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## Carbon Allowances: A New Way of Seeing an Invisible Asset

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# CARBON ALLOWANCES: A NEW WAY OF SEEING AN INVISIBLE ASSET

*Rachel Feinberg Harrison\**

## I. INTRODUCTION

ON September 25, 2008, the United States held its first carbon allowance auction.<sup>1</sup> The Regional Greenhouse Gas Initiative (RGGI) developed the auction in New York, one of its member states, and it was overseen by Potomac Economics, RGGI's independent market monitor.<sup>2</sup> In this auction, all of the allowances offered for sale were sold, totaling 12,565,387 allowances at a price of \$3.07, each raising almost \$38.6 million for the states involved.<sup>3</sup> The success of the second auction, held on December 17, 2008, surpassed those levels, selling 31,505,898 allowances at a price of \$3.38 per allowance.<sup>4</sup> This auction raised about \$106.5 million for the growing number of member states.<sup>5</sup> The chair noted that

The RGGI auctions continue to be the place where market participants come to buy the allowances they need . . . . Once again the results prove that distributing allowances via auctions in a carbon dioxide cap and trade program can be successful. We look forward to developing a partnership with the Obama Administration to create a strong federal climate action plan.<sup>6</sup>

Because of the success of the RGGI auctions combined with the stated goals of the Obama administration, national attention has indeed turned to creating a uniform national policy on climate change, with a specific focus on carbon trading.<sup>7</sup> As the issue hits the national stage, however, the debate has been confused by the two-sided approach of cap and trade

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1. Press Release, Reg'l Greenhouse Gas Initiative, Inc., RGGI States' CO<sub>2</sub> Auction Continues Strong Performance (Dec. 19, 2008) (announcing that "[a]uction with [a]ll [t]en [s]tates [b]uilds on [s]uccess of the [f]irst [a]uction as [a]ll [a]llowances [s]old at a [c]learing [p]rice of \$3.38") (on file with author).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. See Jim Tankersley & Christi Parsons, *G-8 Climate Talks Meet Familiar End; Obama Pledges a New U.S.-Led Push, But Entrenched Obstacles and Divisions Prevail*, L.A. TIMES, July 10, 2009, at A20 (describing President Obama's new U.S. climate policy push).

versus carbon tax. Though there is surely a certain level of semantic and political spin within the dichotomy, it does touch on the real issue of what kind of asset and market system is created by carbon trading.

In this Comment, I will examine the background, current manifestation, and implications of the Regional Greenhouse Gas Initiative. In Part II, I will discuss the issue of climate change and the debate that has brought it to the fore of law, litigation, and policy. I will look to the reactions to and efforts by the United States, the United Nations, and the European Union. I will particularly examine previous efforts at cap and trade markets and regulation instituted in the United States. From there, I will lay out how those programs were first followed and amended by the European Union and its member states to combat rising greenhouse gas emissions. Lastly, I will lay out the impetus for the foundation of the RGGI in the United States. In Part III, I will more specifically examine the current manifestations of the RGGI, in an attempt to clarify the process and intricacies of the allowance auctions and the secondary market thereby created. In Part IV, I will look to the secondary market and the secondary legal implications of a cap and trade mechanism for carbon allocation. Here, the nature of the carbon asset will weigh heavily on the future of the markets and the corporations involved. By necessity, we must examine, not only the consequences of trading in pollutants, but also the nature of the pollutant asset created—commodity, currency, security, UCC good, government permit, tax, or something which is some of each and not completely any of the above. I conclude by determining that it is important from a market and contractual point of view to see carbon allocations under the category of UCC goods.

## II. COMING TO TERMS WITH CLIMATE CHANGE

Though certainly climate change will impact the environment and the multi-specied inhabitants of our planet, in this Comment I will stick to the dollars and cents. It is important for corporations and investors to recognize the impact that climate change will have on the economy.<sup>8</sup> As the discussion of climate change shifts from debate to agreement and, hopefully, further to problem-solving, corporations will be compelled to get involved and, likely will already have come to terms with their involvement in climate change solutions.<sup>9</sup>

For many years climate change was framed, at least by the American media and politicians, as a partisan debate, with some people highly concerned by its certain existence and others doubtful that a problem even

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8. See generally Elise N. Rindfleisch, *Shareholder Proposals: A Catalyst for Climate Change-Related Disclosure, Analysis, and Action?*, 5 BERKELEY BUS. L.J. 45, 49 (2008) (specifically looking at and noting the growing success and frequency of “shareholder proposals as mechanisms for securing disclosure, analysis, and action from corporations in the area of climate change”).

