

Carbon Market North America

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NEWS

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Support grows for price collar in Senate bill

As key senators draft a comprehensive energy and climate change bill before the late-September deadline set by Senate leadership, momentum for the inclusion of price controls on emission permits is building.

Senator Barbara Boxer, who will steer a climate bill through Senate, said last week the environment committee she chairs is considering including price collars in its draft.

The inclusion of both a floor and ceiling price on greenhouse gas allowances as a cost-containment mechanism would signal a slight departure from the approach taken by the House in the Waxman-Markey bill.

That bill uses a strategic allowance reserve as a central cost-containment mechanism for the cap-and-trade system it creates. It sets a \$10 price floor to prevent allowance prices from falling too low but if allowances hit \$28 in 2012, an auction of 1 per cent of permits kept in a strategic reserve would be held to prevent prices from going too high. After 2012, the bill sets a price trigger at 60 per cent above a 36-month moving average of permit prices.

According to Paul Bledsoe, director of communications and strategy for the National Commission on Energy Policy (NCEP), the House bill's allowance reserve is similar in concept to a price collar.

In the Senate, Bledsoe expects there to be strong support for a price collar because previous legislative proposals have had a strong focus on stamping out price volatility.

"Attempts at restricting price volatility have long been a part of the Senate's legislative agenda," Bledsoe told Point Carbon News.

Bledsoe's NCEP, a bipartisan group, released a report last month calling for the Senate to adopt price collars or to strengthen the provisions of the House's strategic allowance reserve.

NCEP was influential in 2007, when Democrat Jeff Bingaman, former Republican (now-Democrat) Arlen Specter and Republican Lisa Murkowski proposed a bipartisan cap-and-trade bill that featured a \$12 "safety valve."

But this time around, Bledsoe said the US is faced with new economic realities that have made a price collar more attractive as a carbon

market cost-containment mechanism.

"The economic downturn has increased interest in having (price) certainty in the early years of the programme," Bledsoe said.

He pointed to two different US government analyses of the costs of cap-and-trade in the US, which came out with widely different carbon price projections.

The Energy Information Administration pegged carbon prices at around \$20 in 2012 and \$32 in 2020, while the Environmental Protection Agency projected the price of allowances would be \$13 in 2015 and \$16 in 2020.

"The disparity between those price projections suggests precisely the need in the early years for some price certainty...that a price collar is likely to address," he said.

Joseph Romm, senior fellow at the Center for American Progress, said he anticipates a Senate bill will replace the House's reserve provision with a form of a price collar because "nobody understood" the reserve concept.

Romm proposed a simple "fix" to the Waxman-Markey reserve proposal in his blog, *Climate Progress*, by keeping the bill's \$10 price floor and using the \$28 reserve trigger price as a ceiling in 2012. These prices should rise by 5 per cent plus inflation each year thereafter.

This modified price collar would appeal to both the moderate Democratic senators who have not yet pledged support for a bill, he said.

Michigan's Debbie Stabenow, for example, has said recently that price collars may be more effective to containing carbon market costs than distributing free permits to emitters.

Meanwhile, market participants are concerned about the growing support for controls on carbon prices and over-the-counter trading.

"We support free markets, and this (price collar) and an OTC derivatives ban is very detrimental in the long term, depending on how long they plan to keep this collar," said Alexandra Galin, policy and working groups manager at the Carbon Markets and Investors Association. She said the trade group's members hope that the Senate will allow the market to "function organically" when it drafts its legislation.

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RGGI exchange snapshot (\$)

Exchange	Contract	Settle	Change
CCFE	Dec 09	2.92	-0.04
CCFE	Dec 10	2.99	-0.06
Nymex	Dec 09	2.90	-0.05

Point Carbon RGGI OTC assessment (\$)

Contract	Best bid	Best offer	Close	Change
Dec 09	2.90	2.95	2.92	-0.03

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

Market comment

RGGI benchmark futures closed 1.4 per cent lower Thursday than a week ago amid sluggish trading. The December 2009 contract closed at \$2.92 on the Chicago Climate Futures Exchange, down from \$2.96 last week.

The contract's brokered bid and offer were \$2.90 and \$2.95, respectively.

The contract traded at a low of \$2.85 Wednesday when a block trade of 40,000 allowances changed hands on the exchange, said a broker.

Trading activity continues to be on screen with the average volume of contracts per trade in the 2,000-4,000 allowance range, said the broker. The over-the-counter market is still seeing minimal activity, he added.

He attributed yesterday's price drop to some market participants selling allowances on new concerns the programme is even longer than previously thought.

