

Argus Q&A: Josh Margolis

Josh Margolis is the newly appointed chief executive of CantorCO2e, a global provider of transaction and related services serving clients in green energy and environmental markets. Margolis, who was previously managing director and co-chief executive of CantorCO2e, oversees management of the company's environmental and renewable energy markets worldwide. Since 1985 he has provided emission trading consulting, market development and trading services for states, regulators and industries around the US and for numerous countries. He was appointed by the California Energy Commission to serve on the California Climate Change Advisory Committee, and helped select California air districts unify their air pollution control rules. He has been a member of the Center for Clean Air Policy's Greenhouse Gas Brain, and has advised the Western Governors' Association on the feasibility of using emissions trading to address the Western regional haze and particulate matter problems. In this interview, edited for length and clarity, Margolis talks about the ongoing legislative and regulatory efforts to address greenhouse gas emissions.

Argus: What are the prospects for federal climate legislation this year?

Margolis: A carbon cap-and-trade program is, in my view, a fact that has yet to occur. We will have a cap-and-trade program. There is a decent chance that it happens this year. And there is an excellent chance that it happens before the courts finish working over the tailoring rule. Simply put, a well-designed cap-and-trade program provides the state with the best way to achieve required emission reductions. Yes, we expect a cap-and-trade program will be limited in scope – at least at first. And there is no doubt it will be accompanied by a complimentary arsenal of command-and-control, fee, fuel, transport, land use, supply chain and education mandates. CantorCO2e is closely monitoring developments and advising a large number of our clients about the latest developments on federal climate legislation. At this point, the Senate Democrats' best hope is to insert climate legislation into the Senate oil spill bill they are developing. The strategy forces senators to either support climate provisions or vote against what is expected

to be a popular oil spill bill. The strategy is designed to get wavering moderate Republicans and conservative Democrats to support climate provisions.

We expect any climate provisions to be focused primarily on the electric utility industry. A utility-only cap-and-trade program appears to be gaining momentum with 'fence-sitting' senators. It could be supported by the electric utility industry in exchange for Congressional direction to the Environmental Protection Agency (EPA) to provide greater flexibility to power generators under the agency's recently proposed Clean Air Transport Rule (CATR) for SO₂ and NO_x.

We understand that a last-ditch plan by Democrats may still be under consideration, depending on how things go this month with a combined spill/energy/climate bill in July. That "Hail Mary" maneuver would be to take whatever bill the Senate passes and merge it with the House-passed climate bill of June 2009 during conference committee this fall. Both houses of Congress would vote on it after November elections when the partisan heat is simmering instead of at full boil.

Argus: EPA's proposal to replace the existing Clean Air Interstate Rule (CAIR) with CATR would set tough standards on emissions and limit interstate trading. Could this give Congress impetus to pass legislation that would supersede a proposed rule which would create separate markets in 31 states and the District of Columbia? There appears to be more interest now in a multipollutant bill drawn up by Sens. Tom Carper (D-Delaware) and Lamar Alexander (R-Tennessee) that would still allow the flexibility of interstate trading.

Margolis: Because of EPA's proposal to limit trade across state boundaries and resulting high compliance costs, there is talk of a Congressional "remedy" to EPA's proposed CATR rule. EPA says it has proposed limiting interstate trading under CATR to avoid the legal challenges that led to CAIR being overturned by federal courts in 2008. While a pre-emption of EPA's long-established au-

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thority to set health-based criteria pollutant standards and program management is unlikely, a more flexible approach to interstate SO₂ and NO_x trading could alleviate the legal challenges that led to the federal court overturn. This approach is being discussed as part of a larger deal to pass climate bill provisions. However, many environmental organizations are opposed to intervention by Congress in EPA's rulemaking. On the other hand, as horse-trading intensifies on the federal oil spill-energy-climate bill, a CAIR fix could be inserted as part of the deal making.

Argus: Do you expect EPA to succeed in implementing its "tailoring rule" to cap greenhouse gases in the face of litigation by industry and environmentalists?

