

# American Bar Association



## **“Regional Greenhouse Gas Initiatives: Lasting Model or Historical Artifact?”**

**Friday, February 13, 2009**

**10:45 am – 12:15 pm**

**Fairmont Copley Plaza**

**Boston, MA**

**State Suite A, Lower Lobby Level**

*Co-sponsored by the ABA Standing Committee on  
Environmental Law and the ABA Section of Environment,  
Energy and Resources*

**Laurie Burt** has been the Commissioner of the Massachusetts Department of Environmental Protection (MassDEP) since September of 2007 following her appointment by Governor Deval L. Patrick.

Since her appointment, Ms. Burt has championed environmental, energy and public health issues, such as the Regional Greenhouse Gas Initiative (RGGI), a statewide stormwater management plan, the streamlining of environmental permits and wetlands appeals, the protection of drinking water resources through conservation, the use of "Landfills Last" to maximize the recycling and reuse of solid wastes, and Brownfields redevelopment efforts.

Ms. Burt is Co-chairman of the RGGI Strategic Communications Team, and she is Governor Patrick's environmental representative on the board of RGGI, Inc. Ms. Burt is also Secretary-Treasurer of the Ozone Transport Commission, a member of the Air Committee for the Environmental Council of States (ECOS), and a key member of the State Voice group, a coalition of environmental commissioners working to support the development of federal legislation that capitalizes on the experience of state climate change and clean energy programs.

She was formerly a partner at the law firm Foley Hoag, LLP of Boston and Washington, D.C., where she started the firm's Environmental Practice Group. Ms. Burt previously served as a Massachusetts Assistant Attorney General in environmental enforcement and most recently as Vice President of the Boston Bar Association.

**William Funk** is the Jeffrey Bain Faculty Scholar & Professor of Law at Lewis & Clark Law School in Portland, Oregon, where he teaches administrative law, constitutional law, and environmental law. Professor Funk is an author of several books and numerous articles and a former chair of the Administrative Law and Regulatory Practice Section of the ABA, as well as a former chair of both the Administrative Law and Natural Resources Sections of the Association of American Law Schools.

Professor Funk is also a Center for Progressive Reform Scholar and a member of the American Law Institute. He has been admitted to practice in New York, the District of Columbia, and before the U.S. Supreme Court. Before coming to Lewis & Clark in 1983, Professor Funk was an assistant general counsel at the U.S. Department of Energy, the principal staff member of the Legislation Subcommittee of the U.S. House of Representatives Permanent Select Committee on Intelligence, and a staff attorney in the Office of Legal Counsel of the U.S. Department of Justice. A graduate of Harvard College and Columbia Law School, Funk clerked for Judge James Oakes of the U.S. Court of Appeals for the Second Circuit.

**Ken Hurwitz** is a partner at the firm and has thirty-two years of energy experience, primarily in the electric power regulatory and environmental area. During the mid-1980s, he served as Executive Director of the Maryland Public Service Commission, but the lion's share of his career has been dedicated to serving the independent power sector as a private practitioner. He has practiced extensively at the Federal Energy Regulatory Commission, the federal appellate courts and before numerous (upwards of fifteen) state utility commissions and also has been called upon to handle complex transactions.

He was recognized by his peers as a Washington, D.C. Energy *Super Lawyer* for 2008. Prior to becoming a partner at HAYNES AND BOONE, Ken was a partner at VENABLE in Washington, D.C., where he headed the energy practice. He holds J.D. and M.B.A. degrees from the University of Pennsylvania Law School and the Wharton School, and a B.A. from Columbia College, where he was admitted to membership in *Phi Beta Kappa*.

**Colin Owyang** is Senior Vice President and US General Counsel at National Grid, the second-largest electricity and gas utility in the United States and the largest utility in the United Kingdom. Since joining National Grid in 2004, Colin has held several positions both in the legal department and in the business. Colin was previously an Assistant U.S. Attorney in Boston where he prosecuted Al Qaeda terrorist Richard Reid (the “Shoebomber”) and mobster Stephen Flemmi (the “Rifleman”). Prior to joining the U.S. Department of Justice, Colin was an attorney at Foley Hoag and clerked for three federal judges in Detroit and Boston. Outside of work, Colin has also served on the boards of community non-profit organizations, including the Boston Center for Community and Justice and the Chinese Economic Development Council, as well as by political appointment to the Massachusetts Governor’s Judicial Nominating Commission and the Middlesex District Attorney’s External Diversity Committee and received the 2007 award from the National Asian Pacific American Bar Association for Best Lawyers Under 40. Colin is a graduate of Yale College, Yale University and the University of Michigan Law School.

**Dr. Richard Pierce** is a professor at the George Washington University Law School. Before joining the Law School faculty, Professor Pierce taught at Columbia University, the University of Virginia, Southern Methodist University, Tulane University, and the University of Kansas. He also was dean of the University of Pittsburgh School of Law. He practiced with Sutherland, Asbill & Brennan in Washington, D.C. Professor Pierce is author or co-author of *Administrative Law and Process* (4th ed. 2004); *Regulated Industries* (4th ed. 1999); *Administrative Law Treatise* (4th ed. 2002); and *Economic Regulation* (1994). He has written numerous articles on government regulation, regulatory economics, and the characteristics of the markets for electricity and natural gas.

