

The State of U . S . Climate Legislation

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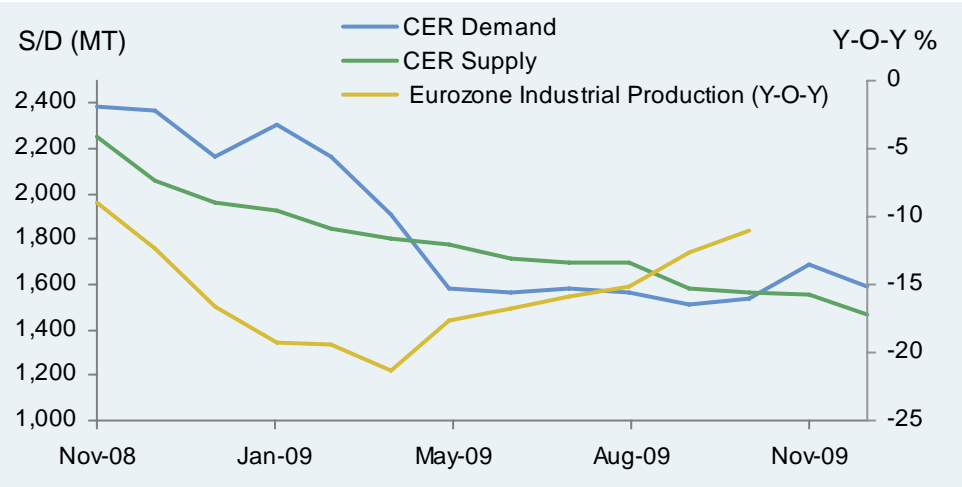
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# 2009 EU ETS market activity

## CER Supply & Demand against European Industrial Production

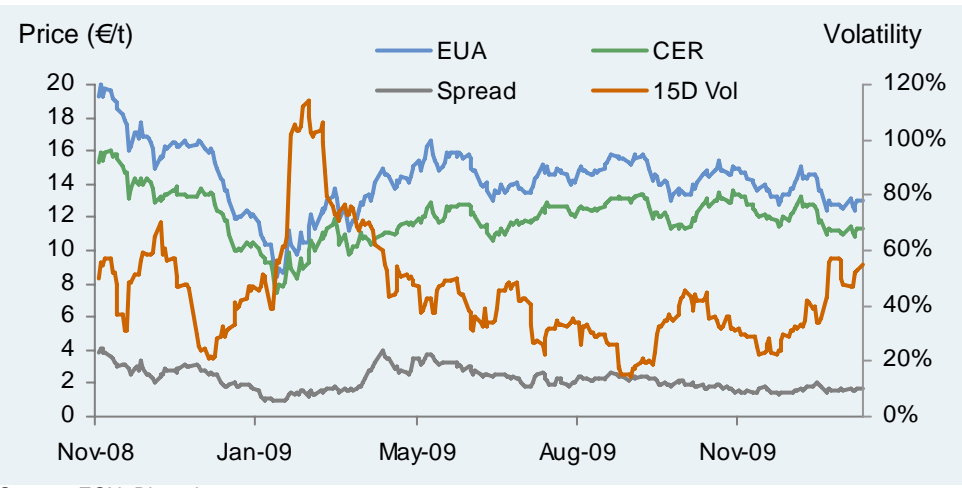


Source: ECX, Bloomberg

## Comments

- European industrial output has been growing since April 2009
- Emissions market has contracted
- Demand has dropped...
- ...but so has supply
- Liquidity has waned but the market has not collapsed - largely because of Phase III banking
  - Industrials were not seen selling in Q4 09 suggesting they are being cautious and retaining credits for Phase III

