

# Carbon Market North America

**PointCarbon**  
NEWS

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## House climate bill clears first major hurdle

After a four-day marathon markup process, the House energy committee approved an energy and cap-and-trade bill Thursday by a vote of 33-25.

The passage of the Waxman-Markey bill fell close to party lines, with only four Democrats voting against the measure.

One Republican, California's Mary Bono-Mack, voted in favour of the bill.

The bill aims to reduce US greenhouse gas emissions 17 per cent below 2005 levels by 2020 through a national emissions trading system.

The bill would give a generous number of allowances to electric local distribution companies as well as energy-intensive, trade-sensitive manufacturers – a compromise that ensured the bill's passage before markup began Monday.

The bill also allows for up to 2 billion carbon offset credits to be used by companies each year to comply with their limits on greenhouse gas output.

In addition to the GHG component, the bill mandates that the US produce 15 per cent of its electricity from renewable energy sources by 2020.

"The margin was a good one, the support was bipartisan, and the bill now goes to some other committees that I think will make improvements," committee chair and bill co-author Henry Waxman told reporters following the vote.

The action now moves to the House ways and means committee, which will sharpen the bill's tax-related provisions and go into greater detail about how to give money back to low- and middle-income ratepayers.

Afterwards, the bill is expected to be approved by the full House this summer.

House Speaker Nancy Pelosi will now negotiate the bill's path with various committee chairmen.

"The other committees of jurisdiction will soon bring forward their own contributions that will further strengthen this critical

legislation," she said in a statement after the committee vote.

"I have asked these committees to work together and with the leadership to finalise this clean energy jobs package with the goal of having this package on the House floor as soon as possible," she added.

President Barack Obama said after the vote: "We are now one step closer to delivering on the promise of a new clean energy economy."

The Waxman-Markey climate bill was altered at the last minute to prevent farmers practicing no-till farming from stopping their practice and then restarting it in order to earn carbon offset credits.

Democratic Congressman Zachary Space of Ohio authored the amendment, and said it would take away the incentive for farmers to stop their no till practices and then restarting them, thereby increasing emissions in the interim.

Meanwhile, Democrats defeated a variety of Republican amendments, including one that would set a \$15 cap on the price of carbon allowances.

A Republican amendment offered by the leading Republican on the committee, Congressman Joe Barton of Texas, that was essentially an entirely different energy bill than the one that was being debated was also shot down.

Key elements of the Barton amendment included striking of the ability of the Environmental Protection Agency to regulate GHGs if Congress fails to act.

Several organisations congratulated Waxman for passing a consensus climate bill immediately after the vote. But some environmental groups were critical of the newly-passed bill.

"Despite the best efforts of Chairman Waxman, the decision-making process was co-opted by oil and coal lobbyists determined to sustain our addiction to dirty fossil fuels," said a green group coalition led by Greenpeace.

## CONTENTS

- 2 RGGI prices and market commentary
- 3 US car standards to slash 900 MT GHGs
- 3 Senate looks to House bill for guidance
- 4 New target to ease US carbon prices
- 4 US energy sector GHGs decline 2.8% per cent in 2008
- 5 Farm groups oppose House climate bill
- 5 Utilities, green groups agree on Redd policy
- 5 Global carbon market news
- 6 Guest commentary by Corneliu Bjola, Greenfiniti Consulting Canada



**RGGI exchange snapshot (\$)**

Exchange	Contract	Settle	Change
CCFE	Dec 09	3.37	-0.10
CCFE	Dec 10	3.50	-0.06
Nymex	Dec 09	3.40	-0.06

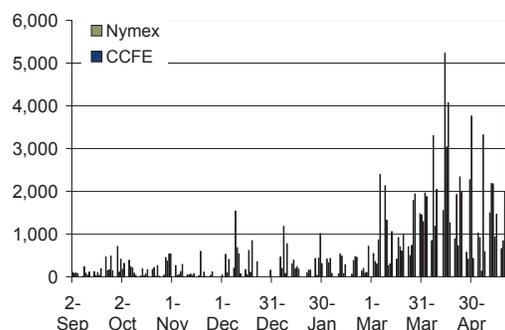
**Point Carbon RGGI OTC assessment (\$)**

Contract	Best bid	Best offer	Close	Change
Dec 09	3.37	3.45	3.40	-0.06

Source: Evolution Markets, Icap and TFS.

