Written Testimony of
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Before

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Oversight: Environmental Protection Agency's Clean Air Regulations – One Year after the CAIR and CAMR Federal Court Decisions

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Good morning Chairman Carper, Ranking Member Vitter and good morning to the distinguished members of this committee. I appreciate the opportunity to appear before you and discuss the implications and impacts of the recent court decisions upon the emission trading markets. My name is Gary R Hart and I represent ICAP brokerage as a market analyst. Prior to my affiliation with ICAP, I spent 28 years with Southern Company and retired as their Manager of Emissions Trading in late 2006. In that capacity I managed a system wide bank of emission allowance holdings valued at over $4 billion.

I helped found the trade association known as the Environmental Markets Association and I was also part of a US EPA delegation to Beijing in late 1999 to instruct the Chinese academia and government on how to implement a cap and trade program. I speak frequently on the use of market based programs to many diverse groups and have been quoted in publications such as the Wall Street Journal, Fortune and most recently in the Washington Post on May 26 regarding the Waxman-Markey bill.

Emissions trading, a unique success story

I have been very fortunate to watch cap and trade grow from a theory or concept included in the 1990 Amendments to the Clean Air Act into a fully functioning policy tool providing real environmental benefits to our citizens. Even groups such as the Environmental Defense Fund, published a pamphlet in September of 2000 titled "From Obstacle to Opportunity - How Acid Rain Emissions Trading is Delivering Cleaner Air." In my opinion, as compared to command and control, market based solutions such as cap and trade offer the following positive advantages:

- It allows compliance options or flexibility
- It creates incentives to over-comply and to sell excess allowances back into the market.
- It establishes a market price to include in the unit dispatch equation thus forcing cleaner units to run first and at greater capacity factors.

- "Forces" the economic allocation of capital dollars to the units with the lowest $/ton removal costs

2008 Federal Court Decisions and the Emission Markets

In March of 2005, the EPA promulgated the CAIR and CAMR rules. From the regulated entity perspective, thousands of man-hours were expended in developing long-term compliance strategies. Complex computer models were used to balance the cost of installing technology against the cost of relying upon the allowance markets to reach a least cost compliance strategy.

In many cases, it was determined that the needed technologies could not be installed in time, and hence decisions were made to purchase emission allowances for future compliance purposes. With the court vacating the CAIR rule, we now find ourselves in a market where there is massive uncertainty as to the future viability of the SO2 and NOx markets and this is coupled with massive holdings of emission allowances that were purchased in anticipation of a two for one surrender ratio beginning in 2010 for SO2 compliance.

In theory, the SO2 and NOx allowance market equilibrium prices should represent the next incremental cost to install control equipment (scrubbers or scr's) on a unit and are expressed in dollar per ton removal costs. Currently, this 20 year "levelized" cost for an SO2 scrubber is estimated to be in the $750 to $ 900 per ton range yet due to these "other factors" the SO2 market is trading at below $100 per ton. This same equilibrium cost for annual NOx has been estimated to be in excess of $2,000 per ton for NOx removal yet current annual NOx allowances are trading at approximately $1,100.

Uncertainty in the Marketplace

"Wait and see" seems to be the prevailing attitude in these markets. This is further reinforced by an article in the April 1st issue of Air Daily where Sam Napolitano, the director of the Clean Air Markets Division at EPA was quoted as follows: "*While no inferences should be made from last week's letter, I am urging "buyer beware". Probably the trading of allowances in the next two years is on good ground, but after that the ground is not so good to be standing on"*. The results of the annual 2009 EPA SO2 allowance auction also points to a real lack of confidence in these markets due primarily to the court decisions. 2009 vintage SO2 allowances sold at an average price of only $69.74 and future vintage allowance sold for only $6.65 (an all time low price). In many of my presentations, I refer to July 11, 2008 as "Black Friday" for the emissions markets. SO2 prices fell from $314 dollars on the morning of July 11th to close at $115 and Annual NOx prices fell from $4,850 per ton that morning to $1,150 per our records at ICAP.

Conclusions

Cap and trade programs establish by Congress and by the EPA to deal with SO2 and NOx emissions have truly been an environmental success story (see attachment 1). Unfortunately, it appears that the EPA has been "painted into a corner" and can only respond to the Court with some type of command and control regime. There was a great deal of effort put forth in late 2008, to attempt to give the CAIR rule legislative authority. I would encourage members of the committee to again consider such a focused technical legal fix to the CAIR rule to restore much needed confidence in these markets.

I wish to thank the distinguished members of this committee for holding this hearing and allowing me to share my views on this most important matter with you.