**Dr. Paul Sotkiewicz** is currently Senior Economist in the Market Services Division at the PJM Interconnection, LLC. At PJM Dr. Sotkiewicz provides analysis and advice with respect to PJM’s market design and market performance with particular attention to demand response mechanisms, intermittent and renewable resource integration, market power mitigation strategy, and the potential effects of climate change policy on PJM’s markets.

Prior to joining PJM, Dr. Sotkiewicz served as the Director of Energy Studies at the Public Utility Research Center (PURC), University of Florida where he delivered executive programs and provided advice in energy regulatory policy and strategy for the World Bank, USAID, and regulatory agencies in the US, Africa, Latin America, and Southeast Asia. From 1998-2000 Dr. Sotkiewicz was an Economist in the Office of Economic Policy and later on the Chief Economic Advisor’s staff at the United States Federal Energy Regulatory Commission (FERC) where he conducted research, analysis, and advice on market design issues related to the, at the time, nascent ISO/RTO markets.

Dr. Sotkiewicz received a B.A. in History and Economics from the University of Florida in 1991, received a M.A. (1995) and Ph.D. (2003) in Economics from the University of Minnesota.

## Constitutional Implications of the Regional Greenhouse Gas Initiative (RGGI)

William Funk  
Jeffrey Bain Faculty Scholar &  
Professor of Law  
Lewis & Clark Law School

## Preemption

- Under existing law --Clean Air Act
- Generally, the CAA preserves state authority to impose stricter pollution standards than the federal government, suggesting no preemption.
  - However, in *Clean Air Markets Group v. Pataki*, 338 F.3d 82 (2d Cir. 2003) (NY required offsets purchase preempted by Clean Air Act's Acid Rain program).
  - Nevertheless, there the state limitation on the purchase of allowances from upwind states interfered with the national allowance system envisioned by the Title IV Acid Rain program.
  - Here, it is not apparent how the RGGI requirements would interfere with the Acid Rain allowances program. Certainly, it would not do it as directly as in *Pataki*.

## Interfering with the Executive's negotiations with foreign powers

- that is, by regulating CO2 emissions the states undermine the ability of the US to negotiate with foreign governments - we won't regulate emissions unless you do - alleged by the administration, but rejected in the context of limiting CO2 emissions from mobile sources by the only court to rule on it - *See Central Valley Chrysler-Jeep v. Witherspoon*, 529 F. Supp. 2d 1151 (E.D. Cal. 2007) (rejecting claim that California's regulation of automobile emissions of carbon dioxide was preempted by executive's foreign policy regarding regulation of greenhouse gases).

## Under new law

- depends on what it says, and it is likely to address the issue. RGGI by its terms would be superseded by a federal law that is comparable.

## Compact Clause

- Text - Article I, § 10, cl. 3 states that "no state shall, without the consent of Congress, . . . enter into any agreement or compact with another state. . . ."
  - By its terms it would seem that RGGI would require congressional consent.

## Supreme Court's Interpretation

- The Supreme Court, however, in 1893 declared that the clause should not be read literally. Rather, it should be read in context to mean that the only compacts requiring consent are those that increase the political power or influence of the states affected and thus encroach upon the full and free exercise of federal authority." In short, agreements that do not encroach upon federal sovereignty do not require consent. *Va. v. Tenn.*
- This test has been restated and applied to the current day.

## Applying the test

- Most recent and applicable case is *U.S. Steel v. Multistate Tax Commn*, 434 U.S. 452 (1978).
  - Federal interest in the subject does not require consent.
  - Doesn't limit federal government's authority to regulate CO2.
  - Most of RGGI involves parallel action by the several states with no enforcement authority to require that action. In the past, the Court has viewed such promises of parallel action as not requiring consent.
  - The Regional Authority as an interstate creation with separate authority, but so was the interstate tax commission. The regional authority acts in an ministerial capacity; the interstate tax commission acted in an advisory function.

## Outcome not entirely clear

- Compare Note, *The Compact Clause and the Regional Greenhouse Gas Initiative*, 120 Harv. L. Rev. 1958 (2007) (concluding RGGI does not violate Compact Clause) with Note, *United We Stand: The Interstate Compact as a Tool for Effecting Climate Change*, 41 Ga. L. Rev. 229, 249-54 (2006) (concluding that RGGI does violate Compact Clause).
- However, no court has ever found a violation of the Compact Clause, so it would be a novel decision if a violation were found with RGGI.

## Dormant Commerce Clause

- As you know, the so-called Dormant Commerce Clause prohibits states from discriminating against interstate commerce except where absolutely necessary to address a local problem; discrimination is never allowed merely to protect local industry.

## Offsets

- Model Rule XX.10.3 (a) limits the location of offset projects to participating states or non-participating states whose regulatory agency has entered into an MOU to carry out certain obligations, including auditing and enforcement of offset terms.

