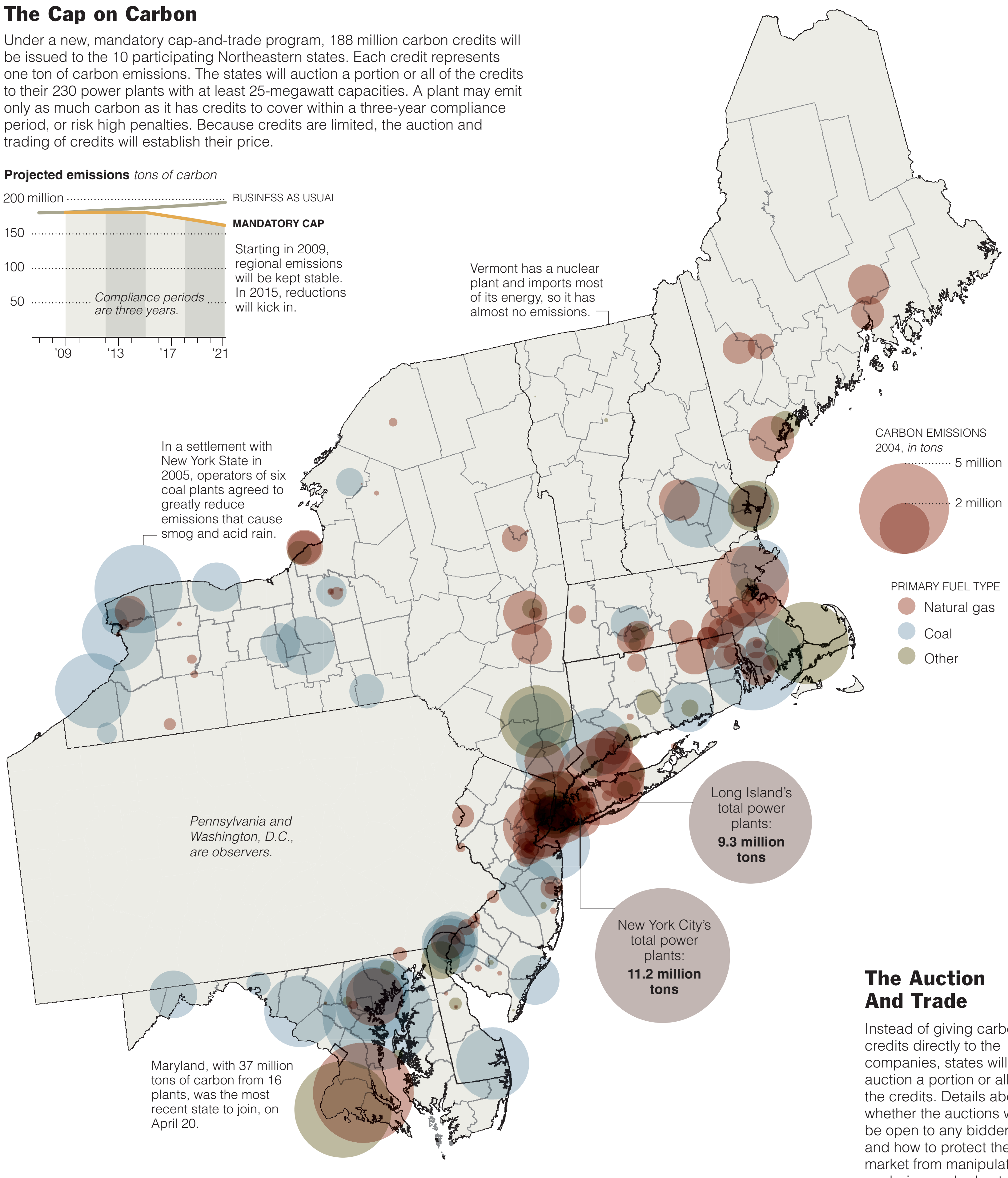
The Cap on Carbon

Under a new, mandatory cap-and-trade program, 188 million carbon credits will be issued to the 10 participating Northeastern states. Each credit represents one ton of carbon emissions. The states will auction a portion or all of the credits to their 230 power plants with at least 25-megawatt capacities. A plant may emit only as much carbon as it has credits to cover within a three-year compliance period, or risk high penalties. Because credits are limited, the auction and trading of credits will establish their price.



