

US GHG Markets – November 2009 (1/2)

Monthly Market Update



Federal

Obama to Attend Copenhagen and U.S. Announces Proposed Reduction Target

In late November, the White House announced the U.S. will go to the Copenhagen climate talks offering a proposed emissions target “in the range of 17% below 2005 levels by 2020.” While the target is not be legally binding (it can’t be without the Senate passing a bill), the target is believed to put pressure on the U.S. Senate to pass climate change legislation. A proposed target is also believed to indicate a level of confidence the President and the Senate currently have in getting a Senate bill passed. The White House announced if China and other emerging economies are willing to offer contributions on how they will reduce their emissions, the President was prepared to offer the reduction target range. The 17% target is contained in the Waxman-Markey bill, which passed out of the House in June of this year.

To best achieve a positive outcome in Copenhagen, the President will plan to attend the negotiations in the final days of talks on December 18th.

Senator Kerry, Lieberman, and Graham Outline Compromise Climate Bill

U.S. Senators Kerry (D-MA), Graham (R-SC), and Lieberman (I-CT) have announced they will be introducing a new climate bill which will be based on the Kerry-Boxer bill, but that will be able to garner the 60 votes necessary to pass the legislation from the Senate. At the moment, the Kerry-Boxer bill does not have the support of 60 Democratic Senators, forcing Kerry to reach across the aisle for Republican votes.

The troika of Senators released an outline of their bill in advance of Copenhagen climate negotiations. The bill would include:

- 17% reduction in greenhouse gas emissions from 2005 levels in the “near term” and an 80% reduction in the “long term”;
- Create a federal program for carbon reductions, which would override regional initiatives and regulatory carbon controls by the EPA;
- Cost containment measures, which may include a “price collar” and strategic reserve;
- Provisions to encourage development of nuclear power;
- Investment in clean coal technology and carbon capture and storage;
- A prominent role for agricultural and international offsets; and
- Robust carbon market oversight.

Senate Majority Leader Harry Reid has officially announced a bill will likely be voted on in the spring of 2010. At the moment, the Senate is debating healthcare and financial reform legislation, the former of which is expected to be finalized by Christmas. Policy experts believe there is a small window in 2010 in which lawmakers must pass cap and trade legislation. The Senate must focus on passing a bill in advance of mid-term elections as the prospects for passing a bill going into elections is significantly reduced.

Stabenow Offsets Bill

Democratic Senator Debbie Stabenow is pushing to have her offsets bill included in the compromise legislation coming from the Senate. The bill establishes rules for the creation of an agricultural and forestry offsets program in the United States and provides specific project types that may be eligible for offset credit. As of this writing, the Farm Bureau wrote a letter to the Senator expressing its approval of the bill and commending the Senator on her work on the bill. Given the influence of the Bureau, it is believed it is very likely the Senator’s offsets bill would be incorporated into a compromised Senate bill to garner support.

EPA Now Authorized and Obligated to Reduce GHG Emissions

In early December, EPA finalized its findings that greenhouse gases (GHGs) pose a threat to public health. The “endangerment finding” now gives the EPA the legal authorization and obligation to regulate mobile and stationary sources of GHGs under the Clean Air Act. Lisa Jackson, EPA Administrator, told a press conference that she doesn’t view direct carbon regulation as a

substitute for Congress passing comprehensive climate change legislation. Jackson noted she believes the regulations would be complimentary to whatever is passed out of the Congress.

The finding represents the legal foundation the EPA must have to finalize regulations proposed this spring that would require automakers to set higher fuel economy standards for new vehicles. In addition, the EPA is expected to impose regulation requiring new or expanded mobile sources of GHGs to use Best Available Control Technology. EPA has already issued its mandatory GHG reporting rule, requiring sources emitting 25,000 mtco2e to report.

To date, the endangerment finding has been perceived to be an impetus to pressure Congress to pass a climate change bill. In the event, the Congress does not pass a bill the EPA endangerment finding will act as a backstop measure to regulate GHGs in the United States.