## Discrimination?

- By distinguishing between participating states and non-participating states, the Model Rule discriminates against interstate commerce in offsets. Normally such discrimination would result in a law being a violation of the dormant commerce clause. Here, however, two factors may save such a distinction.
  - First, the restriction is not protectionist in intent or effect; it is clearly designed to assure the same adequate monitoring and enforcement of out-of-region offset projects as in-region projects will receive from their own state.
  - Second, cases such as *Dean Milk v. City of Madison*, 340 U.S. 349 (1951), suggest that reasonable attempts to provide equivalent out-of-state safeguards as are provided to in-state entities are not discriminatory merely because they differ in certain ways or involve an added cost attributable to the difficulty of out-of-state enforcement.

## The problem of leakage

RGGI requires generators of electricity to have allowances for the CO2 they emit. As discussed earlier, RGGI does not restrict the importation of electric power from outside the RGGI states. Consequently, Load Serving Entities (LSEs), or electricity distributors, might choose to purchase electricity from out-of-region, rather than purchase it from generators within the RGGI states, because that electricity might be cheaper because its production would not have to comply with RGGI's requirements. This could undermine the reduction of CO2 emissions intended by RGGI.

## How to deal with Leakage

- It is not clear how RGGI will deal with leakage. See Potential Emissions Leakage and the Regional Greenhouse Gas Initiative (RGGI), <http://rggi.org/docs/20080331leakage.pdf>
- Report's Alternatives –
  - Essentially ignore the problem; monitor; wait for the federal system – No dcc problem
  - Regulate LSE's outside the RGGI allowance system, e.g., emissions portfolio standard – no dcc problem

## "Load-based cap"

Essentially cap-and-trade at the LSE level, rather than (or incorporating) cap-and-trade at the generator level

- By treating in-state and out-of-state power equally, it would not be a discriminatory law.
- Pike v. Bruce Church Test for non-discriminatory laws that affect interstate commerce.
  - Does the burden on interstate commerce clearly outweigh the local benefits of the law.
- Applying the test –
  - Burden is minimal.
  - Burden of persuasion is on those who wish to challenge law
  - Normally, environmental protection is considered an important and valuable local benefit. However, in the context of mitigating global warming, its diffuse benefits might be deemed de minimis.
- Outcome is uncertain, but the clearly non-discriminatory, non-protectionist purpose and effect are likely to lead to such an approach being upheld.

## Options not addressed by Report

- A ban on some or all of the import of out-of-region generated electric power. This would clearly violate the dormant commerce clause.
- The so-called Hybrid Approach – the hybrid approach would require LSE's to obtain allowances for any power purchased from outside RGGI.
  - This would be facially discriminatory and could be upheld, if at all, under the compensatory tax doctrine. *Henneford v. Silas Mason* (1937) – Washington state's compensatory use tax to protect state sales tax.
  - Three part test – *Oregon Waste Systems v. DEQ* (1994)
    - state must identify the intrastate burden it is attempting to compensate
    - the tax must be shown to be roughly equivalent to that burden, and
    - the events on which the taxes are imposed must be so substantially equivalent as to be proxies for one another

## Applying the test

- The burden is the cost of the allowance avoided
  - the allowance required is identical to the burden
  - although the events are dissimilar (allowance for generation versus allowance for importation), they are so similar as to be proxies for one another.
- Outcome is unclear – dueling law review articles
- Since *Henneford v. Silas Mason* in 1937, however, the Supreme Court has rejected every attempt to use the compensatory tax doctrine to avoid dormant commerce clause violations outside of the sales/use tax situation.

## Likely RGGI Response

- It appears that the RGGI states are leaning toward the monitor and wait approach.

## Conclusion

- While the issue cannot be free from doubt, it appears
  - Fairly clear that RGGI is not preempted by federal law at this time
  - That the Compact Clause is not violated, and
  - That the model rule restriction on offsets is probably not a violation of the Dormant Commerce Clause, and
  - That the apparent direction to deal with Leakage will not violate the Dormant Commerce Clause

# Constitutional Implications of the Regional Greenhouse Gas Initiative (RGGI)

William Funk

## Outline

### I. Preemption

#### A. Under existing law

1. Clean Air Act – Generally, the CAA preserves state authority to impose stricter pollution standards than the federal government, suggesting no preemption. 42 U.S.C. § 7416.
  - a. However, in *Clean Air Markets Group v. Pataki*, 338 F.3d 82 (2d Cir. 2003)(NY required offsets purchase preempted by Clean Air Act’s Acid Rain program).
  - b. Nevertheless, there the state limitation on the purchase of allowances from upwind states interfered with the national allowance system envisioned by the Title IV Acid Rain program.
  - c. Here, it is not apparent how the RGGI requirements would interfere with the Acid Rain allowances program. Certainly, it would not do it as directly as in *Pataki*.
2. Interfering with the Executive’s negotiations with foreign powers – that is, by regulating CO<sub>2</sub> emissions the states undermine the ability of the US to negotiate with foreign governments – we won’t regulate emissions unless you do – alleged by the administration, but rejected in the context of limiting CO<sub>2</sub> emissions from mobile sources by the only court to rule on it – *See Central Valley Chrysler-Jeep v. Witherspoon*, 529 F. Supp. 2d 1151 (E.D. Cal. 2007)(rejecting claim that California’s regulation of automobile emissions of carbon dioxide was preempted by executive’s foreign policy regarding regulation of greenhouse gases).