9. *Id.* at 47 (noting that “[b]usinesses can no longer afford to ignore climate change, for these risk[s] and opportunities directly impact their business and, in turn, their shareholders’ investment”).

existed. More recently, a consensus belief in climate change seems to have emerged.<sup>10</sup> The U.S. Climate Change Science Program has asserted with certainty that climate change will lead to “long-term physical changes to the environment with potentially far-reaching consequences.”<sup>11</sup> Some have claimed that “average global temperatures could rise three to ten degrees Fahrenheit by the end of the century.”<sup>12</sup> These findings in the United States were also reflected by those of the Intergovernmental Panel on Climate Change (IPCC), who upgraded their belief that the net effect of human activities has caused some kind of worldwide warming to “very high confidence.”<sup>13</sup> The IPCC further noted that carbon dioxide concentrations have grown 31% since 1750.<sup>14</sup>

Greenhouse gases are those which contribute to global warming conditions.<sup>15</sup> There are six recognized greenhouse gases: carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride.<sup>16</sup> Unlike other pollutants, there are no “hot spots”<sup>17</sup> in greenhouse gas emissions, in that an emission in any location affects every location the same way as it does in the location where it is emitted.<sup>18</sup> For example, an emission in Dallas would affect Dallas to the same degree that it would affect New Orleans, or San Francisco, or Timbuktu.<sup>19</sup> Effectively limiting the growth of greenhouse gases and reducing their output will require a global response. Consequently, the United Nations and the European Union have made comprehensive policy changes.<sup>20</sup>

#### A. CORPORATE RESPONSE

Before addressing the policies set forth by government agencies, it is necessary to note that many corporations have, in fact, recognized the potential economic toll that the failure to address climate change may

10. Paul Bowden, *EU Emissions Trading—Latest Developments*, in INTERNATIONAL ENVIRONMENTAL LAW 97, 99 (ALI-ABA Course of Study, 2007) (noting the increased recognition of climate change in the scientific and corporate arenas).

11. Jeffrey A. Smith, *Disclosure of Climate Change Risks and Opportunities*, in HOW TO COMPLETE YOUR SECURITIES OFFERINGS ON A TIMELY BASIS 149, 151 (PLI Corp. Law & Practice, Course Handbook Series No. 13988, 2008).

12. Rindfleisch, *supra* note 8 at 47.

13. Bowden, *supra* note 10, at 99.

14. Joseph Allan MacDougald, *Why Climate Law Must be Federal: The Clash Between Commerce Clause Jurisprudence and State Greenhouse Gas Trading Systems*, 40 CONN. L. REV. 1431, 1435, 1451 (2008) (recognizing that because of the absence of stringent federal greenhouse gas regulation, states have developed their own restrictions, which are inherently inefficient without a broader plan).

15. *Id.* at 1435.

16. Kevin Doran & Elaine Ginnocchio, *United States Climate Policy: Using Market-Based Strategies to Achieve Greenhouse Gas Emission Reductions*, 3 ENVTL. & ENERGY L. & POL’Y J. 31, 33-34, 51 (2008) (emphasizing the importance of “carbon pricing,” but also noting the need for comprehensive policies addressing climate change).

17. John C. Dernbach & Seema Kakade, *Climate Change Law: An Introduction*, 29 ENERGY L.J. 1, 1, 11 (2008) (explaining “the basic elements of climate change law”).

