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Climate Change Policy & Carbon Finance

January 2009 Update

Federal Developments

Markey to Lead New Energy and Environment Subcommittee. On Jan. 8, 2009, Rep. Edward J. Markey (D-Mass.) was named chair of the newly created House Energy and Commerce Subcommittee on Energy and the Environment, replacing Virginia's 9th District Rep. Rick Boucher (D-Va.). Rep. Markey has been an outspoken advocate for aggressive mandatory greenhouse gas (GHG) emission reductions, while Rep. Boucher, concerned with the costs to implement GHG regulation, has pushed for more moderate reductions combined with funding for carbon capture and sequestration development. Rep. Markey's selection therefore marks yet another tectonic shift in the legislative philosophy of the House Energy and Commerce Committee under new Chairman Henry Waxman (D-Calif.).

New EPA Administrator Signals Dramatic Shift in Carbon Policy at Confirmation. At Senate Environment and Public Works Committee confirmation hearings held Jan. 14, 2009, Lisa P. Jackson, the Obama Administration's nominee for EPA Administrator, vowed to address carbon dioxide (CO_2) as a pollutant under the federal Clean Air Act. Most dramatically, Jackson indicated that she would work with Congress to regulate CO_2 emissions under existing EPA authority. While the Supreme Court recently found that EPA has authority to regulate CO_2 and other GHG emissions, EPA has yet to make the necessary endangerment finding that CO_2 emissions pose a serious threat to human health. Making such a finding would trigger regulation of CO_2 by the agency. Many legislators and business representatives, including the U.S. Chamber of Commerce, are strongly opposed to any climate change legislation that would allow a mandatory federal carbon market to be designed and monitored solely by EPA without the involvement of other federal agencies (e.g. SEC, CFTC, DOE, FERC).

Incoming Department of Energy Secretary Supports Carbon Capture, Creation of Renewable Energy Investment Bank. Senate confirmation hearings and a 100 Day Action Plan may signal the direction Dr. Steven Chu will take as President Obama's nominee for Secretary of Energy. At his Senate Environment and Natural Resources Committee confirmation hearing, Dr. Chu strongly supported carbon capture and storage (CCS) from coal-burning power plants as well as the need for urgent development of viable CCS technologies. Separately, Dr. Chu helped draft a "100 Day Action Plan" with a non-profit think tank providing policy advice for the incoming Obama Administration. A key provision of the plan is the creation of a $200 billion National Clean Energy Bank, similar to the U.S. Export-Import Bank and Overseas Private Investment Corporation, which would finance clean energy projects through loans, loan guarantees, credit, and insurance mechanisms. The Plan also calls for the deployment of more rigorous energy efficiency standards as well as labeling, measurement and verification systems.

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Carbon Markets

Global Carbon Market Trading Exceeded $100 Billion in 2008. Notwithstanding the global financial meltdown for most energy commodities in the fourth quarter of 2008, trading volume in global carbon markets increased by over 80 percent in 2008, analysts at trade publication *Point Carbon* have reported. Approximately 4.9 billion tons of CO_2-equivalent units were traded (with European Union carbon market trading comprising two-thirds of the total volume), leaving the estimated overall market value at $122 billion. Veronique Bugnion of *Point Carbon* said as part of its market report that "[t]he fact that global carbon markets have now broken the 100 billion dollar mark is more than symbolic, it represents a market that has doubled in size in an otherwise depressed environment."

Growth Expected for Carbon Market in 2009. *New Energy Finance*, a premier carbon market publication, estimates that even with a global recession in 2009 the value of the global carbon markets will rise 25 percent to over $150 billion. The forecast is based on the expansion of the EU EUA market as well as the increased liquidity in the certified emissions reductions (CER) markets. Given regional and national cap-and-trade programs that are likely to emerge, *New Energy* expects the greatest growth in the CER markets. The projected growth is largely due to increased volume of sales rather than price, as price per share is expected to increase 6 percent while volume is expected to increase by 21 percent.