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](http://www.pointcarbon.com/news/methodology)

**Exchange volumes ('000) all RGGI contracts**

Source: CCFE and Nymex

**2009 European and CER prices (€)****Market comment**

December 2009 RGAs slid 2 per cent this week and are expected to be locked in a \$3.30-\$3.40 range.

The benchmark RGGI December 2009 contract closed at \$3.40 on the Chicago Climate Futures Exchange (CCFE), down 2 per cent on last Thursday's close.

The contract's brokered bid and offer were \$3.37 and \$3.45, respectively.

Trading activity in Regional Greenhouse Gas Initiative allowances (RGAs) continued to be muted this week with benchmark allowances closing at a low of \$3.38 and a high of \$3.47 on the CCFE.

Brokers said a lot of the market's attention was turned to the House energy and commerce committee, where members have been voting this week on amendments to the leading climate change bill by Congressmen Henry Waxman and Edward Markey.

No change was made to a provision in the bill which allows emitters that bought RGGI allowances before 31 December 2011 to trade them in for federal allowances.

Market participants noted speculators started to lose interest in RGAs as soon as they realised that holders of RGGI emissions permits could trade them in for federal allowances based on their average auction price.

The conversion of allowances based on their price – not the ton of carbon dioxide they represent – means there is no upside to owning RGAs above the average price where allowances have cleared at auction.

The market is betting the average auction of allowances will be within the \$3.38-\$3.40 range, said one broker.

Brokers now expect RGAs to remain within that range until the next auction on 17 June.

"There is not much incentive for speculators to go long," commented one broker.

"But that could still change," he said, if a new bill emerges that gives permits more value in a federal scheme.

With allowances expected to stay rangebound in the near term, attention has turned to the options market where activity was more robust this week, said observers. One broker noted interest in call options is high.

Buying activity was robust in call options that expire December 2009 with an average strike price in the \$4-\$4.50 range, he said.

A total 1,805 call option contracts expiring in December 2009 with a \$4 strike price changed hands on the CCFE this week. Previously, interest was higher in call options with an average strike price range of \$5-\$5.50, reflecting more bullish expectations that prices would surpass \$5.

## US car standards to slash 900 MT GHGs

President Barack Obama unveiled new vehicle standards this week that will cut GHG emissions by 900 million tonnes.

With representatives from the auto industry by his side at the White House rose garden, the US president announced the new national vehicle emissions regulations that would require carmakers to reduce greenhouse gas emissions from their fleets 30 per cent by 2016.

The new rules would also set an average fuel efficiency target for new vehicles at around 35.5 miles per gallon for new passenger vehicle and light trucks by 2016, four years earlier than the 2007 energy bill called for.

The new fuel economy standards are projected to reduce oil consumption by 1.8 billion barrels over the life of the programme, resulting in yearly 5 per cent increases in vehicle efficiency from 2012 to 2016, the White House said in a statement.

Obama called the announcement "historic," claiming it had been impossible to achieve this standard in the past and that "the status quo is no longer acceptable."

Ten car companies, including Ford, General Motors and Honda, as well as the United Auto Workers, a union representing US car employees, endorsed the new regulations.

The cuts mandated by the new regulations mirror those set by California in 2002 that had been had stalled because the Bush administration's Environmental Protection Agency (EPA) refused to grant the state an implementation waiver, allowing it to enact the standards, which were more stringent than the federal government's.

Thirteen US states and the District of Columbia had plans to adopt California's tailpipe standards and joined California in pressuring the EPA to allow them to adopt their own fuel efficiency standards.

California Governor Arnold Schwarzenegger said: "This historic agreement to reduce greenhouse gases will mean cleaner air for our children and grandchildren, greater economic security as we rely less on foreign oil, and a chance at renewal for our auto industry."

The Alliance of Automobile Manufacturers praised the programme for harmonising vehicle emissions standards nationally, claiming it delivers greenhouse gas reductions "equal to or better than those that would be realised under separate programmes by different regulatory bodies," it said in a release.

The standards were also welcomed by Congressman Edward Markey, co-author of the leading House climate change bill, which members of the House energy and commerce committee approved Thursday night.

The original draft of his bill contained language that would have created a federal fuel economy programme by

harmonising federal standards with California's rules.

This language was removed when Markey and the bill's co-author, Congressman Henry Waxman, learned of the announcement, Markey's office said in a statement.