California

California Air Resources Board Releases Draft Regulatory Language

Draft regulation language for California’s cap and trade program was released on November 24, 2009. The draft regulation proposes language (and asks for public input) for several key provisions of the program, including:

- Compliance instruments, including California GHG allowances and offsets;
- Allowances budgets from 2012-2020 (illustrative only);
- Registration and tracking of compliance instruments;
- Surrender requirements for regulated facilities;
- Trading and banking;
- Free allocation and/or auctioning of allowances and distribution of allowance value; and
- Enforcement and penalties.

Evolution Markets reviewed the draft language in detail. A detailed summary of the draft regulation language, including some analysis, is available on our Web site : http://www.evomarkets.com/reports/new/CARB_Regulations_CapandTrade_Dec_12_09.html

California Facilities’ 2008 Emissions Data Released: Facilities Begin Planning for Compliance

In mid-November, the California Air Resources Board (ARB) released reported 2008 greenhouse gas emissions data for California facilities. In total, more than 97% of the state’s 600 largest facilities were reported to be complying with the mandatory reporting requirement. The total emissions reported for 2008 was roughly 183 MMTCO2e. Due to reporting, facilities now know their greenhouse gas emissions profile – a fundamental building block of the cap and trade program. The ARB is currently revising projected emissions for the capped sector in California. Based on this data, the ARB will set the cap and allowance budgets for 2012-2020. In a recent Cap Setting stakeholder meeting, the ARB announced their intent to allow 4% of a facilities surrender obligation (equal to the total emissions the facility is allowed to emit in a given compliance period) to come from offsets. For example, for every 100 MTCO2e a facility emits, it must surrender 96 allowances and 4 offsets. Based on projected emissions, where the cap will be set in 2012, the method of allocation and now, the ability to roughly calculate offset quantities, facilities are now able to move further along planning their compliance pathways.

The pre-compliance offsets market in California continues to gain momentum in the wake of the clarified cap and trade provisions. Some firms have begun purchasing offsets, most notably Climate Reserve Tonnes (CRTs), to hedge financial risk under the cap and trade program. Others continue to build cases with management internally to begin purchasing.

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For more information on California pre-compliance offsets and the latest market activity, please contact the Carbon Desk in our San Francisco office at 415.963.9137.

Economic and Allocation Advisory Committee Draft Report Released

The California Economic and Allocation Advisory Committee (EAAC) released a draft report outlining the Committee's approach to allowance allocation under AB 32. The EAAC, a 17-member committee comprised of regulatory, financial and economic experts, was established May 22, 2009 by the California Air Resources Board (ARB) and the California Environmental Protection Agency. The EAAC's two main roles are: 1) to provide input on the evaluation of economic impacts of AB 32, and 2.) to present the ARB with recommendations on the allocation method of allowances (and use of allowance value) in the California cap and trade program.

The EAAC is using four criteria to evaluate allocation methods – fairness, cost effectiveness, environmental effectiveness and simplicity. The report provides a detailed overview of the two methods for allowance allocation – auction and free allocation. AB 32 requires an unspecified quantity of allowances to be auctioned from the outset of the program (January 1, 2012). The minimum requirements for the Western Climate Initiative (WCI), of which California is a Partner, are 10% in 2012 increasing to 25% in 2020. The California ARB has suggested their intent is to transition to 100% auction by 2020 and will begin auctioning a larger quantity than the WCI minimum requirement of 10% in 2012.

In a recent public EAAC meeting, certain committee members expressed a desire to auction 100% of allowances from the outset of AB 32. The view was subsequently tempered by the recognition that allowance costs from an auction could not be passed on in certain "energy-intensive trade exposed industries." The EAAC appeared to recognize industries that compete in global markets with other firms that don't incur the cost of allowances prices may not be able to pass on allowance costs in the form of higher priced goods. Example of these firms may be chemical companies. To keep these industries competitive in the global market, and to prevent these businesses from leaving California due to additional costs, a concept known as "leakage," the Committee may consider free allocation of allowances to these firms in California.