New data from the Energy Information Administration (EIA) revealed this week carbon dioxide emissions from the US energy sector are set to fall 5 per cent in 2009.

The economic recession, combined with natural gas displacing some coal as a source of electricity, is leading to the emissions drop, the EIA said in its new US short-term energy outlook.

Fuel-switching in the electric power sector and falling industrial use are projected to lead to a 7.9 per cent decline in US coal-based CO2 emissions for 2009, the agency said.

"Fundamentals drove the price down yesterday," said the broker.

As RGGI prices fall, the value the allowances would have under provisions in the Waxman-Markey legislation will also decline and could depress prices further.

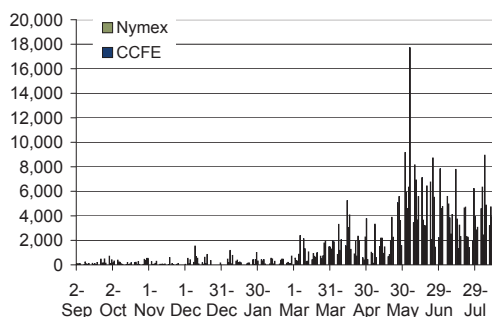
"With the programme fundamentally long, I'm not sure it is going to have huge value in a federal programme," said a trader.

The recently-passed House climate bill allows holders of RGGI emissions permits that were issued before 31 December 2011 to trade them in for federal allowances based on their average auction price.

The ratio is likely to be around three-to-one based on projected federal allowance prices.

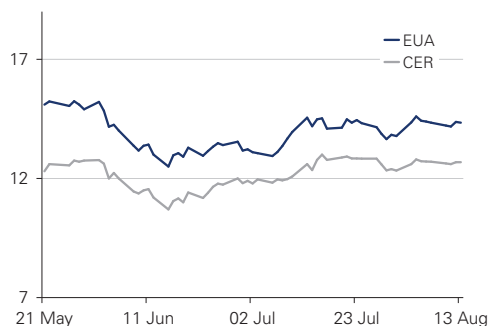
Some speculators are also concerned cap-and-trade legislation will not pass in the US Congress this year, a concern that some say is starting to be factored into RGGI bids and offers. Without federal cap-and-trade legislation, some believe RGGI prices could fall to zero, though others believe it would maintain some value as a stand-alone programme.

Exchange volumes ('000) all RGGI contracts



Source: CCFE and Nymex

2009 European and CER prices (€)



'Three amigos' pledge cooperation on emissions trading

North American leaders agreed this week to cooperate on developing emissions trading systems.

US President Barack Obama, Mexican President Felipe Calderon and Canadian Prime Minister Stephen Harper signed a declaration on climate change and clean energy during the so-called "Three Amigos" summit in Guadalajara, Mexico.

The heads of state affirmed their support for an agreement made at the G8 summit in Italy last month that global temperatures should not rise above 2C, and a goal to cut global emissions 50 per cent below 1990 levels in 2050.

They also agreed on areas in which the three countries can work together, including capacity and infrastructure building to "facilitate future cooperation in emissions trading systems."

The declaration represents the first official statement that the three trading partners will work together to address climate change and cooperate on emissions trading.

Prior to the agreement, Obama had signed separate bilateral clean energy agreements with Harper and Calderon, but neither specifically mentioned cooperation on emissions trading systems.

Since last year, Canada's environment minister has said that Canada would aim to align its own emissions trading system with a future scheme in the US.

But the US Congress is focussing on its own efforts to draft a comprehensive energy and climate change bill centred around a domestic emissions trading system.

Obama, Calderon and Harper agreed that their countries will work together as they implement "ambitious mid-term and long-term goals" and develop their own "low-carbon growth plans."

The three leaders also backed Mexico's proposal for a "green fund," a financing mechanism in which rich and poor countries pay into a fund that would help poor countries cut emissions and adapt to climate change.

"We will conduct further work on the proposal and will consider other views presented for scaling-up financing from both public and private sources," the agreement said.

The declaration also commits the three countries to:

- Develop "comparable approaches" to measuring, reporting and verifying emissions reductions, including cooperating in implementing facility-level greenhouse gas reporting throughout the region;
- Build a smart grid in North America for more efficient and reliable electricity inter-connections, as well as regional cooperation on carbon capture and storage.

- Work in key sectors to accomplish emission reduction goals.

The declaration requires the countries to develop a "trilateral working plan" and submit the results of it at the next North American leaders' summit in 2010.

US CO2 emissions down 5% in 2009: EIA

Carbon dioxide emissions from the US energy sector are set to fall 5 per cent in 2009.

