

## Argus Q&A: Kyle Danish

*Kyle Danish is a lawyer with the firm Van Ness Feldman in Washington, DC. He advises clients on climate strategy, emissions trading-related transactions and regulation under the Clean Air Act. Danish's clients include electric generators, oil and gas companies, financial institutions, offset providers, and manufacturers. He also provides counsel to the Coalition for Emission Reduction Projects, a coalition of companies that supports offsets as a key component of federal greenhouse gas (GHG) reduction legislation. In this interview, edited for length and clarity, Danish talked to Argus about the draft legislation by Sens. John Kerry (D-Massachusetts) and Joe Lieberman (I-Connecticut).*

**Argus:** What do you think are among the more significant changes in this bill from the preceding Waxman-Markey or Kerry-Boxer bills?

**Danish:** The most significant change is the sector-by-sector approach. The way that the bill regulates the power sector first, starting in 2013, and then brings in manufacturers in 2016 is different. The approach to the transportation sector is also quite different in that refined product producers are going to simply buy allowances to cover their emissions, at a fixed fee, and will not otherwise participate in the trading program. In other ways it's quite similar to the Waxman-Markey bill.

**Argus:** How does the bill's approach on offsets compare with Waxman-Markey?

**Danish:** On the domestic side the bill largely incorporates the framework of the bill introduced last year by Sen. Debbie Stabenow (D-Michigan). On the whole it is a very positive but still rigorous framework for domestic offsets and has a workable set of provisions for early offsets.

On the international side the story is not as good. A number of provisions that made it very difficult to obtain international offsets are still there, and some new provisions make it even more complicated. The headliner on the international side is the stripping away of any pathway to obtain REDD (Reducing Emissions from Deforestation and Forest Degradation in Developing Countries)

offset credits on a project basis – based on the effectiveness of the project in reducing deforestation where the project is located. Instead the only way to obtain REDD offset credits is to demonstrate that your activity contributed to reducing deforestation across an entire nation or maybe a very large state, which can only be done in the context of a national program – the bill establishes detailed requirements for such a national program. The problem is that such programs do not exist now and, for nearly all developing countries, will not be established for many years. As a result, it is very difficult to see where international offsets will come from under this bill. Modeling by the Environmental Protection Agency (EPA), Energy Information Administration and Congressional Budget Office of past bills has shown that international offsets are critical to containing costs. So, this is a troublesome aspect of the Kerry-Lieberman bill.

**Argus:** The REDD program seemed to show progress at the UN talks in Copenhagen last year. Do you not expect those talks to produce results in time?

**Danish:** There has been significant progress in the international discussion on REDD, and an understanding that the international REDD regime will have to develop in phases. Ultimately, we need a program in which credits are provided only for national level reductions in deforestation. But because it will take a number of years to get to these national programs, we need an interim period that will provide credit on a project basis, possibly with some discount for the possibility that deforestation is just shifted to other places. Otherwise there won't be investment in REDD activities for a long time, with a lot of deforestation during that period. That system was in place in Waxman-Markey and in the Kerry-Boxer bill. There was an ability to earn project-based credits for a period of eight years in all but the very largest countries, such as Brazil and Indonesia. That bridge phase was omitted from the Kerry-Lieberman bill.

**Argus:** Is there also a shift away from project-based credits for other international offsets?

*Continued on p2*

ARGUS US CARBON | Policy, Technology & Markets

For subscription inquiries, contact Ashli George at 202-349-2867 or [ashli.george@argusmedia.com](mailto:ashli.george@argusmedia.com)

# Kyle Danish

*Continued from p1*

**Danish:** There has been an emphasis in each of the bills on transitioning developed countries that are major economies to “sectoral” limits. Each bill has a process by which EPA and the State Department are to identify sectors and countries that, because of their relatively stronger economies, should have sectoral limits. There are other provisions that allow project-based crediting, including through the Clean Development Mechanism or its successor. There is also a requirement that, starting on a particular date, you can no longer use project-based credits from the countries and sectors identified as appropriate for sectoral limits. The problem that has not been fixed in Kerry-Lieberman is that the phase-out date, 1 January, 2016, is precipitous. We are unlikely to have finalized sectoral limits with these key countries by 2016, much less have operational trading programs with them. There is a real risk that we would have a sharp drop in the supply of international offset credits starting in 2016. If you couple that provision with the omission of a pathway for REDD project-based credits, there is a real question about the supply of international offset credits. Prior EPA modeling assumed nearly 1bn international offsets being used in the program in 2020, but it’s hard to know where they will come from under these rules. You have to keep in mind that from 2018 international offsets are subject to a 20pc penalty on use; you have to turn in five for every four tonnes. So these become a diminished credit starting in 2018.

**Argus:** Will the bill’s limits on participation in allowance trading make compliance more expensive?

**Danish:** That is a real risk. Under the market oversight rules in the bill, only allowance-surrendering entities and certain other entities approved by the Commodity Futures Trading Commission (CFTC) can participate in the market. The CFTC can open the market to these other entities only for the purpose of promoting liquidity. But there’s a lot of uncertainty about how that process will work, how many entities will come in. Some power com-

panies and manufacturers have trading desks, but many don’t and could benefit from having entities in the market that are just there to find allowances and offset credits in significant numbers and make them available for delivery. You will have a much more cumbersome market if you don’t have those. I saw those provisions as a placeholder and an invitation for discussion. They may be there in part because we don’t yet have financial regulatory reform legislation. But once that is passed we might be able to argue we have a sufficiently regulated marketplace for any kind of commodity – that we should feel comfortable allowing all participants into the market. Unfortunately, policymakers have not heard enough about how well the Acid Rain market has worked. That experience has to come forward a little more.