When Carbon Is Currency

By HANNAH FAIRFIELD

AMID steadily increasing carbon emissions, and a federal government hesitant to take the lead on climate legislation, 10 states have joined to create the first mandatory carbon cap-and-trade program in the United States. They aim to reduce emissions from power plants by 10 percent in 10 years.

Leaders of state environmental and energy regulatory agencies hammered out the detailed model for the program, the Regional Greenhouse Gas Initiative, over the course of three years. The program sets a cap on the total amount of carbon that the 10 states — as a whole — can emit. Starting in 2009, each state will receive a set amount of carbon credits for its power plants, and each plant must have enough allowances to cover its total emissions at the end of three-year compliance periods.

In 2003, George E. Pataki, then New York's governor, invited governors of 10 other states from Maine to Maryland to discuss a program to cut power plant emissions. All but one of the states joined the program; Pennsylvania has observer status.

Officials have closely watched the European Union, which started its carbon trading market in 2005; analysts say the Europeans have stumbled on some fronts. "We've learned a lot from the Europeans," said Judith Enck, adviser on environment issues to Gov. Eliot Spitzer of New York. "The way we distribute the allowances will be vastly different than the European experience."

To build a carbon market, its originators must create a currency of carbon credits that participants can trade. In Europe, power companies received these credits directly and could buy or sell from one another as needed. But most companies passed the cost of the credits on to consumers even though they received them free — giving the companies windfall profits. Power companies in Britain alone made about $1 billion from free credits in 2005, according to a study by the British government.

Participants in the United States want to avoid that problem by selling some or all of the credits at auction, with the proceeds going to state energy efficiency programs.

In Europe, power companies were not the only businesses to profit from the new carbon market. Because power plants there can use credits earned from offset projects that take greenhouse gases out of the atmosphere (or put less of them into it), businesses wanting to earn offset credits inundated the Europeans with proposals — many of which would have a negligible effect on emissions or were for reductions that would have taken place anyway.

To sidestep that problem, the program here limits offsets to five categories: capture of landfill gas, curbs on sulfur hexafluoride leaks, planting of trees, reductions in methane from manure, and increased energy efficiency in buildings. Power companies can offset 3.3 percent of a plant's total emissions from any combination of the five categories.

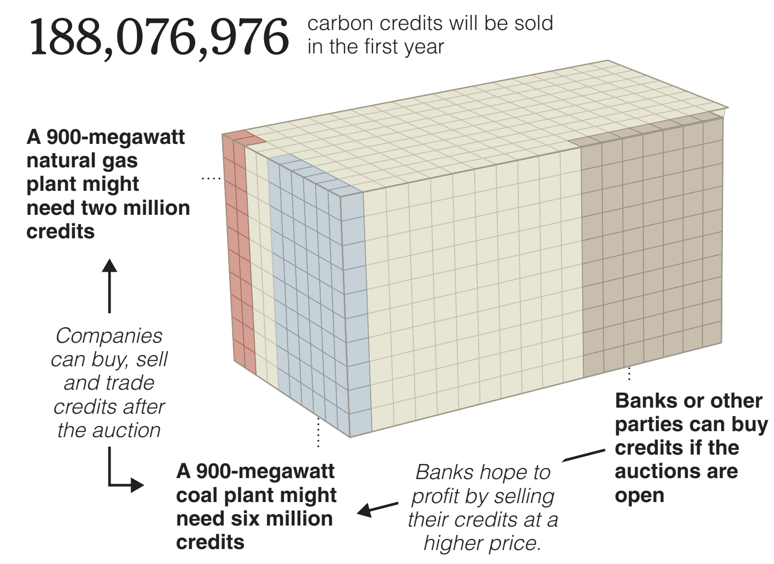
"We saw what happened in Europe, so we limited the categories and set our criteria upfront," said Christopher Sherry, chairman of the regional program's staff working group and a research scientist at the New Jersey Department of Environmental Protection. "We did that so we would have assurance that the reductions actually take place."

