

## Cap and Trade 101

“Cap and Trade” is language often aired regarding the new Climate Change Legislation. House Resolution HR 2454, the American Clean Energy and Security Act of 2009 which passed the house on June 26<sup>th</sup>. It has yet to pass the Senate. Like other recent major bailout bills, there were only a couple hours of debate. No one read the 1428 page bill, and were not even permitted a copy of the completed bill, being withheld even minutes before voting. Like the American Recovery and Reinvestment Act, the new Climate Change legislation has sweeping economic changes. No, I haven’t read it all either, but here’s a bit about Cap and Trade. If you conceptually understand it already, read on anyway.

Cap and Trade is intended to promote clean energy and reduce green house gases, by making the use of coal, natural gas and petroleum expensive. Here’s an Example: You operate coal fired electricity generation. The “Cap” is where you are legally limited to some reference value of carbon you can emit. In HR 2454 you are limited to 97% of green house gases emitted in 2005, to be accomplished by 2012. This drops to 83% by 2020, 58% by 2030 and 17% by 2050. You can apply all the available technology to limit your emissions to previous levels. If that’s not enough then you can “Trade”.

Trade is where you invest in some enterprise that limits carbon output. Planting trees, maybe some agricultural activities, generating electricity with wind or solar or something similar could qualify. If you choose not to actually own those assets, you can purchase carbon credits through something like a stock exchange. The seller doesn’t sell their asset to you, the wind farm, the trees, etc, but a carbon credit which represents the “green-ness” of it, based on the equivalent carbon benefit, which eliminates, sequesters or otherwise controls a quantity of carbon. Potential sellers involved in generation with wind or solar for example then have a small annual revenue stream to help defray their costs. The buyer uses the certificate to satisfy the legislation. Buyer and seller go to the carbon brokers who own the exchanges and companies that set them up to transact.

The London private equity firm, Generation Investment Management (GIM), is such a company with major interests in carbon trading and the international exchanges. GIM was founded by Al Gore, a well known proponent of cap and trade legislation and promoter of the Global Warming message. Co-founders include Henry Paulson, former Treasury secretary and several others from Goldman Sachs.

Further, the legislation allows for the creation of a Carbon Storage Research Corporation, which is a private organization similar to the Federal Reserve Bank, and not a government agency. The corporation receives its “taxes” from electricity generation companies, and disbursements are intended to fund research grants for more carbon control.