"Combining today's announcement with a comprehensive clean energy plan being considered by Congress this week will deliver a one-two punch against America's dangerous dependence on foreign oil," said Markey.

Those that criticised the move included public policy group Competitive Enterprise Institute, which said the standards would "have the deadly effect of causing new cars to be lighter, smaller and less crashworthy."

"It kills consumers by reducing vehicle size, and now it may well kill car companies by forcing them to produce cars that consumers don't want," said Sam Kazman, the enterprise's general counsel.

Following Obama's announcement, Canadian Environment Minister Jim Prentice said Canada will adopt new US vehicle emissions standards because it would not benefit consumers and carmakers in the US and Canada to have competing standards.

"Our government has set as an objective the intent of having a single, dominant North American standard that we would ascribe to," said Prentice.

## Senate looks to House bill for guidance

The Senate environment committee will start dissecting the Waxman-Markey now that it has cleared a House vote, its chairman, Senator Barbara Boxer, said.

As soon as the comprehensive energy and climate draft is reported out of the House energy committee, "we'll start doing some workshops on their bill," she told reporters after stepping out of a committee hearing this week.

Boxer's committee has jurisdiction over drafting climate change legislation in the Senate, and last year took the first step in Congress to move a cap-and-trade bill through the legislative process.

The cap-and-trade bill she sponsored with Independent Senator Joe Lieberman and retired Republican Senator John Warner, made it to the Senate floor for consideration last summer but fell well short of the 60 votes it needed for passage.

Now, Boxer's committee will look for guidance from the House energy committee, and learn from Chairman Henry Waxman's successes and failures with his bill.

Boxer told reporters her committee would look at the Waxman-Markey bill together with the Lieberman-Warner bill, "compare some of the structure," and "pick the best aspects."

"I am proceeding to write a bill (that is) in our committee's jurisdiction," Boxer said, noting she only has responsibility

for the climate change portion of a comprehensive energy and climate change bill.

The Senate energy committee, chaired by Senator Jeff Bingaman, has jurisdiction over drafting an energy bill, including measures to implement a national renewable energy standard, like the one found in Waxman-Markey.

Boxer was not able to specify a timeline for action to pass a cap-and-trade bill in the Senate, leaving those decisions “up to Senator (Harry) Reid,” the majority leader.

Senator James Inhofe, the top Republican on the environment committee, said at a hearing this week that while the Waxman-Markey bill is certain to pass in the House of Representatives, a similar bill “will not have the votes” in the Senate.

Boxer acknowledged she was unlikely to find a co-sponsor for her future bill among her Republican colleagues on the environment committee.

Nonetheless Boxer said she is “networking” with Senate Republicans, such as Maine’s Susan Collins and Olympia Snowe, to secure some votes from across the aisle.

In addition, she said Lieberman has been in talks with former Republican presidential nominee Senator John McCain about cap-and-trade legislation.

Boxer said she learned from her experience with the Lieberman-Warner bill and had advised Waxman to reach out to coal-state senators to win their support early.

She applauded Waxman for reaching compromises with Democratic colleagues from coal-reliant and manufacturing states to ensure support for his bill.

“I like the fact that they made breakthroughs with colleagues that were against it (cap-and-trade legislation) before,” Boxer said.

## **New target to ease US carbon prices**

The relaxation of the US’s mid-term target in the Waxman-Markey energy and climate change bill will reduce allowance prices 3 per cent, according to an Environmental Protection Agency analysis.

The Waxman-Markey energy and cap-and-trade bill now includes a mid-term target to reduce greenhouse gases 17 per cent below 2005 levels by 2020, down from the 20 per cent its original draft proposed over the same time period.

“The changes in early-year cap levels lowers allowance prices slightly,” the EPA analysis said. The 2012, 2030, and 2050 targets remain the same.

A previous EPA analysis found that US allowance prices would be \$13 to \$17 in 2015.

Changes to the offset provision in the bill will lower

allowance prices an additional 7 per cent or more, the EPA analysis said.

The new bill would value offsets at the same level as other reductions, striking a 20 per cent discount on offsets that was included in the draft version of the bill.

That should make offsets a more attractive price containment mechanism.

The bill allows for 2 billion offset credits to be used per year to meet compliance, split evenly between domestic and international offsets.

But if there is an insufficient number of domestic offsets, then the system will allow for up to 1.5 billion offset credits to be used per year.