Although Northeastern states have taken the lead in inaugurating a mandatory carbon market, California and some of its neighbors are not far behind. Those states are watching closely; Mr. Sherry and others involved in the 10-state effort are already helping California figure out how best to accomplish its climate plan.

"The idea is to see what everyone else has done, and learn from it," said Dale Bryk, a lawyer at the Natural Resources Defense Council who has been involved with the Northeastern regional program and California's advisory committee. "Let's not start from scratch." □

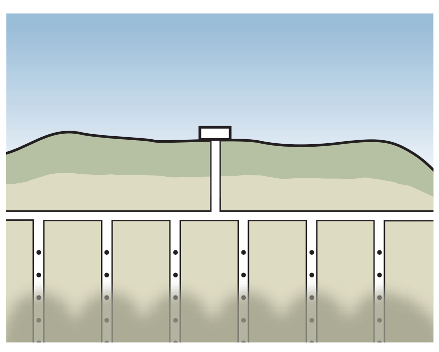
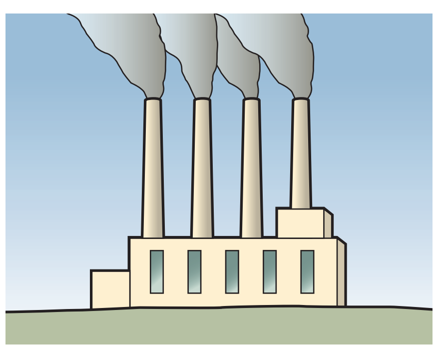
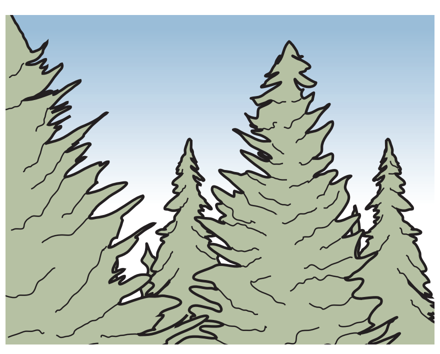
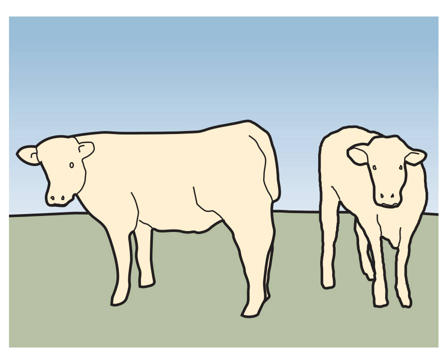
The Auction And Trade

Instead of giving carbon credits directly to the companies, states will auction a portion or all of the credits. Details about whether the auctions will be open to any bidders, and how to protect the market from manipulation, are being worked out.



Beyond the Cap: Offsets

Up to half of the program's carbon reductions may come from offsets, which swap emissions at the power plant for projects that reduce greenhouse gases elsewhere. Critics of offsets say that in the popular push to use offsets to be "carbon neutral," many proposed projects do not create real reductions. Designers of the program offered only five ways that power plants can count offsets as carbon credits, and they have spelled out the requirements in great detail. Several dozen proposals for offset projects have been submitted so far.


	Capturing landfill gas	Reducing SF_6 leaks	Planting forests	Managing manure	Making buildings energy-efficient
CLIMATE IMPACT	Methane's global-warming potential is rated 23, meaning that one ton has the same effect as 23 tons of carbon dioxide.	Sulfur hexafluoride has a global warming potential of 22,200, the highest of all greenhouse gases.	Trees take carbon dioxide out of the air during photosynthesis.	Livestock waste, on farms where manure is stored in pits or lagoons, is a large source of methane emissions.	Energy consumption in many buildings can be cut by 40 percent.
HOW TO ACHIEVE IT	Landfill gas can be collected from vertical wells in the landfill and then burned, which converts the methane to carbon dioxide, greatly reducing its greenhouse-gas potency.	SF_6 is an insulator for circuit breakers and other equipment in power plants. Leaking seals and joints can be fixed, and the gas needs to be contained while equipment is installed or serviced.	New forests must be planted with local species. The land must be preserved so that there is no danger that the the trees will be cut down decades later.	Methane from animal manure can be captured and burned to produce electricity and heat.	Owners can improve heating and cooling systems, upgrade hot water systems and switch to high-efficiency lights.

