**TESTIMONY BEFORE THE**

**UNITED STATES SENATE**

**COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS**

**"Examining Global Warming Issues in the Power Plant Sector"**

**THURSDAY, JUNE 28, 2007**

**By: Thomas J. Borelli Ph.D.**
**Portfolio Manager**
**Free Enterprise Action Fund**
**173 Oakland Avenue**
**Eastchester, NY 10709**

We thank the Members of the Committee on Environment and Public Works for inviting me to provide this testimony today.

I am Tom Borelli, a portfolio manager for the Free Enterprise Action Fund (ticker FEAOX) a publicly traded mutual fund. Our fund seeks to increase our returns by advancing free market principles in the companies we own. To meet our financial goals and the free market values of our shareholders, we frequently challenge CEO decisions that may harm the company's long-term profitability.

All too often, today's CEOs make decisions based on appeasing social and political pressure or by trying to generate revenue through legislation that favor their company. In our view, these strategies are shortsighted because they stymie competition, innovation and jeopardize future earnings.

For these very reasons, we strongly oppose cap and trade legislation and company participation in the United States Climate Action Partnership (USCAP). Accordingly, we are in opposition to legislation that sets carbon dioxide limits and allocations for the utility industry.

While the science implicating human activity on global warming is uncertain and speculative, the economic costs of cap and trade legislation are certain and severe. We are deeply concerned about the affect of cap and trade on both the U.S. economy and on the future profitability of the companies in our portfolio – including PG&E and Duke Energy.

Some CEOs support cap and trade because they believe they can ride the waves of public opinion and game the political process to obtain government subsidies and greater carbon allocations. Others support cap and trade because they think its good public relations.

However, jumping on the global warming bandwagon to be liked or chase transient and uncertain gifts from Congress does not constitute a sound business plan.

Moreover, by pursuing these ill-conceived strategies, CEOs are overlooking their primary responsibility to their shareholders.

The Free Enterprise Action Fund is the only mutual fund that is using its shareholder standing to demand a debate about global warming in the boardroom. We have challenged numerous corporations – including those in the utility industry – to justify their support of carbon dioxide regulations.

For example, we have written to utility companies including PG&E asking them to justify their support of carbon dioxide emission limits and to estimate the increase in energy costs to consumers. Their response has been superficial, dismissive and did not disclose an estimated rate increase to consumers.

However, our advocacy efforts beyond the utility industry are more illuminating. Through our interactions with the CEOs of some of the largest companies in America, we have shockingly discovered that they have not evaluated or disclosed the severe economic consequences of cap and trade legislation to their customers or shareholders.

By neglecting to conduct proper due-diligence regarding the impact of carbon dioxide regulations to their business, these CEOs are deceiving their shareholders. Such deception and negligence potentially exposes these companies to consumer dissatisfaction, lower earnings and possibly shareholder lawsuits.

Specifically, companies are negligent because they are:

- Refusing to consider alternative views on the science
- Refusing to conduct basic cost-benefit analysis of the regulatory scenarios like cap and trade on their business
- Failing to disclose the consequences of cap and trade legislation to their shareholders
- Failing to disclose that pursing cap and trade regulations may harm its customers and shareholders

Many CEOs are ignoring government studies that estimate the economic impact of cap and trade. For example, during the Clinton administration the Energy Information Agency found under the best scenario, cap and trade will:

- Raise gasoline prices by nearly 53 percent
- Raise energy prices by more than 86 percent
- Reduce economic growth by 1.9 percent, which is $256 billion of 2006 GDP
- Reduce economic activity across most industries including the construction, manufacturing, transportation and finance industries
- Raise interest rates because higher energy prices will exert upward pressure on overall prices and contribute to inflation

More recently, the Congressional Budget Office (CBO) report on Cap and Trade concluded:

"… most of the cost of meeting a cap on CO2 emissions would be borne by consumers, who would face persistently higher prices for products such as electricity and gasoline. Those price increases would be regressive in that poorer households would bear a larger burden relative to their income than wealthier households would."

Given the severe impact on energy prices and overall economic growth, CEOs should be very worried about cap and trade legislation. Unfortunately, we found through our questions at annual shareholder meetings that CEOs are detached from the economic reality of cap and trade. For example:

**GE's CEO** Jeff Immelt refuses to have GE report to its shareholders regarding the cost and benefits of the company's support of global warming regulations. Moreover, he claimed he could grow GE's earnings even if cap and trade legislation caused a decline of GDP of 2 percent. Followers of GE's stock will recognize that the company's share price has underperformed the stock market under good economic conditions.

**JPMorgan's CEO** Jamie Dimon was unaware of the economic impact of cap and trade but said he would not support regulations that would harm his company's earnings. Yet the company's environmental policy states they are going to lead an effort to lobby for a national policy on global warming.

**Citi's CEO** Chuck Prince was also unaware of the economic impact of cap and trade but he felt the economic pain resulting from global warming regulations is worth the environmental gain. Citi supports a national policy to reduce greenhouse gas emissions but its funding of new coal power plants is the subject of criticism by environmental activists.

**Caterpillar's CEO** James Owens admitted he did not conduct a cost-benefit analysis of cap and trade before deciding to join USCAP. In addition, he was not aware of the CBO study that found cap and trade regulations would hurt his coal industry customers.

This CEO survey illustrates a complete ignorance about the consequences of global warming regulations on the economy and their businesses.

Caterpillar's participation in USCAP is a perfect illustration of CEO incompetence and deception surrounding cap and trade legislation. Caterpillar's future profit depends on a growing economy and growth in the energy and mining industries. In fact, according to its 10-K filing with the Security and Exchange Commission (SEC), it cites a decline in the economic growth and a decline in the mining industry as a key risk to its business.

Yet inexplicably, Mr. Owens is a member of USCAP, which supports cap and trade regulations that are going to harm the economy and the coal business – a key customer for Caterpillar products. Astonishingly, CEO Owens is lobbying against his own earnings!

Not only is Owens harming his company, he is keeping his shareholders in the dark. Nowhere does Caterpillar disclose to its shareholders that its support of cap and trade can potentially lead to a decline in its business.

Similarly, DuPont is another member of USCAP who may be lobbying against its own earnings. DuPont's 10-K filing repeatedly warns its shareholders about the negative impact of high-energy prices on its business. Yet according to government studies, cap and trade will increase energy prices. Again, nowhere can shareholders find any disclosure from DuPont that its involvement in cap and trade regulations is a potential business risk.

From the perspective of a portfolio manager, I am extremely concerned about the economic impact of cap and trade legislation on the economy and our portfolio. Growth of the stock market depends on a cheap and plentiful energy supply to feed a thriving economy. Capping energy is capping economic growth.

More concerning is the myopic view of CEOs who only talk about the so-called benefits of addressing global warming but are totally unaware of the ramifications of carbon caps on the U.S. economy.

What little gain a few companies may obtain from cap and trade must be balanced against the overall affect the legislation will have on the economy. Ironically, a few companies may win the battle for cap and trade but loose the war for earnings because of an economic downturn.

This matter brings to mind the saying attributed to socialists Karl Marx and Vladimir Lenin: the last capitalist we hang shall be the one who sold us the rope. Companies supporting cap and trade are not only selling the rope, they are building the scaffold.