit ideas to news@pointcarbon.com

Contacts

Editorial enquiries

Valerie Volcovici
vv@pointcarbon.com
Tel +1 202 289 6553
Fax +1 202 289 3967

Sales enquiries

Stefanie Rhodes
str@pointcarbon.com
Tel +1 202 289 3930 ext. 251
Mob +1 202 413 5788
Fax +1 202 289 3967

Other enquiries

Point Carbon
contact@pointcarbon.com
P.O. Box 7120 St.Olav
N-0130 Oslo
Norway
Tel +47 22 40 53 40
Fax +47 22 40 53 41

Website

www.pointcarbon.com

Offices

Washington D.C.

1200 First Street, NE
Suite 310
Washington, DC 20002

washington@pointcarbon.com
Phone: +1 202 289 3930
Fax: +1 202 289 3967

Boston

Point Carbon LLC
8 Faneuil Hall Marketplace, 3rd Floor
Boston, MA 02109

boston@pointcarbon.com
Phone: +1 617 386 9299
Fax: +1 617 973 6406

Oslo

Point Carbon
Akersgata 55, 3rd floor
P.O. Box 7120 St.Olav
N-0130 Oslo, NORWAY

contact@pointcarbon.com
Phone: +47 22 40 53 40
Fax: +47 22 40 53 41

London

Point Carbon London
Second Floor
102-108 Clerkenwell Road
London, EC1M 5SA
United Kingdom

london@pointcarbon.com
Phone: +44 (0)20 7253 7878
Fax: +44 (0)20 7253 7856

Kiev

Point Carbon Kiev
3 Sportyvna Ploscha
Entrance IV, 4th floor
Olymp Business Center
01601 Kiev
Ukraine

kiev@pointcarbon.com
Tel: +38 044 499 0308
Tel/Fax: +38 044 499 0309

Malmö

Point Carbon Malmö
Östra Förstadsgatan 34
212 12 Malmö
Sweden

contact@pointcarbon.com
Phone: +47 22 40 53 40
Fax: +47 22 40 53 41

Tokyo

Point Carbon representative
2-3 Kandanshiki-cho
Chiyoda-ku Tokyo
101-8443 Japan

tokyo@pointcarbon.com
Tel: +81 80 3170 0094
Fax: +81 3 3365 5586