The economic recession, combined with natural gas displacing some coal as a source of electricity, is leading to the emissions drop, the Energy Information Administration (EIA) said in its new US short-term energy outlook.

This is the first time the EIA, the official energy statistics arm of the US government, has analysed CO2 emissions from coal, natural gas and petroleum in its regular short-term energy outlooks.

Fuel-switching in the electric power sector and falling industrial use are projected to lead to a 7.9 per cent decline in coal-based CO2 emissions for 2009, the agency said.

The electric power sector's consumption of coal is projected to be 975 million short tons in 2009, the first time since 2002 annual consumption would fall below the billion-short-ton level, it said.

Natural gas-based CO2 emissions are projected to decline by 2.3 per cent in 2009, despite increases in the electric power sector's use of the fossil fuel.

Petroleum CO2 emissions are expected to fall by 4 per cent in 2009, mostly due to declines in transportation sector consumption.

The agency expects an economic rebound to lead to a 0.7 per cent increase in CO2 emissions in 2010.

Coal-based CO2 emissions are expected to increase 1.1 per cent in 2010. Emissions from natural gas are expected to grow slightly as consumption increases 0.5 per cent. And petroleum CO2 emissions are projected to increase 0.6 per cent in 2010.

The EIA projects total US CO2 emissions from the energy sector will be 5.815 billion tonnes of CO2e in 2009, compared to 5.879 billion tonnes in 2008.

Florida, Ohio utilities to replace coal-fired units

Florida officials approved this week two new nuclear units to replace two ageing coal-fired units, while an Ohio utility announced plans to repower one of its coal-fired units using mostly renewable biomass fuels starting 2012.

A Florida siting board, of which Governor Charlie Crist is a member, unanimously approved Progress Energy's request to build two nuclear units – the first approved in

the state since 1976.

The board gave Progress permission to site the twin 1,100 MW nuclear units under the condition that it discontinue two coal-fired units on the same site by December 2020.

Last August the Florida Public Service Commission, the state's utilities regulator, determined the state needed the new electricity generation from the Levy 1 and 2 units.

As the fourth-largest US state, Florida ranks third nationally in per-capita energy consumption and is the fifth biggest emitter of greenhouse gases.

Meanwhile, Ohio Edison's R.E. Burger facility, near Shadyside, Ohio, will become the largest coal-fired electricity plant in the US to repower with renewable biomass fuels, according to a release.

The unit is expected to emit 400,000 tonnes of CO₂ a year, based on 20 per cent coal co-firing, compared with more than 1.7 million tonnes from just coal-fired combustion.

The utility is converting to biomass to comply with the federal Clean Air Act, a law administered by the Environmental Protection Agency (EPA), which requires utilities to reduce six pollutants, including carbon monoxide, sulfur oxides and nitrogen oxides.

Carbon dioxide, the main greenhouse gas responsible for global warming, is not covered by the act.

The plan comes as the US Congress is developing climate legislation that seeks to reduce greenhouse gas emissions from the electricity sector and other major emitting sectors.

Ohio generates 87 per cent of its energy from coal and is the nation's fourth largest emitter of greenhouse gases.

Gore optimistic on China

China will sign a Copenhagen treaty if the US passes climate legislation, former Vice President Al Gore said.

Gore said Chinese officials have sent a strong signal in 'back channel' discussions.

"It is fair to say that if we have passed legislation, then they will be obliged to be part of the treaty," Gore said Monday, with reference to the international climate talks scheduled for Copenhagen at the end of the year.

He added that India was a 'different case' to China in terms of economic development and carbon pollution.

Gore was speaking at a clean energy conference in Las Vegas, where he was joined on stage by Senate leader Harry Reid, who is attempting to steer the energy and climate bill through the upper chamber of the US legislature by October at the latest.

Reid said it was important to pass a legislative package

that encompasses renewables, energy efficiency, carbon caps, and energy dependency, with particular attention to natural gas.

He added he would not be satisfied with a bill without a strong component to improve electricity transmission lines, saying he wanted to give planning authority to the Federal Energy Regulatory Commission.

Green group slams Canadian offset rules

The Pembina Institute, a Canadian environmental group, criticised Canada's proposed domestic offset system and submitted its comments to the country's environment ministry on the last day of the federal government's public comment period on the proposal.

As a way to comply with greenhouse gas emission reduction targets under a national cap-and-trade system, the government proposes that emitters can use offset credits sourced from Canadian projects started after 1 January 2006.

The government is due to come out with a full suite of greenhouse gas regulations by December this year.