The Committee will continue their work on the allocation issue. The Committee is expected to prepare a report with its findings for January 2010. The ARB plans to address the Committee's recommendations on allocation in the Spring 2010 draft regulation. For the latest copy of the draft report, click here:

http://www.climatechange.ca.gov/eaac/meetings/2009-11-18/EAAC_Allocation_Report_2009-11-16-3.pdf

Climate Action Reserve Announces Composting as a New Protocol

The Climate Action Reserve (CAR) announced this month their intent to develop a new greenhouse gas offset protocol for organic waste composting. The new protocol will provide a standardized approach for quantifying and monitoring greenhouse gas emissions avoided from the diversion of municipal food waste from landfills to composting facilities. The result of such an activity will be the aerobic rather than anaerobic decay of organic waste, thereby avoiding or eliminating greenhouse gas emissions. The new protocol will largely be build off the newly CAR-approved Organic Waste

Verified Emission Reductions (VERs) Offers

▼ TYPE	▼ COUNTRY	▼ SIZE (tons CO@e)	▼ VINTAGE	▼ BID/ASK	▼ PRODUCT
Livestock Methane	Midwest USA	50k/year	2009-2015	\$7.50 / \$11.00	Climate Action Reserve (CRT's)
Landfill Gas	Midwest USA	75k/year	2009-2013	\$6.25 / \$8.50	Climate Action Reserve (CRT's)
Forestry	California	100k/year	2009	\$7.75 / \$8.85	Climate Action Reserve (CRT's)
Wastewater Treatment	USA	100k/year	2008-2009	\$2.50 / \$4.00	Climate Action Reserve (CRT's)
Landfill Gas	USA	100k/year	Pre-2009	\$0.40 / \$0.90	Registered Chicago Climate Exchange (CCX) Offsets

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Digestion Project Protocol.

The Climate Action Reserve will host a kick-off meeting to discuss the new Composting Protocol in Portland, Oregon on December 9, 2009.

Regional

WCI Releases White Paper on Market Oversight for Public Comment

The Western Climate Initiative (WCI) released a white paper for public comment on market oversight of the regional cap and trade system. The comment period is open until December 18th. The Market Oversight Committee is contemplating the following issues:

1. Whether current U.S. and Canadian regulation of commodity markets is appropriate
2. Whether to place restrictions of OTC instruments
3. Appropriate transparency and disclosure requirements

The white paper can be downloaded by clicking here: http://www.westernclimateinitiative.org/components/com_publiccomments/documents/WCI_Market_Oversight_White_Paper_11-18-09.pdf

RGGI Releases Report on Sixth Auction

The results from the sixth Regional Greenhouse Gas Initiative (RGGI) auction were released on December 4th. Similar to the previous auction in September, this one included both vintage 2009 allowances and vintage 2012 allowances.

Approximately 30 million vintage 2009 allowances sold at the auction for the clearing price of \$2.05. (See table 1 below.) The vintage 2009 allowances closed December 3rd at \$2.06. By comparison, the last quarterly RGGI auction in September cleared at \$2.19, but closed at \$2.50 the night before results were announced.

The vintage 2009 auction saw an increase in participation relative to the last auction with 62 bidders compared to 54 in September. Bids were submitted for 2.6 times the available supply, but the auction still cleared 7% lower than Auction 5. With the market expected to be oversupplied by approximately 30-40 million allowances compared to actual emissions, this price was expected by the market.

As with the previous auction, non-compliance entities did not participate in the Vintage 2012 portion of the auction. The auction cleared right at the \$1.86 reserve price, which obviously indicates minimal demand for the allowances. Furthermore, only 1.6 million of the 2.2 million allowances on auction for the 2012 vintage were sold.

Auction 5 Stats	Vintage 2009	Vintage 2012
Bidders	63	8
Percent Compliance	65%	100%
Clearing Price	\$2.05	\$1.86

* Data from rggi.org



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