New York Stock Exchange Launches EU Carbon Allowances Fund. On Dec. 15, 2008, the investment firm XShares Advisors launched the AirShares European Union Carbon Allowances Fund. The Fund is a carbon trading fund based on EU carbon allowances (EUAs) future contracts that trades on the New York Stock Exchange's (NYSE) electronic trading platform Arca. The launch comes only a few months after Barclays Bank launched IPath, global carbon exchange traded notes, which also trades on the NYSE. IPath measures returns based on performance of the bank's global carbon index, which invests in EUAs as well as United Nations (UN) clean development mechanism (CDM) certified emission reduction (CER) credits.

Demand Strong for RGGI Emissions Allowances. Demand for carbon allowances was strong at the December 2008 Regional Greenhouse Gas Initiative (RGGI) auction. The RGGI auction, a regional cap-and-trade program, netted $106.5 million for 31.5 million carbon allowances available. The clearing price for the December 2008 auction was $3.38 per allowance, which was higher than the $3.07 per allowance for the RGGI's September 2008 auction. Overall, demand was strong. Environment Northeast, an environmental nonprofit research group, released a report on the eve of the December auction, finding that demand for allowances will remain strong given increased investor confidence in RGGI's longevity and widespread belief that a more comprehensive state and federal carbon trading scheme is coming. The next RGGI auction will be on March 18, 2009.

Department of Agriculture Creates Office to Verify Carbon Offsets. On Dec. 18, 2008, outgoing Secretary of Agriculture Ed Schafer announced the creation of the Department's Office of Ecosystem Services and Markets ("the Office"), charged with developing agricultural and forestry carbon product markets. The Office will develop uniform standards, accounting procedures, reporting requirements and verification processes for agricultural offset projects. Currently, farmers and landowners sell land and forestry credits on the established carbon market.

Developments at Regional, State and Municipal Levels

Virginia Will Not Join RGGI. In a final report ("Report") issued by the Commonwealth of Virginia's Climate Change Commission, Commission advisors recommended that

Virginia not join the RGGI or any other existing or developing regional carbon market trading regimes. The Report recommended instead that Virginia delay any state-based action until federal legislation is passed to implement a federal GHG cap-and-trade system. While Governor Tim Kaine (D) has said he supports a national cap-and-trade system, Virginia relies heavily on coal for electricity and therefore might face opposition to any state-based mandatory climate change cap-and-trade plan.

Midwest States Will Distribute Allowances. Member U.S. states and Canadian provinces participating in the Midwest Greenhouse Gas Reduction Accord (MGGRA) will have more power to dictate how GHG emission allowances will be distributed under the regions' climate change cap-and-trade program. The MGGRA is a voluntary cap-and-trade agreement among the states of Illinois, Iowa, Kansas, Michigan, Minnesota, Wisconsin, and the Canadian Province of Manitoba. The MGGRA members have set 2020 GHG emissions reduction targets at 15-25 percent below 2005 levels and 2050 targets at 60-80 percent below 2005 levels.

Carbon Credit Auditor Der Norske Veritas Expects Reinstatement Soon. Der Norske Veritas (DNV), a major Norway-based UN CDM auditor, expects to regain UN accreditation before the Feb. 11-13, 2009 UN CDM Executive Board Meeting. In November 2008, DNV was suspended by a UN Climate Change Secretariat Panel for irregularities in its auditing activities, including failure to use qualified auditors to evaluate CDM projects. The suspension has caused headaches for DNV's customers, which could delay UN certification of 10 million CER carbon credits to be traded on the CDM.

International Developments

EU Approved Major Overhaul of European Cap-and Trade Regime. On Dec. 17, 2008, the EU approved major changes to the EU's cap-and-trade scheme (ETS), bringing certainty to EU carbon regulation for the next 12 years. The EU amended the ETS by setting a 2020 target for greenhouse gas emissions at 21 percent below 2005 levels. Under the ETS amendments, utilities from certain member states and certain industrial sectors will be able to attain carbon trading permits for free, which troubles some environmentalists. The EU also approved 300 million EUAs for construction of carbon capture and storage facilities. EUA trading produced a poor return in 2008, producing on average a 33 percent loss, according to data published by *Point Carbon*.

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For more information on climate change policy and regulatory developments or questions on how to prepare your company, please contact Cameron Prell, cprell@williamsmullen.com or Chris Koves, ckoves@williamsmullen.com, at 202.833.9200.