Five years into the programme, international offsets will be discounted by 20 per cent, according to the new bill.

Moreover, allocation of allowances to the electricity sector will lessen the impact on consumer and industrial electricity bills.

The largest free allocation in the bill – 30 per cent – goes to local distribution companies, with an additional 5 per cent going to merchant coal generators.

Although generous, that is not enough allowances to cover all of the emissions from the sector.

“It also will place slight upward pressure on allowance prices, because it will lessen somewhat the incentive for consumers to conserve electricity,” the analysis said.

## **US energy sector GHGs decline 2.8% per cent in 2008**

Lower energy prices and slower economic growth led to a 2.8 per cent drop in GHGs in 2008.

The Energy Information Administration (EIA), which collates energy statistics for the US government, said Wednesday that US energy-related carbon dioxide emissions were 5.8 billion tonnes in 2008, down from 6 billion tonnes in 2007.

The energy-related sectors include greenhouse gas emissions from petroleum, coal and natural gas.

Electric power sector emissions fell 2.1 per cent in 2008 compared to 2007 levels because of lower demand for electricity and a decrease in fossil fuel use, the EIA said.

Greenhouse gas emissions from coal were 2.13 billion tonnes in 2008, compared to 2.15 billion tonnes in 2007.

Meanwhile, greenhouse gas emissions from the petroleum sector totalled 2.4 billion tonnes in 2008, compared to 2.59 billion tonnes in the previous year.

Non-carbon energy generation rose by 18.6 billion kWh, or 1.7 per cent in 2008, compared to the previous year.

## Farm groups oppose House climate bill

President of the American Farm Bureau Federation, Bob Stallman, sent a letter to the House energy and commerce committee this week to voice the bureau's opposition.

The group, which represents US farmers and ranchers nationally, shot down the bill, claiming it would harm the US agricultural sector.

"We call on all members of the committee to reject this bill when it comes up for a vote," wrote Stallman.

Policymakers expect the agricultural community to play a critical role in the successful passage of federal climate legislation because of the support needed from members of Congress that represent rural districts.

Stallman said the House climate bill "ignores the complex needs of a very diverse US agricultural community."

Among the group's grievances is that the bill will increase the sector's operating costs and reduce its competitiveness abroad.

Stallman said the measure doesn't provide for alternative forms of energy to fill the gap when fuel costs escalate.

A spokeswoman said it also opposes the bill because it does not spell out the role that agricultural offsets could play in federal climate legislation.

"The bill gives no guarantee that agricultural offsets will be allowed. For that reason, we oppose it," she said.

## Utilities, green groups agree on Redd policy

A diverse coalition of utilities, corporations and environmental groups this week released details of joint "principles" for addressing international forests in US climate change legislation.

Two of their principles have already been incorporated into the Waxman-Markey climate change bill, which was approved Thursday night by the House of Representatives' energy committee.

The bill includes a coalition recommendation that companies should earn credits for reducing greenhouse gas emissions by financing efforts to prevent deforestation.

It also includes a coalition proposal that in a federal cap-and-trade programme, 5 per cent of the value of new greenhouse gas emission allowances should be set aside for tropical forest conservation.

The fact that a group, with members ranging from American Electric Power (AEP) to the Sierra Club, could agree on including deforestation in domestic greenhouse gas legislation is significant, according to coalition members.

"When environmentalists and major corporate leaders can agree, real change has come," said Jeff Horowitz, founder of Avoided Deforestation Partners.

## RECENT GLOBAL CARBON POLITICS

The **UN** this week released a key draft text aimed at securing a new climate change deal in December. The 53-page negotiating text addresses how governments could cooperate against climate change.

The text does not outline what each country will commit to either separately or collectively and it is still unclear what the overall goal of the summit will be. However, it does offer options that could form the basis of a long-term goal. On mitigation, there are various options all developed countries could take to cut emissions from 2013 through 2020, and up to 2050. The options for rich nations, including the US, offer greenhouse gas emissions cuts of "**at least 25-40 per cent**" or "by more than 25-40 per cent" and "by least 45 per cent" below 1990 levels by 2020.

The UN this week also outlined how

a global carbon market could look in a new post-2012 deal. Proposals include a "**sectoral crediting mechanism**" for poor countries, and another scheme that could issue carbon credits to developing nations that cut emissions in line with their domestic plans.

Under the sectoral proposal, developing nations would set emission thresholds for **industry sectors** such as steel and power as part of their commitment to cut greenhouse gases in a post-2012 global climate pact.