## Dec 10 EUA Vs CER (€/t) with Spread (€/t) and 15D Volatility (%)

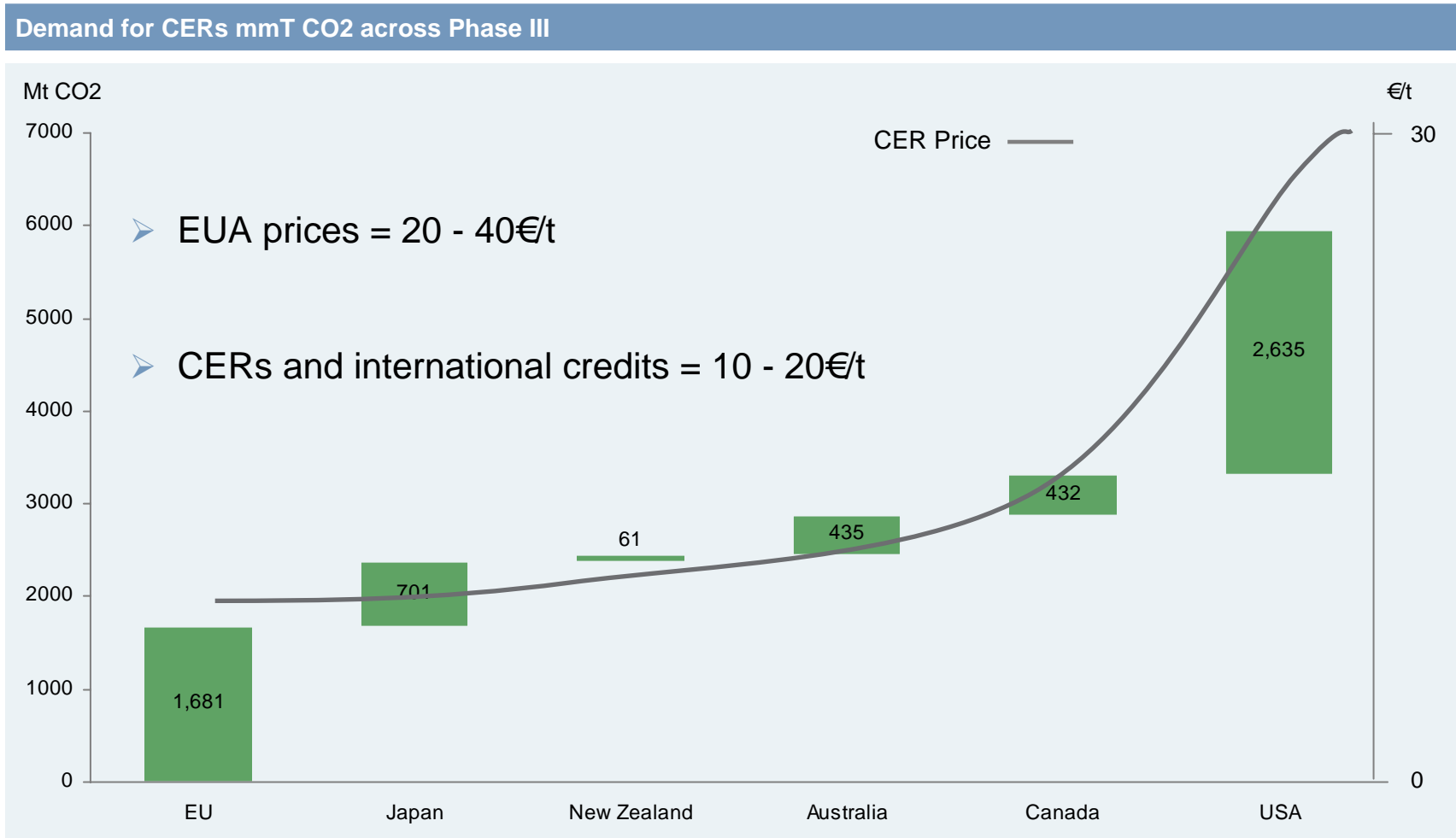


Source: ECX, Bloomberg

## Comments

- EUA and CER correlation has increased
- Compliance arbitrage has compressed
- Market flatlines post-recession
- Volatility peaked in early 2009
- Volatility is largely correlated with deflated prices
- Deflated confidence and pricing post Copenhagen