- B. Under new law – depends on what it says, and it is likely to address the issue. RGGI by its terms would be superseded by a federal law that is comparable.

### II. Compact Clause

- A. Text – Article I, § 10, cl. 3 states that “no state shall, without the consent of Congress, . . . enter into any agreement or compact with another state. . . .”

1. By its terms it would seem that RGGI would require congressional consent.
- B. The Supreme Court, however, in 1893 declared that the clause should not be read literally. Rather, it should be read in context to mean that the only compacts requiring consent are those that increase the political power or influence of the states affected and thus encroach upon the full and free exercise of federal authority.” In short, agreements that do not encroach upon federal sovereignty do not require consent. *Va. v. Tenn.*
1. This test has been restated and applied to the current day.
- C. Applying the test – Most recent and applicable case is *U.S. Steel v. Multistate Tax Commn*, 434 U.S. 452 (1978).
1. Federal interest in the subject does not require consent.
    - a. Quere: is this the place to argue that it interferes with US foreign policy? Trouble is: the same problem occurs if a single state acts. The problem is not peculiar to an agreement among states.
  2. Doesn't limit federal government's authority to regulate CO2.
  3. Most of RGGI involves parallel action by the several states with no enforcement authority to require that action. In the past, the Court has viewed such promises of parallel action as not requiring consent.
  4. The Regional Authority as an interstate creation with separate authority, but so was the interstate tax commission. The regional authority acts in an ministerial capacity; the interstate tax commission acted in an advisory function.
- D. Outcome not entirely clear. Compare Note, *The Compact Clause and the Regional Greenhouse Gas Initiative*, 120 Harv. L. Rev. 1958 (2007)(concluding RGGI does not violate Compact Clause) with Note, *United We Stand: The Interstate Compact as a Tool for Effecting Climate Change*, 41 Ga. L. Rev. 229, 249-54 (2006)(concluding that RGGI does violate Compact Clause).
1. However, no court has ever found a violation of the Compact Clause, so it would be a novel decision if a violation were found with RGGI.

### III. Dormant Commerce Clause

- A. As you know, the so-called Dormant Commerce Clause prohibits states from discriminating against interstate commerce except where absolutely necessary to

address a local problem; discrimination is never allowed merely to protect local industry.

B. Offsets –

1. Model Rule XX.10.3 (a) limits the location of offset projects to participating states or non-participating states whose regulatory agency has entered into an MOU to carry out certain obligations, including auditing and enforcement of offset terms.
2. By distinguishing between participating states and non-participating states, the Model Rule discriminates against interstate commerce in offsets. Normally such discrimination would result in a law being a violation of the dormant commerce clause. Here, however, two factors may save such a distinction.
  - a. First, the restriction is not protectionist in intent or effect; it is clearly designed to assure the same adequate monitoring and enforcement of out-of-region offset projects as in-region projects will receive from their own state.
  - b. Second, cases such as *Dean Milk v. City of Madison*, 340 U.S. 349 (1951), suggest that reasonable attempts to provide equivalent out-of-state safeguards as are provided to in-state entities are not discriminatory merely because they differ in certain ways or involve an added cost attributable to the difficulty of out-of-state enforcement.

C. The problem of leakage – RGGI requires generators of electricity to have allowances for the CO<sub>2</sub> they emit. As discussed earlier, RGGI does not restrict the importation of electric power from outside the RGGI states. Consequently, Load Serving Entities (LSEs), or electricity distributors, might choose to purchase electricity from out-of-region, rather than purchase it from generators within the RGGI states, because that electricity might be cheaper because its production would not have to comply with RGGI's requirements. This could undermine the reduction of CO<sub>2</sub> emissions intended by RGGI.

D. It is not clear how RGGI will deal with leakage. *See* Potential Emissions Leakage and the Regional Greenhouse Gas Initiative (RGGI), <http://rggi.org/docs/20080331leakage.pdf>

E. Dealing with leakage –

1. Essentially ignore the problem; monitor; wait for the federal system – No dcc problem

2. Regulate LSE's outside the RGGI allowance system, e.g., emissions portfolio standard – no dcc problem
3. “Load-based cap” – essentially cap-and-trade at the LSE level, rather than (or incorporating) cap-and-trade at the generator level
  - a. By treating in-state and out-of-state power equally, it would not be a discriminatory law.
  - b. Pike v. Bruce Church Test for non-discriminatory laws that affect interstate commerce.
    - (1) Does the burden on interstate commerce clearly outweigh the local benefits of the law.
  - c. Applying the test –
    - (1) Burden is minimal.
    - (2) Burden of persuasion is on those who wish to challenge law
    - (3) Normally, environmental protection is considered an important and valuable local benefit. However, in the context of mitigating global warming, its diffuse benefits might be deemed de minimis.
  - d. Outcome is uncertain, but the clearly non-discriminatory, non-protectionist purpose and effect are likely to lead to such an approach being upheld.
4. Options not addressed by Report –
  - a. A ban on some or all of the import of out-of-region generated electric power.
    - (1) This would clearly violate the dormant commerce clause.
  - b. The so-called Hybrid Approach – the hybrid approach would require LSE's to obtain allowances for any power purchased from outside RGGI.
    - (1) This would be facially discriminatory and could be upheld, if at all, under the compensatory tax doctrine. Henneford v.