Pembina claims most, if not all, emission-reduction projects that started as early as 2006 have been done under business-as-usual (BAU) conditions and can therefore not claim to be additional – or incentivised by carbon finance.

Emission-reduction activities have been developed without the owners knowing about offset project design and rules or aware of the value of future credits.

This makes it unlikely that they were started on the basis of potential crediting under a national offset system, Pembina argues.

"Therefore, projects that have already begun reducing emissions should be considered BAU, which renders them ineligible for the receipt of offset credits under any effective incrementality criterion," said Pembina.

The organisation cites low-till agriculture projects in Canada as an example of practices that have happened without the incentive of earning money from selling credits.

"Low-till agriculture is now a dominant practice in Canada, which means that a large proportion of these projects are part of BAU (business as usual)," said Pembina.

According to Statistics Canada, the majority of Canadian farmers were already practicing no-till (46 per cent) or conservation tillage (26 per cent) in 2006, said Pembina.

Canadian farmers already use this practice, which is meant to enhance the carbon sequestration properties of soil, because it saves fuel and labour costs, it said.

Alberta pipeline creates dilemma for US

The construction of an Alberta oil sands pipeline could undercut the US goal to green its economy.

US Secretary of State Hillary Clinton is due to decide as early as this month whether the construction of the Alberta Clipper pipeline will be allowed on US soil.

The pipeline, proposed by Canada's Enbridge Energy, would carry up to 450,000 barrels of heavy crude oil a day from the Alberta oil sands in western Canada to refineries in North Dakota, Minnesota and Wisconsin.

Environmentalists have spoken out against the project, claiming it undermines the US administration's pledge to wean itself of "dirty oil" and reduce its GHG emissions.

The production of Alberta's oil sands creates five times the amount of greenhouse gases than conventional crude oil, according to some analyses.

Addressing concerns about the carbon output of the oil extraction, the State Department said the Canadian environmental permitting process already addressed the environmental impacts of the oil sand extraction.

"Various previous oil-related projects in Alberta have faced environmental scrutiny and this project will be no different," it says on the State Department web site.

The decision by the US over whether to permit the construction of the pipeline is a "key challenge the new US administration faces," said Simon Dyer, oil sands policy

director at Canadian green group the Pembina Institute.

"Any locking-in that the US makes to a high-carbon economy goes in the opposite direction to its pledge for a clean energy future," said Dyer.

It is unclear what the State Department will decide on the issue, but its own analysis of the environmental impact of the pipeline downplays concerns it could be detrimental to US efforts to reduce greenhouse gases.

In its study of the potential carbon output that could be generated from refining of oil delivered by the pipeline, the State Department indicates the greenhouse gas emissions would be relatively low.

Documents posted on the department's website analyse the potential greenhouse gas output based on a number of studies that compare the carbon intensity of the oil sands compared to regular crude oil.

Based on these studies, the State Department estimates that refining the heavy crude oil transported by the Alberta Clipper project would result in greenhouse gas emissions ranging between 1.5 million and 7.8 million tonnes a year.

This is assuming every barrel transported by the pipeline would be on top of existing supply. The analyses do not factor in the process emissions associated with the extraction of the oil from the Albertan tar sands.

Environmental groups, led by the Sierra Club, have launched a campaign to stop Secretary Clinton from allowing the pipeline to be built in the US.

RECENT GLOBAL CARBON POLITICS

Informal talks in Bonn this week have failed to shorten the 200-page draft negotiating text and only very partial progress has been made, UN climate chief **Yvo de Boer** said Friday. "If we continue at this rate, we are not going to make it," he said. He added that negotiations would need to pick up speed quickly for the world to achieve a successful result at the UN climate change summit in Copenhagen.

As expected, the **Australian Senate** Thursday rejected the government's proposed emissions trading scheme. The Labor government did not manage to muster the support needed to successfully make the carbon pollution reduction scheme law. All non-Labor senators voted against the scheme. Climate Change Minister Penny Wong said the government would continue to push for a carbon trading scheme.

EU industrial output fell 15.6 per cent in June compared to a year earlier, new data showed. The year-on-year comparison for June is less of a decline than in any previous month of 2009 across the 27-nation bloc, according to Eurostat, the EU's statistical office.

German utility **Eon** has seen its trading volume in European CO2 allowances grow fourfold. Its trading volume in EUAs was 252.51 million between 1 January and 30 June, compared with 58.28 million in first-half 2008, according to the company's financial results.