**Argus:** What comparisons can be drawn from the Acid Rain market, even though it is considerably smaller than what would be created by federal legislation?

**Danish:** The size difference cuts both ways. The Acid Rain program is a smaller market so you could argue that it has been less vulnerable to major systemic risks. But if we expect the carbon market to be a lot larger and to have many more offsets, there is a good argument for having a broader group of participants. Most power companies are not necessarily going to be well positioned to locate a million tonnes worth of offset credits from disparate agriculture, forestry and other projects distributed around the world. It will be much easier for that company to stick to its business and rely on other entities to aggregate and efficiently deliver those credits to the company.

**Argus:** What are the potential implications of the bill’s market language for offsets?

**Danish:** The bill creates a whole set of market disciplines for something called “greenhouse gas instruments,” which are

*Continued on p3*

	<p><b>Argus US Carbon is published by Argus Media Ltd</b></p>	<p><b>Moscow office:</b> 12-1 Krivokolennyi pereulok, floor 5, Moscow, Russia 101990 Tel: +7 495 933 75 71 Fax: +7 495 933 75 72</p>
<p><b>Main offices:</b>  <b>London</b> (head office): Argus House, 175 St John St, London EC1V 4LW          Tel: +44 20 7780 4200 Fax: +44 20 7780 4201          email: agm@argusmedia.com — email: sales@argusmedia.com  <b>Houston office:</b> 3040 Post Oak Blvd, Suite 550, Houston, TX 77056          Tel: +1 713 968 0000 Fax: +1 713 622 2991  <b>Washington office:</b> 1012 Fourteenth Street NW, Suite 1500,          Washington, DC 20005          Tel: +1 202 775 0240 Fax: +1 202 872 8045  <b>Singapore office:</b> 22 Malacca Street, #10-02 Royal Brothers Building, Singapore          048980          Tel: +65 6496 9966 Fax: +65 6533 4181</p>		<p><b>Publisher:</b> Adrian Binks  <b>CEO Americas:</b> Euan Craik  <b>Business development:</b> Daniel Massey, Miles Weigel, Caroline Gentry  <b>Bureau chief:</b> Ross Allen  <b>Argus US Carbon Editor:</b> Mike Ball  <b>Production editors:</b> Andrew Sutton, Daniel Wackerow</p>
<p><b>Sales and marketing</b>          Chris Bozell, Peter Brown, Charles Davis, Karen Johnson, Ashli Matus George,          Umer Qureshi, Susan Teves, Howard Walper, Tammy Tiedt, Christina Vassil</p>		<p>Reproduction, scanning into an electronic retrieval system or copying to a          database is strictly prohibited without the written permission of the publisher.          All rights reserved (ISSN 1942-387X). Copyright © 2010 Argus Media Ltd</p>

## Kyle Danish

*Continued from p2*

defined as allowances and any other type of instrument that EPA thinks ought to be a greenhouse gas instrument. It could include offsets. The issue is that “greenhouse gas instruments” can only be traded on exchanges and are subjected to requirements for clearing, which means anyone buying or selling such an instrument will have to post margin and work through a clearinghouse. Those requirements are probably fine for allowances or maybe for offset credits already issued and in somebody’s account.

However, transactions in which you’re buying potential future offset credits from a particular project or projects are a different story. That type of transaction is very difficult to standardize and offer on an exchange because it has contingent circumstances that are difficult to package into a standard product. They have to go through a regulatory process; it involves the performance of a particular project. So standardizing them is very hard. For the same reason they are difficult to clear. A clearinghouse will have a difficult time determining the universe of risks associated with particular types of projects that have to go through a regulatory process. This is also a problem that extends to what types of entities can participate in the market. At some point you need someone involved with the offset project to be able to bring the credits to market, and under the system in the bill, you might have to wait for a series of rulemakings to determine what group of market makers can participate in the emissions trading market.

That kind of uncertainty could discourage investment in offset

projects because you wouldn’t know who is going to bring these things to market and how. I realize I’m painting a somewhat dire picture, but an educational process needs to occur. It’s not clear that the drafters of these provisions understand this particular type of transaction and why it may not be workable under these types of restrictions.

**Argus:** What are you looking for to tell you the bill may come up for a vote this year? What role will the upcoming vote on Sen. Lisa Murkowski’s (R-Alaska) disapproval resolution play?

**Danish:** I would watch closely the theater around the Murkowski resolution. That could force some senators go on the record about what they think should happen on GHG regulation. They’re going to have to confront the questions of whether Congress should create a regulatory program and, if so, when. That being said there is still a relatively low probability of enactment of Kerry-Lieberman or any other climate change legislation this summer for reasons that include the economy, the pressures of mid-term elections and this program’s complexity.

But this is a very good bill for most companies affected by GHG regulation, whether on the risk side or the opportunity side. Most people still believe that this kind of program is more workable and efficient than regulation under the Clean Air Act. And while there is some unfinished business in this bill, it’s pretty positive on the development of a viable, effective carbon market. We might not see a better deal than this next year. It seems to me that it is worthwhile to do what we can to improve it.

### ARGUS US CARBON | Policy, Technology & Markets

Get better information – not just more. Gain access to regional market coverage, exclusive commentary from industry leaders, and analysis of emerging carbon policy.

For a free trial subscription, call 713.968.0000 or contact [sales@argusmedia.com](mailto:sales@argusmedia.com). Visit Argus US Carbon online at [www.arguscarbon.com](http://www.arguscarbon.com).