Silas Mason (1937) – Washington state’s compensatory use tax to protect state sales tax.

- (2) Three part test – Oregon Waste Systems v. DEQ (1994)
  - (a) state must identify the intrastate burden it is attempting to compensate
  - (b) the tax must be shown to be roughly equivalent to that burden, and
  - (c) the events on which the taxes are imposed must be so substantially equivalent as to be proxies for one another
- (3) Applying the test –
  - (a) the burden is the cost of the allowance avoided
  - (b) the allowance required is identical to the burden
  - (c) although the events are dissimilar (allowance for generation versus allowance for importation), they are so similar as to be proxies for one another.
- (4) Outcome is unclear – Compare Note, *The Commerce Clause Meets Environmental Protection: The Compensatory Tax Doctrine as a Defense of Potential Regional Carbon Dioxide Regulation*, 47 B.C. L. Rev. 737 (2006)(suggesting the rationale of the compensating tax cases could be applied to charges applied to out-of-state generators) with Comment, *The Regional Greenhouse Gas Initiative and the Dormant Commerce Clause: Analysis and Recommendations* (2008)(suggesting that a hybrid approach to allowances would have difficulty meeting the compensatory tax test, because it is not a tax)(attached).
- (5) Since *Henneford v. Silas Mason* in 1937 the Supreme Court has rejected every attempt to use the compensatory tax doctrine to avoid dormant commerce clause violations outside of the sales/use tax situation.

5. It appears that the RGGI states are leaning toward the monitor and wait approach.

**American Bar Association  
Section of Administrative Law & Regulatory Practice**

**Regional Greenhouse Gas Initiatives—  
Lasting Model or Historical Artifact?**

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**Mid-Year Meeting  
Boston Massachusetts  
February 13, 2009**

The topic we have been assigned is regional greenhouse gas initiatives – lasting model or historical artifact? There is some ambiguity in the title. It could refer to initiatives within regions of the United States, such as the initiative that is being implemented by most of the states in the northeast, or to multi-national initiatives, such as the cap and trade system the EU is implementing. Under either interpretation, my answer is the same -- regional initiatives are unlikely to have any significant beneficial effect. Only a global initiative has any realistic prospect of success. Unfortunately, I see little likelihood that an effective global initiative can be implemented in time to avoid a significant increase in global temperatures.

I believe that global warming will have catastrophic effects that include the deaths of millions of people, the displacement of scores of millions, and the impoverishment of hundreds of millions. Moreover, the effects of global warming will be felt most by poor populations that are least able to cope with them. The areas that will be particularly hard hit include central Africa, central India, coastal Indonesia and coastal Bangladesh. If I were global energy czar, I would immediately implement a large global hydrocarbon tax. If such a tax was carefully designed and implemented, it could avoid any significant additional increases in global temperature by reducing global emissions of carbon dioxide by eighty per cent by 2050. No initiative that is less than global in scope has any chance of accomplishing that daunting task.

The United States now has a charismatic political leader who begins his tenure as President with extremely favorable popularity ratings both in the United States and in most of the rest of the world. President Obama has repeatedly expressed his strong support for programs designed to address global warming. The political and economic

obstacles to implementation of an effective strategy to avoid significant increases in global temperatures are so great, however, that even the most able and committed leader is unlikely to be able to overcome them. I will begin by describing the obstacles to implementation of a potentially effective national global warming strategy. I will then explain why no national strategy can be effective unless most other nations adopt a similar strategy and why I see that goal as unattainable at any time in the foreseeable future.

If President Obama authorizes them to do so, the talented team that he has assembled to address energy and environmental issues will draft and urge enactment of a cap and trade system that is designed to reduce emissions of carbon dioxide in the U.S. by eighty per cent by 2050. Their choice of a cap and trade system will be easy. There is a broad consensus that only one of two mechanisms has the realistic potential to accomplish the goals of a strategy to avoid global warming – a carbon tax or a cap and trade system. Most economists prefer a carbon tax, but politicians who want to move aggressively to address global warming are nearly unanimous in their preference for a cap and trade system. The only national politicians who have publicly supported a carbon tax are Ralph Nader and John Dingle. I share the strong preference of most economists for a carbon tax, but I get a bit nervous when I find that, among politicians, only the odd couple of Nader and Dingle are willing to support a carbon tax.

It is important to understand why the vast majority of politicians oppose a carbon tax. One reason is rhetorical – Americans do not like taxes or politicians who propose taxes. But our aversion to taxes is not limited to the word “taxes” – we have a strong aversion to anything that increases prices significantly. We become particularly upset by

significant increases in the price of energy, as became apparent during the relatively brief period in which gasoline prices soared in 2008. Herein lies a problem. A cap and trade system will have effects on the price of energy that are remarkably similar to the effects of a carbon tax. Any cap on carbon dioxide emissions will create an artificial shortage of hydrocarbons by limiting sales of hydrocarbons to twenty per cent of the present level. That will increase significantly the price of all hydrocarbons and goods and services derived from hydrocarbons. Any cap and trade system must yield the same price effects as a carbon tax to be effective.