Sources: Regional Greenhouse Gas Initiative; World Resources Institute; Natural Resources Defense Council; M. J. Bradley & Associates

Hannah Fairfield/The New York Times; illustrations by Al Granberg

Arbitration

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and not mandatory."

Because Wall Street firms force arbitration on their clients, you might expect them to fight the idea of investor choice in litigation. But Lewis D. Lowenfels, a securities law expert at Tolins & Lowenfels in New York, said arbitration has lost some of its appeal to big firms. Punitive damages, for instance, were long barred in arbitration, but a 1995 court decision changed that. And while plaintiffs in arbitration have virtually no limit to the claims they can bring, in court, many of those claims would not be allowed in court.

"Imaginative general counsels at these firms might sit down and say, 'This may not be so bad,' " Mr. Lowenfels said.

Should Mr. Leahy and Mr. Feingold hold hearings on mandatory arbitration, they may want to call Mabel Strobel, 86, as a witness. Ms. Strobel sued **Morgan Stanley,** her former brokerage firm, in 2002 after she lost $281,729. Although she "won" her case in 2004, her $5,000 damage award paled next to the $10,350 she was ordered to pay in arbitration fees. And that was on top of the $281,729 she lost.

Hearing from the arbitrators on the case would also be instructive. They are Paul J. Sipe, founder of two San Diego banks; Robert B. Hansohm, a former Los Angeles Police Department official; and Nils S. Sandberg, an investment adviser.

In a nutshell, Ms. Strobel's broker persuaded her to sell an investment property and buy volatile stocks and mutual fund shares with heavy sales charges. Morgan Stanley did not dispute the amount of Ms. Strobel's losses, but said she was a savvy and risk-taking investor with a 10-year time horizon for her investments, even though she was 79 when she opened her account.

After an arbitration panel found Morgan Stanley liable for Ms. Strobel's losses, Jeffrey P. Lendrum, her lawyer, filed a motion in federal court to vacate the ruling. Last November, Roger T. Benitez, a federal district court judge in California, ordered the arbitration panel to "make a proper damage award" in the Strobel case. The arbitrators were "in manifest disregard of the law with respect to damages," the judge concluded, adding that if it could, the court would award Ms. Strobel all the money she lost.

Morgan Stanley moved to stay the order and appealed it. On April 9, Judge Benitez rejected the motion and ordered the arbitrators to issue an appropriate award within 30 days or be subject to civil contempt.

Last Monday, the panelists declined to follow the judge's order. In a letter to the NASD, Mr. Sipe, the panel's chairman, said even though it found Morgan Stanley liable, the panel had concluded that Ms. Strobel's broker did not cause her losses and that the investments were suitable for her. The panel "provided a fair and equitable assessment of this case," Mr. Sipe wrote.

Neither Mr. Sipe nor Mr. Hansohm could not be reached; Mr. Sandberg did not return a call. A Morgan Stanley spokeswoman said: "This was a fair and complete arbitration process and the ruling speaks for itself."

Mr. Lendrum, Ms. Strobel's lawyer, said he would seek to hold the arbitrators in contempt for failing to follow the judge's orders. He expects Judge Benitez to rule soon. "When we reach a point where arbitrators believe that they are not bound by the law, or worse yet by judicial orders, the mandatory arbitration that customers unknowingly agree to when opening a new brokerage account must be abandoned," he said.

The two senators have similar worries. "No consumer should be obligated to forfeit their right to a day in court," Mr. Leahy said in a statement. "I hope the S.E.C. will take these concerns seriously and will act to protect consumers."

We'll see how the S.E.C. — the investor's advocate — responds. □