

## Tackling carbon legislation: Not if, but when!

Several versions of carbon legislation are currently pending in Congress. While each has its own nuances, most of the proposals center upon some version of a cap and trade scheme. Speakers at a recent Deloitte Center for Energy Solutions forum outlined key considerations in shaping federal carbon legislation, as well as the potential ramifications of passing — or failing to pass — a federal mandate.

### The cost of passage

Carbon reduction is a national economic matter; it is not an industry-specific topic that only relates to energy companies. Accordingly, much of the debate surrounding proposed carbon legislation revolves around its impact upon consumers in the form of higher energy prices. Would a federal carbon reduction mandate be worth the price if it slows U.S. economic growth? How much can energy customers bear?

Speakers widely acknowledged that reducing CO<sub>2</sub> emissions will cost money; however, they proposed that this cost must be weighed against carbon's toll on society, which is currently not being captured. When the hidden costs of greenhouse gas emissions are factored in, the costs of carbon mitigation appear much less severe. They further asserted that, despite different assumptions and baseline numbers, most studies indicate that carbon legislation will not have a significant deleterious effect on the U.S. economy over the long term.

Speakers generally concurred that the economic cost of acting on the problem is likely to be less than the human and economic costs of not addressing it. Indeed, many see federal cap and trade legislation as an "insurance policy" that must be taken out. Even if one doesn't believe that human activity is causing global warming, the consequences of being wrong are too catastrophic to risk.



"Once CO<sub>2</sub> is regulated under the Clean Air Act, EPA will have to consider CO<sub>2</sub> issues in granting permits to build or modify a plant, and the important things to remember are that EPA does not have to pass regulations for this requirement to go into effect and if there is a dispute over the permit, as there is likely to be in many cases over CO<sub>2</sub> technology requirements, you can't proceed with construction until the dispute is resolved in your favor."

**Kenneth Berlin**, Partner, Environmental and Climate Change, Skadden, Arps, Slate, Meagher & Flom LLP

### The implications of inaction

The goal of cap and trade legislation is to put market mechanisms in place to encourage technology investments, which will help move us to a clean energy economy. As one speaker surmised: "It's about applying private capital to address societal issues." Accordingly, speakers reminded the audience that carbon reduction is a high stakes game with economic considerations that cut both ways: Not only must the ramifications of passing a federal mandate be thoroughly evaluated, but also the implications of not passing one.

Speakers emphasized that without federal cap and trade legislation, there would be no price put on CO<sub>2</sub> emissions and, therefore, industry would not have a clear market signal on how to move forward with R&D and capital investments. Advances in alternative energy would also be at risk since the cap and trade bills currently before Congress propose using funds from the sale of carbon allowances to subsidize renewables. Speakers also cautioned that state and regional schemes would likely arise in the absence of federal legislation. This patchwork would be both costly for industry to navigate, as well as be much less effective in achieving carbon reduction goals.

The legal implications, however, truly gripped the audience's attention. If federal cap and trade legislation is not passed, provisions of the Clean Air Act, as administered by the Environmental Protection Agency, will likely come into effect, under which CO<sub>2</sub> will be subject to regulation as a pollutant. Speakers stressed this could have several detrimental economic effects:

- Permitting could stop. As a matter of law, new facilities and plants proposing major modifications would be required to employ the "best available carbon control technologies" in order to get a construction permit; however, no one knows exactly what those technologies are. This uncertainty would likely spark extensive debate, and subsequently litigation, about what constitutes the best available control technology, effectively halting construction until the matter is settled.
- If and when "the best available control technology" is determined, construction costs and risks could soar as companies are forced to deploy infant technologies that have not yet been brought up to scale.

As used in this document, "Deloitte" means Deloitte LLP and its subsidiaries. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

- Wide-scale litigation would be triggered, as the door will be open for public and private groups to sue for damages caused by emissions. While they may be difficult cases for plaintiffs to win, nuisance suits could cost companies millions in legal fees and make it difficult to move forward with capital investments.



“It is important that we establish a transparent value for carbon emissions, but we must avoid placing a disproportionate burden on any one consumer or business segment.”

**Red Caveney**, Senior Vice President,  
Government Affairs, ConocoPhillips

### Key considerations in formulating legislation

Against this backdrop, energy-intensive industries generally favor a national framework on carbon reduction if it does not impose disproportionate burdens on certain sectors or segments of society. The Waxman-Markey Bill, which recently passed in the House of Representatives, does not put carbon caps on the transportation sector, which accounts for 30 percent of the nation’s greenhouse gas emissions. Some speakers argued that omitting transportation from any proposed legislation would greatly reduce its effectiveness in curtailing emissions, as well as unduly shift the cost of carbon reduction to other industries. While opinions differed on how to handle the sector’s contribution to CO<sub>2</sub> emissions, speakers concurred that the CO<sub>2</sub> output of our nation’s vehicles must be addressed in some way, whether by inclusion in a national cap and trade system or by mandate, such as tougher fuel efficiency standards.