Politicians prefer a cap and trade system to a carbon tax because most members of the public have no idea that a cap and trade system is functionally equivalent to a carbon tax. Once a cap and trade system begins to have its intended effects, however, the public will rebel and demand that politicians “do something” to solve the problem of soaring energy prices. Politicians will have an easy means of responding to those pressures. They can simply issue more emission permits to the point at which the artificial shortage created by the cap on emissions is reduced or eliminated, thereby producing a rapid large reduction in energy prices. Politicians can get a double benefit by issuing the permits to politically-favored constituencies. That is another reason many politicians like a cap and trade system – it provides a vehicle through which they can improve their prospects of reelection by allowing them to trade emission permits that have large cash values for political support. Of course, if and to the extent that politicians respond to public pressure to reduce energy costs by issuing more emissions permits, they will reduce or eliminate the beneficial effects of a cap and trade system. I fear that any cap and trade system adopted in the U.S. is likely to meet this fate.

Perhaps I am being too pessimistic, however. Assume for present purposes that the U.S. is successful in enacting and implementing a national cap and trade system that has the potential to reduce carbon dioxide emissions in the U.S. by eighty per cent. The net effect of such a program on global emissions of carbon dioxide would be modest unless other countries are willing to implement similar programs. If the U.S. is successful in reducing carbon dioxide emissions by eighty per cent and other countries do nothing to reduce such emissions, the effects of the “successful” U.S. effort will include significant *increases* in carbon dioxide emissions in other countries.

The U.S. can reduce its emissions of carbon dioxide significantly only by reducing its consumption of hydrocarbons. All hydrocarbons are sold on global markets. Any reduction in hydrocarbon consumption in the U.S. will decrease the world price of hydrocarbons. If other countries decline to implement effective cap and trade systems or large carbon taxes, consumers in those countries will respond to the lower price of hydrocarbons by increasing the quantity they consume, with attendant increases in carbon dioxide emissions. Thus, any effective cap and trade system implemented unilaterally by the U.S. would have little beneficial effect in reducing future increases in global temperatures. In economic terms, the beneficial effects of an effective U.S. system would be dependent on the difference between the price elasticity of demand for hydrocarbons in the U.S. and the price elasticity of demand for hydrocarbons in other countries. Thus, for instance, if the price elasticity of demand for hydrocarbons in the U.S. is 1.0 and the price elasticity of demand for hydrocarbons in the rest of the world is 0.8, eighty per cent of any reduction in U.S. emissions would be offset by increased emissions in other countries.

This effect of a “successful” unilateral U.S. effort to reduce carbon dioxide emissions explains why sub-national regional efforts to reduce carbon dioxide emissions are expensive exercises in futility. If and to the extent that California and/or the northeastern states are successful in reducing carbon dioxide emissions in their jurisdictions, most of those reductions will be offset by increased emissions elsewhere, including states and regions in the U.S. that do not implement similar systems. It also explains why the U.S. must persuade other nations to join us if we want to implement a system that will be effective in reducing global emissions of carbon dioxide.

I have no doubt that President Obama understands this reality and that he anticipates the need to provide the leadership needed to induce other nations to join the U.S. in such an effort. Of course, the EU has a head start on the U.S. in this respect. It has been implementing a cap and trade system for several years. Many leaders of European nations have long criticized the U.S. for its unwillingness to participate in the EU’s cap and trade system and have maintained that an effective U.S. leadership role is the missing ingredient that is critical to the success of any global initiative. I agree that a strong U.S. leadership role is a necessary condition for success in implementing an effective global system, but I doubt that it is a sufficient condition.

The EU’s experience with its cap and trade system has not been encouraging. The EU set a relatively high cap on emissions – the reduction in emissions it envisioned was a tiny fraction of the reduction required to avoid global warming. The EU has not come close to attaining even that modest goal. Many EU countries have increased their emissions by amounts in excess of the increases in emissions in the U.S. during the period the EU cap and trade system has been in effect.

The EU has now reached agreement on a future cap and trade system with a cap that is twenty per cent below the present level of emissions. If the EU were to meet that goal, it would be one quarter of the way to the ultimate goal of an eighty per cent reduction by 2050. The EU is highly unlikely to meet even that goal, however. The negotiations that led to the December 2008 agreement were very difficult. Poland adamantly opposed adoption of a more ambitious cap on emissions. It estimated that the new proposal would increase the cost of energy in Poland by ninety per cent. Even Germany, one of the EU members that strongly supported the original cap and trade system, was unwilling to participate in a more ambitious program unless it could issue additional emissions permits to its heavy industries.

Only France was enthusiastic about implementing a new cap and trade system that included a cap that is a bit closer to the eighty per cent reduction required to avoid additional global warming. France's agenda has long been apparent – it is the largest supplier of nuclear generating plants in the world, and it sees an ambitious global initiative to reduce carbon dioxide emissions as a means of increasing dramatically the market for its nuclear generating units. In order to induce the many EU members who were opposed to the new system to acquiesce in it, France had to agree to include gaping holes through which any EU member can escape as soon as consumers, electricity generators, or industries find the effects objectionable.