However, if countries beat their proposed limits, carbon credits in the form of **certified emission reductions** or other types of credits could be earned.

The global **voluntary market** was worth \$705 million in 2008 with over 123 million voluntary carbon credits transacted, according to a new report by Ecosystems Marketplace and New

Carbon Finance. This was double the value of the market last year.

The **Japan Chamber of Commerce and Industry**, (JCCI), told the government it favours the second-least ambitious of six government options to cut greenhouse gas emissions by 2020. The JCCI said "the most appropriate from the standpoint of international fairness," would be a cut of 6 per cent to 12 per cent compared with 2005 emissions. This translates into a 1-5 per cent rise compared with 1990 levels.

**NZ and Australia** climate ministers meet this week to debate emissions trading ties. "We do not want investment decisions being made on either side of the Tasman on the basis of who has the softest climate change policies," Nick Smith, New Zealand's minister for climate change, told a conference.

## GUEST COMMENTARY

### The first mover advantage

*By Corneliu Bjola, Greenfiniti Consulting Canada*

On 10 December 2008, the Government of Ontario submitted for public consultation a bold proposal for establishing a greenhouse gas cap-and-trade system. The most exciting part of the initiative was twofold: the ambitious target for emission reduction (6% below 1990 levels by 2014, 15% by 2020 and 80% by 2050) and the early start date of the programme (1 January 2010).

Taken together, these ambitious objectives would have allowed Ontario to become the leading North American jurisdiction in regulating GHG emissions. In short, it would have granted Ontario the first-mover status and all related benefits (e.g., setting the rules of the game, capturing a larger share of investments, minimising resistance to implementation, and building politically fungible emission trading experience).

Five months after that, the situation looks less promising. The deadline would be almost certainly missed, while the reduction targets look less firmly day by day under the pressure of economic conditions. The cause of this reversal has, though, little to do with technical or even economic obstacles, but rather with flagging political leadership. Simply put, the Ontario government is waiting for the Canadian federal government to act, while the latter is taking cues for Washington about what to do.

On the surface, this strategy makes sense. Why go ahead with a provincial regulatory system that might conflict with impending federal or US emission trading provisions? On a closer look, this

strategy is self-defeating. It will demote Ontario to the last-mover status and bring about a string of negative consequences.

First, it is far from sure whether the US Congress will be able to adopt cap-and-trade legislation this year or ever. While the vote in the House of Representatives is fairly secured, the situation in the Senate is much more problematic. Would the Waxman-Markey bill fail in the Senate, Ontario would miss at least two years to establish itself as a major player in the emerging North American GHG trading market. By that time, the Western Climate Initiative will come into force and the first mover advantage will naturally go to the larger member state, California.

Second, further delay is also detrimental for Ontario within the Canadian political context. British Columbia and Alberta have already GHG reduction legislation in place while two other provinces, Saskatchewan and Quebec, are actively moving in the same direction. This would put pressure on the federal government to tailor and harmonise its cap-and-trade legislation with their provisions. Put differently, as times passes, Ontario, the largest province, would have lesser input and control over the rules of the federal emission regulatory system.

Third and most importantly, two more years of delay represent as many years of inaction of the climate change front. That would make not only the environmental problem more difficult to address, but it would likely aggravate the economic conditions as well. Catching up with the other

Canadian provinces and US states would require more stringent emission targets and a broader scope of application. In other words, the Ontario industry would have to undertake more structural changes, but in a shorter period of time.

What needs to be done? There is still a bit of time left to put everything back on track, but that would require three critical adjustments. First, someone must take political ownership of the issue as forcefully as Henry Waxman has done in the US Congress.

The person up to this task is George Smitherman, the current Minister of Energy and Infrastructure, who repeatedly proved himself to be able to successfully handle politically difficult and sensitive files. Second, swift decisions must be taken on key issues such as the scope of regulation, distribution of allowances and the use of offsets.

Again, the Waxman-Markey bill could offer the right template for addressing these questions, especially in view of Ontario government's sensible intention to design a system well integrated in the North American market. Third, the emission trading infrastructure must be brought up to speed and that requires speedy integration with the Climate Registry programme and timely completion of the auction platform for GHG allowances. To conclude, a great deal of good work has been already done, but stronger political leadership is now needed to push the cap-and-trade regulation over the line.

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