Speakers also asserted that legislation must be formulated within the broader context of energy security and the global competition for resources that is likely to occur if world energy demand soars as anticipated over the next several years. To this end, they prefer that cap and trade legislation be comprehensive, incorporating broad provisions for developing all forms of domestic supply. This includes traditional fuels such as oil, gas, coal and nuclear as well as alternatives and renewables. Speakers further stressed that oil and gas will still play a major role in meeting the world’s escalating energy demand for a number of years. Consequently, legislation should avoid policies that cause necessary disinvestment in hydrocarbon-intensive industries, which will need capital in order to meet demand and to stay competitive.



“The U.S. invented the concept of using markets to solve public problems. Get private capital motivated, set up incentives properly, and let the marketplace solve problems that to some extent the marketplace created.”

**Martin Gitlin**, Managing Director,  
Carbon Credits USA,  
Noble Carbon Credits Limited

### The importance of involving developing nations

Despite the many challenges of formulating climate change legislation in the United States, some believe that domestic efforts are merely the tip of an already melting iceberg. The

bigger challenge is: “How do we encourage developing nations to reduce emissions?” Speakers emphasized that the U.S. must get serious about carbon reduction in order to bring China and India on board. Without them, the actions of developed nations could be moot. Notably, speakers felt that the U.S. originated the concept of using markets to solve problems (as it did with SO<sub>x</sub> and NO<sub>x</sub>), but ceded that leadership role in recent years. The United Nations Climate Change Conference to be held in Copenhagen in December 2009 could provide an opportunity for the U.S. to demonstrate leadership in the world’s environmental discussions — which in turn could help secure cooperation from China and other developing nations, as well as to position itself as a technology innovator and exporter in resolving the carbon dilemma.

### The indispensable, but indefinite, role of technology

Reducing carbon emissions will be expensive — particularly in the short term — and it will take time, most likely decades. Speakers did not evade this stark reality. They stressed, however, that it is impossible to calculate costs and time-frames because technology is the wild card. A U.S. carbon market would spur R&D, potentially leading to advancements that could offset costs and accelerate the transition to a new clean energy economy. Speakers reminded the audience that even incremental advancements can sometimes generate dramatic results, as in the case of horizontal drilling technologies. These new capabilities have unlocked an estimated 100+ years of domestic natural gas supply, thus potentially transforming the natural gas sector. This development could assist in achieving much greater energy security in the U.S. and position natural gas, with its clean-burning characteristics, to serve as a vital element of the bridge to a cleaner energy future.



“The investment in technology, and its evolutionary and sometimes revolutionary impact, does release new economic growth and opportunity, and I believe we’re on the cusp of that today.”

**Rebecca Ranich**, Director,  
Federal Energy & Resources,  
Deloitte Consulting LLP

### How about now?

From determining an equitable way to allocate allowances to assessing how to manage the greenhouse gas emissions of the transportation sector, the details surrounding carbon legislation are extraordinarily complex. Nevertheless, many believe that the crux of the matter is easy to grasp: Will carbon legislation be a burden that weighs down the U.S. economy or an engine that powers new markets?

Speakers unequivocally agreed that a federal policy that quantifies the liability of carbon in some way would accelerate — rather than hinder — economic growth by giving companies a stable framework upon which to evaluate potential projects and to attract investment capital. Through their insightful commentary, forum participants answered the “when” in the carbon reduction debate: Now is the time to tackle carbon legislation, and the sooner a thoughtful federal policy is enacted, the better for both U.S. industry and its citizenry.

## Deloitte.

Center for Energy Solutions

### About the Deloitte Center for Energy Solutions

The Deloitte Center for Energy Solutions provides a forum for innovation, thought leadership, groundbreaking research, and industry collaboration to solve the most complex energy challenges.

Through the Center, Deloitte’s Energy & Resources Group leads the debate on critical topics on the minds of executives—from legislative and regulatory policy, to operational efficiency, to sustainable and profitable growth. And we provide complete solutions through a global network of specialists and thought leaders.

With locations in Houston and Washington, D.C., the Deloitte Center for Energy Solutions offers interaction through seminars, roundtables and other forms of engagement, where established and growing companies can come together to learn, discuss and debate.

[www.deloitte.com/energysolutions](http://www.deloitte.com/energysolutions)