As I interpret the sad history of the EU cap and trade program, the initial enthusiasm to tackle the problem of global warming dissipated rapidly once the public and the politicians realized that a real cap and trade program has the same effects as a carbon tax. I expect the new agreement to be as ineffective as the old agreement. Its

efficacy will be eroded by the regular increases in the number of emissions permits issued in response to pressure from consumers and industries to reduce the price of energy.

Perhaps I am being too pessimistic, however. Assume for present purposes that the EU and all other industrialized nations are willing to join the U.S. in adopting and implementing an effective cap and trade program. Even that would not be sufficient to avoid global warming. Industrialized nations account for a significant proportion of current carbon dioxide emissions, but developing countries are expected to account for virtually all of the future increases in emissions. Thus, for instance, China alone accounted for 67% of the total increase in emissions in 2007 and 98% of the total increase came from 48 countries.\* Those countries have three common characteristics. All are developing countries that are striving to accomplish what the U.S. and the EU accomplished during the first half of the twentieth century -- to increase the availability of carbon-intensive products and services like cars and electricity to their citizens. None are willing even to consider adopting a carbon tax or a cap and trade system that includes a cap below their current levels of emissions that would take effect any time in the near future. All 48 use subsidies to make hydrocarbons and electricity generated through use of hydrocarbons available to their citizens at prices far below world market prices.

I see no possibility that developing nations will adopt meaningful programs to reduce their carbon dioxide emissions any time in the foreseeable future. The political and economic costs of reducing emissions of hydrocarbons in developing nations are prohibitively high. Many developing nations are offering to commit to begin to reduce

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\* 2007 is the last year for which we can rely on statistics to provide accurate measures of the effects of alternative global warming initiatives. The deep global recession that began in 2008 will result in unplanned reductions in carbon dioxide emissions so large that they will dwarf any effects of the global warming initiatives that are being implemented in various regions. Until the global recession ends, we will have limited ability to measure the effects of any global warming initiative.

their emissions at some point in the distant future. If you take those commitments seriously, I would like to talk to you about buying a bridge in Brooklyn or a bundle of securitized subprime loans. The politicians who make commitments on behalf of their remote successors are not the politicians who will make the critical decisions to reduce carbon dioxide emissions decades from now. The politicians who actually must make those decisions will either renege on the commitments of their predecessors or be replaced by other politicians.

If industrialized nations implement effective cap and trade systems, they will reduce significantly the quantity of hydrocarbons they consume. That, in turn, will produce a significant reduction in the global price of hydrocarbons. Developing countries will respond by increasing their consumption of hydrocarbons and attendant emissions of carbon dioxide. Any net global gain will be attributable only to differences in price elasticity of demand between industrialized countries and developing countries. Even if that difference is extremely large, any reduction in emissions in industrialized countries will be largely offset by increases in emissions in developing countries. Even if industrialized nations reduced their emissions to zero, emissions by developing nations would exceed by a large margin the amount that scientists tell us will continue to produce increases in the global temperature.

I would urge President Obama at least to defer any attempt to persuade Congress to adopt an effective global warming initiative until after he has convinced Congress to take the actions needed to get us out of our current economic crisis. I am a fan of Nobel Laureate Paul Krugman. He has persuaded me that our only hope of avoiding a global depression is to enact a stimulus package that involves additional expenditures of at least

700 billion dollars over the next two years. He argues persuasively that we could have emerged from the great depression of the 1930s within a few years if we had been willing to enact an analogous stimulus package in 1932. President Roosevelt was not able to persuade Congress to take such a bold step, however. We were willing to increase spending to the extent needed to emerge from that depression only in response to the threat of global takeover posed by Tojo and Hitler.

I hope that President Obama will be able to persuade Congress to enact the stimulus package needed to avoid a repeat of the 1930s. I do not want him to divert any of his energy from that challenging task in an attempt to persuade Congress to enact a global warming initiative. If President Obama is able to avoid a depression and get us out of the recession by 2011, he will be reelected with a mandate sufficient to allow him to turn to the other parts of his agenda. If he is unable to accomplish that critical task by 2011, he will be a one-term President.

I am not optimistic about the prospects for adopting and implementing an effective global warming initiative even after we emerge from the present global recession. That is a debate I would like to lose, however. I am hoping that someone can devise and implement a necessarily global strategy that will be effective in avoiding significant increases in global warming.



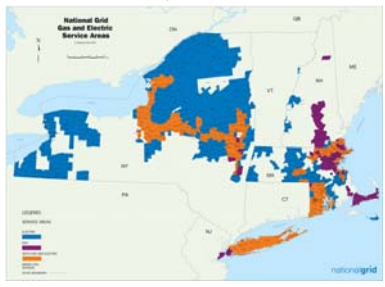
**ABA Mid-Year Conference**  
February 13, 2009

Colin Owyang –  
Senior Vice President and US General Counsel

  
 The power of action.