Margolis: No, not at the end of the day. A number of very smart legal experts characterize EPA's legal defense of drawing an artificial threshold higher than the Clean Air Act as "weak." Those legal experts expect EPA to lose environmentalist-generated lawsuits trying to force the agency to regulate emission sources as low as 100 short tons/yr. That means, according to EPA's own estimates, over 6mn sources would be required to reduce carbon emissions. If EPA loses its legal challenges, we expect the agency will be required to phase in controls over a period of time until the earlier of two events – all greater than 100st/yr sources are covered or Congress intervenes and imposes a more mainstream, multi-faceted solution that includes a well designed cap-and-trade program. However, we expect that a court ruling that challenges the artificial threshold and expands the control requirements to all greater than 100st sources would have a significant chilling effect on investment, capital, lending and insurance. Financial markets are increasingly concerned about the long-term return on investment in companies that are subject to huge carbon liability caused by a court decision. It could cause a massive shift in capital and investment activity away from companies that have significant carbon liability. A major court loss by EPA could also

send everyone scrambling back to Congress to pass climate legislation.

Argus: What are your views on the initial California Air Resources Board (CARB) proposals for methodologies to adapt for offset projects under a future California compliance system? What looks positive and what is worrying for participants?

Margolis: The good news is that "Mary Credits" are one step closer to reality. Those are credits that are blessed by Mary Nichols, chairwoman of CARB. As soon as this autumn, buyers and sellers will be able to distinguish between compliance ready credits (those approved by Mary Nichols and CARB) and those not quite ready for prime time. It's akin to Mary saying "Gentlemen, start your engines." The concerns? There are two. The first is that the protocol schedule will slip and the October deadline for approval will prove to be illusory. Protocols that arrive with the winter snows will put a chill on otherwise very good projects and their proponents. The second is that CARB may not recognize the value of otherwise high quality out-of-state offsets. It is our hope that the folks in Sacramento will recognize that California can lead the nation by rewarding responsible air quality entrepreneurs with "California Gold Credits."

Argus: CARB has proposed adapting only four of the California Action Reserve's 12 protocols for compliance so far. Do you agree with Gary Gero, the president of the reserve, that all the reserve's methodologies are rigorous and should be adapted for use under AB 32, California's law to reduce greenhouse gases?

Margolis: Yes, for the most part. We believe that there are no better credits than those that bear Gary's stamp of approval. I have every confidence that Mary's staff will take a hard look at these credits, and conclude that they were blessed in accord with methodologies supported by some of the best and most skeptical minds. They are peer reviewed and result from a lengthy and very public process.

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Will CARB want to tweak the existing protocols? Perhaps. But I would be surprised if CARB concludes that the new and improved versions of the protocols yield wildly different results. I think it is highly likely that CARB will use the existing protocols and adjust them only as needed. This approach will save CARB from recreating the wheel and provide companies greater certainty sooner for mapping out their compliance strategy for AB 32.

Argus: Some market participants and Gero expect CARB to seriously consider the concerns expressed at the board's recent workshop about limitations on use of offsets and the extent to which this could make emissions reductions more expensive. Do you think CARB will have to be more flexible here?

Margolis: Yes, I think CARB should be more flexible. Offset quality rather than originating location and methodology should be the deciding factor. CARB should build as many "green on-ramps" as possible to achieve AB 32's goals. CARB has proposed to move forward to convert only four CAR protocols to AB 32 compliance protocols this year. We believe that CARB should move forward with as many CAR protocols as possible this year in order to provide greater regulatory certainty and the lowest possible compliance cost to companies required to reduce greenhouse gases under AB 32. We understand that CARB needs to see California Environmental Quality Act-compliant protocols. The fact that CARB is allowing for out-of state destruction of Ozone Depleting Substances suggests that credits from out-of-state landfill gas control

projects should also gain recognition. It is a fair bet that given the strength of the reserve protocols, the environmental review required for compliance with the state's environmental quality act should be relatively straightforward.

Argus: Are you watching other carbon offset registries, such as the Voluntary Carbon Standard and the American Carbon Registry, or does CantorCO2e prefer to stick to Climate Action Reserve offsets. And do you take a view on which registry's offsets are most likely to be accepted under a federal compliance system?

Margolis: No. We do not pick standards, credit types, or registries. We are advocates of the deal. And we understand, especially in the carbon markets, that each buyer and seller has different needs. We are successful when we close the deal. We are one of the largest and most active brokers in carbon, emissions reduction credits and renewable energy certificate markets worldwide. Every buyer has a reason why they want to buy a specific type of offset, whether it is for compliance or voluntary purposes. Our role is to help our clients achieve their objectives by making sure the right buyers, sellers, credits, and terms are matched and a transaction happens.

We also advise our clients on the potential for various carbon protocol standards that may be included in federal legislation. But ultimately it is our clients' decision as to which offsets they want to buy based upon a variety reasons, including compliance costs, investor demands, branding issues, corporate greening programs, product development opportunities, supply chain challenges, customer interests and retailer demands.

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