Dutch firm Guanabara said this week it will maintain its bid for **Ecosecurities** at 77 pence per share. Guanabara made the statement in response to interim results published by Ecosecurities on 4 August. Guanabara attributed its firm position in part to declines in Ecosecurities' contracted portfolio and

inventory of carbon credits, coupled with expectations of a shrinking cash position in the short term.

New forests can cut 25 million tonnes of CO2e per year by 2020, the Kyoto Forestry Association said. The government's pending decision on the design of the **New Zealand** emissions trading scheme will decide whether the sector can achieve huge greenhouse gas emission reductions. The government is considering capping or fixing the price of carbon credits in the ETS. It is also mulling a ban or part restriction of sales of NZ credits to foreign buyers.

Japan's second-biggest steelmaker JFE achieved its carbon dioxide emission reduction target in fiscal 2008. The company emitted 52.9 million tonnes of CO2 in fiscal year 2008. That is a reduction of 13.6 per cent year-on-year and 9 per cent below 1990 levels.

GUEST COMMENTARY

P-r-o-t-e-c-t-i-o-n-i-s-m?

By Jennifer Cleall, Davis LLP Climate Change Law Practice Group

Ten Democratic Senators sent a letter to President Barack Obama on 6 August advising him that they would not support a climate bill which did not contain provisions to maintain a level playing field for American manufacturing.

Does the letter call the potential success of the US climate bill into question? The senators represent midwestern coal producing states, without whose support the Senate can not pass a major climate change bill, policy watchers say.

Evan Bayh of Indiana; Sherrod Brown of Ohio; Robert Byrd and John D. Rockefeller IV of West Virginia; Bob Casey and Arlen Specter of Pennsylvania; Russ Feingold of Wisconsin; Al Franken of Minnesota; and Carl Levin and Debbie Stabenow of Michigan, warn:

"It is essential that any clean energy legislation not only address the crisis of climate change, but include strong provisions to ensure the strength and viability of domestic manufacturing.... In addition a longer-term border adjustment mechanism is a vital part of this package to prevent the relocation of carbon emissions and industries if other major emitting carbon countries fail to commit to an international agreement requiring commensurate action on climate change."

The letter continues to focus on the "border adjustment mechanism" (read: tariff) and suggests that the mechanism could spur countries to reach a global accord in Copenhagen in December "by eliminating the competitive benefit of not acting to address this global problem"

The letter concludes "[w]e would find it extremely difficult to support a final measure that does not effectively deal with these important measures. We look forward to working with you and your Administration to ensure that climate change legislation does not produce an international race to the bottom."

Does this letter and its race-to-the-bottom warning spell p-r-o-t-e-c-t-i-o-n-i-s-m? Certainly sounds like it. In fact, President Obama confirmed that he was concerned about the letter, calling the tariff provision "potentially protectionist."

This is a serious situation for President Obama, who has pledged to lead the world to a new treaty in Copenhagen. The president shot out of the proverbial climate change gate early in his term, passing energy efficiency and conservation reforms and promising aggressive domestic legislation. The problem, as the New York Times reports, is "to get the legislation passed will require compromises aimed at protecting the economies of manufacturing and coal states."

In terms of impact on the world stage, are countries, such as India and China, faced with a "border measurement adjustment" going to be in a negotiating mood in Copenhagen? Can't imagine they will. Will other senators whose interests differ from those 10 who penned the letter have their own demands? Can't imagine they won't.

India and China, who already consider one another allies at the climate change bargaining table, pay much lip service to the importance of battling climate change, but are

actually vehemently opposed to binding carbon emissions cuts. On 31 July, Indian Environment Minister Jairam Ramesh reiterated an entitlement based excuse as to why India shouldn't be subject to climate change restraint. He argued that having to meet binding cuts will prevent India from raising its people out of poverty as developed countries have already done on the back of industrial growth fuelled by coal, oil and gas. In other words, since the US has been releasing GHGs for years in its citizens' pursuit of the American Dream, it's India's turn.

Clearly this is a position tailored to a domestic audience for political gain. India is probably the perfect climate change "rogue state" to America - it needs the US far less than China does - between the two, China would probably capitulate to emissions reductions first. India is a developing nation and not reliant on foreign trade like China is and for that matter, Canada. India doesn't care if everyone else wants carbon cuts - India wants progress. Even so, a carbon tariff on India's exports to the US is going to go over like a lead balloon.

In any case, the senators' letter and India and China's relative climate change positions are demonstrative of the complex situation the president is facing with US climate policy still under construction. The president's ability for achieving compromise will be tested in the upcoming months and the United States' resulting domestic and international policy will have to be built on the president's ability to build consensus.

Guess we'll see how he does soon.

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