**National Grid: An International Electricity and Gas Company**

**National Grid Electricity and Gas Service Areas - US**




- ◆ Largest utility in UK; second largest in US\*
  - +50% UK, 50% US
  - +50% Electricity, 50% Gas
  - +50% Transmission, 50% Distribution
  - +27,000 employees
  - +Almost 18 million customers
- ◆ Northeast US
  - + Distributes electricity to 3.3 million customers
  - + Services 1.1 million customers of Long Island Power Authority (LIPA)
  - + Provides natural gas to 3.4 million customers
  - + Currently owns 4,000 MW of generation – largest investor owned capacity in NY

\*Based on customer numbers; includes the servicing of LIPA's 1.1 million customers

  
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**National Grid Perspective on Climate Change**

- ◆ The science is convincing.....
- ◆ We are acting.....
  - Early vocal supporter of and contributor to RGGI formation
  - Strong advocate of national, mandatory, economy wide, cap and trade legislation
  - Proud supporters of the McKinsey carbon abatement study:
    - Energy efficiency - cost effective near term step to a lower carbon future
  - Established business imperative to reduce our worldwide carbon emissions 80% by 2050
  - Lines of business accountable for meeting annual, diminishing, carbon budgets to achieve our targeted reductions
  - Price of carbon factored in to all investment decisions
  - Rate decoupling with proper incentives is essential for harvesting energy efficiency

  
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**Regional vs. National Approach**

- ◆ National approach preferred....
  - Level playing field across the economy
  - Greater reductions, more comprehensive approach
  - Avoids regional economic inequities
  - Avoids “leakage” of emissions and revenue from regulated area to unregulated area
  - Encourages increased dispatch of cleaner, but higher cost, underutilized generation
- ◆ but in the absence of federal action....
  - RGGI creates a workable template for a broader national program
  - RGGI achieves real reductions – 18 million tons of CO2 per year by 2018 (10% of current power plant CO2 emissions in the Northeast)

  
 The power of action.

**RGGI Allowance Auctions**


- ◆ National Grid - early supporter of 100% auctioning of CO2 allowances with proceeds earmarked for consumer benefit
  - Free allowance allocation based on historical emissions would have rewarded high emitters
  - Electric customers pay either way – auction most efficient
  - Auction provides funding for energy efficiency and other low carbon initiatives to reduce consumer cost impact and further reduce CO2
- ◆ Our strategy –
  - Our low emitting units (primarily natural gas fueled) require only 50% of the allowances of an equivalent coal plant
  - Bid “quarter-ahead” for anticipated emissions
  - Accumulate allowances by “dollar cost averaging” each quarter over the three year compliance period
  - First auction – successfully acquired desired quantity at the \$3.38 clearing price

  
 The power of action.

**Cautions and Concerns**

- ◆ Open participation in auctions could result in market speculation and allowance price escalation
  - So far Initial two auctions suggest only minimal participation by non-regulated entities (only ~20% of allowances purchased by non-regulated entities)
- ◆ Limitation on use of offsets for compliance (3.3% of compliance requirement)\* seems arbitrary and could lead to unnecessary compliance cost increases
- ◆ Low carbon liquid biofuels not currently eligible as a CO2 emission reduction compliance option
  - Only sustainable solid biomass and biogas currently eligible
  - Arbitrarily reduces compliance options for our facilities
  - Sustainable liquid biofuels must be given equal eligibility!

\* If allowance prices reach \$10/ton maximum use of offsets rises to 10% of compliance requirement

  
 The power of action.

### Will auction proceeds be dispersed efficiently and effectively? The jury is still out.....

- ◆ Auction proceeds (\$600+ million per year or more) are to be used for “consumer benefit or strategic energy purposes” to reduce the RGGI cost impact on the [electric rate payer](#)
  - promote energy efficiency
  - promote renewable or non-carbon emitting energy technologies
  - stimulate investment in emission abatement technologies
- ◆ Each state adopting its own auction proceed disbursement approach
- ◆ NYSERDA proposal for NY auction proceed disbursement raises concerns
  - Minimum 25% for long term CO2 abatement/adaptation R&D – Why?
  - Other unspecified proportions to:
    - Building sector energy efficiency
    - Electric power supply & delivery
    - Transportation – why?
    - Agriculture, forestry and bioenergy - why?
  - Who will get the money and deliver the projects?
  - Will the electric ratepayers get their money’s worth?



7

### Electric Rate Payer Should be the Primary Beneficiary of Auction Proceeds

- ◆ **National Grid and other innovative electric utilities are best positioned to deliver cost effective energy efficiency results that will benefit the ratepayer**
  - National Grid - 20 year track record of delivering energy efficiency benefits to customers
    - 29 billion kWhRS in customer energy use reduction
    - \$3.6 billion in customer energy cost reduction
  - Energy efficiency skill sets, processes in place - highly effective
  - Established access to customers, knowledgeable of their needs and energy usage patterns
  - One stop shopping for all energy needs through existing trusted relationship
- ◆ **What will happen to the ratepayers investment when a nationwide CO2 program is established?**
  - RGGI/federal partnership must be forged to assure fair treatment of early action RGGI states and stakeholders within a federal climate change legislative framework
    - National legislation should reward, not penalize, early action by RGGI participants
    - Allowance currency should be harmonized to avoid stranded allowance purchases



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