# Phase III price summary assuming an international agreement



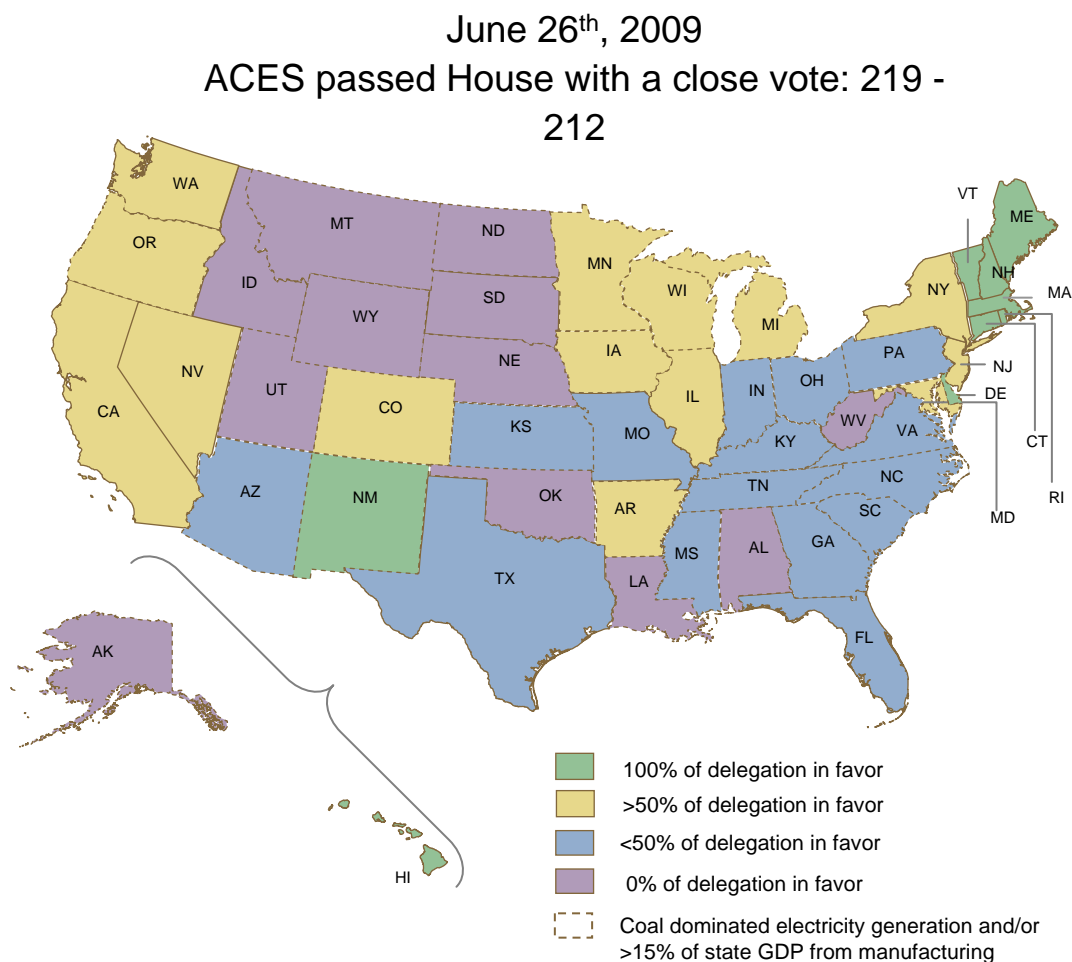
Source: New Energy Finance, J.P.Morgan

# US climate change policy formation has moved into the Senate

## Key policy developments in 2009/2010

- House: Passed American Clean Energy and Security Act (“ACES” or “Waxman/Markey”), June 26, 2009
- Senate: Not expected to address climate change legislation until spring, 2010
  - 60 votes needed to pass legislation
  - Key issue is to soften economic impact (e.g., job loss in coal/manufacturing states, energy price increases)
- Environment and Public Works committee passed the “Clean Energy Jobs and American Power Act” (November 5, 2009)
  - Contentious 11-1 procedural vote
  - Passed out of committee without amendments
- Stabenow introduced the “Clean Energy Partnerships Act of 2009” (November 6, 2009)
  - Contains extensive list of offset projects/categories
- Kerry working on compromise bill with Lieberman, Graham and the White House to secure votes for a climate bill
- EPA published its finding that current and projected concentrations of six GHGs threaten the public health and welfare of current and future generations (December 15, 2009)
  - Possible avenue to develop cap-and-trade for GHGs under existing Clean Air Act

## Overlay of US House votes for ACES and states with significant coal and manufacturing activity



Source: EPA, Bureau of Economic Analysis, J.P. Morgan analysis

# Timing: expect policy-driven volatility in the formation of a US market