18. MacDougald, *supra* note 14, at 1435.

19. *See id.*

20. *See infra* Part II.F.

take.<sup>21</sup> From a business standpoint, companies risk direct losses from climate change, specifically from physical impact and phenomena like flooding and hurricanes.<sup>22</sup> As Professor Elise Rindfleisch points out, corporate actors also risk the potential future costs of compliance.<sup>23</sup> Certain industries will have to assume incredible financial obligations to meet the potentially stringent regulations that the future may hold.<sup>24</sup> In the more immediate future, especially before a federal plan is implemented in the United States, companies will have to deal with the cost of varied and inconsistent programs in different regions.<sup>25</sup> To hedge against these likely future costs, some corporations have decided to create their own programs to reduce emissions and have seen positive public response to these efforts.<sup>26</sup> For example, GE created the Ecomagination campaign with goals to reduce carbon emissions and provide eco-friendly products to other countries.<sup>27</sup> And BP has also managed to reduce its own carbon emissions while increasing its profits.<sup>28</sup>

The corporate world has taken further efforts to recognize and police the potential costs associated with climate change. For example, over fifty white papers have been published by major investment banks specifically addressing the issue of climate change.<sup>29</sup> Additionally, in the Stern Review, Sir Nicholas Stern asserts that waiting to stabilize greenhouse gas emissions could eventually cost the United Kingdom 5–20% of its GDP, while taking actions to deal with the problems now would only cost 1% of its GDP.<sup>30</sup> American corporations have begun to take part in voluntary climate change disclosure, beginning a framework that could result in the “privatization” of such disclosures.<sup>31</sup> Currently in the United States, private standards require more disclosures and stricter standards than those required by the SEC.<sup>32</sup> The private market has taken advantage of a void in federal policy, creating “a wide variation in the depth, quality, and format of formal SEC reporting on climate change[ ] and . . . an unprecedented divergence between the scope and quality of mandatory reports

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21. See Rindfleisch, *supra* note 8, at 47 (specifically mentioning General Electric and BP).

22. *Id.* at 49-50.

23. *Id.* at 51.

24. *Id.*

25. See *id.* at 52. Rindfleisch further notes that an overarching federal program is highly likely with the new makeup of the Congress. *Id.* at 51-52.

26. *Id.* at 47-48.

27. *Id.* at 47; see also GE: ecomagination, <http://ge.ecomagination.com/> (last visited Oct. 31, 2009).

28. Rindfleisch, *supra* note 8, at 47-48.

29. Smith, *supra* note 11, at 152. Investment houses, like Barclays, have even become involved in the RGGI submitting comments and opinions on proposed rules and procedures. See generally Comments of Barclays Capital on RGGI Auction Design, submitted by Steven Schleimer, Director, Energy & Envtl. Mkt. Regulation, Barclays Capital (Nov. 15, 2007), available at [http://www.rggi.org/docs/barclays\\_capital.pdf](http://www.rggi.org/docs/barclays_capital.pdf).

30. Bowden, *supra* note 10, at 99.

31. Smith, *supra* note 11, at 152.

32. *Id.*

on the one hand and voluntary reports on the other.”<sup>33</sup>

As Peter Lehner notes, corporations must be involved in any climate change program.<sup>34</sup> Without creating a cost in climate change or in carbon emissions, corporations will have significantly less impetus to effect change in their structure and goals.<sup>35</sup> Essentially, climate change is a negative externality for which society as a whole pays, but for which no individual company will see the cost.<sup>36</sup> Lehner argues that we must change the system in which corporations operate, asserting that “[t]he legal framework is set by the laws within which corporations act. The institutional and financial framework is the particular market in which corporations operate and the incentives established.”<sup>37</sup> As such, governments and policymakers have set out to “change the ground rules within which companies are operating so the right incentives are sent throughout the companies’ operations” and further encourage corporations to take part in climate change efforts.<sup>38</sup>

#### B. INTERNATIONAL RESPONSE AND THE KYOTO PROTOCOL

The Kyoto Protocol to the UN Framework Convention on Climate Change binds its signatory countries to greenhouse gas limitations that were enforceable beginning in 2005.<sup>39</sup> The United States, though a part of the UN Framework Convention, has refrained from ratifying the Kyoto Protocol, and, therefore, is not tied to any international goals for limiting greenhouse gases (GHG).<sup>40</sup> Among the world’s major developed countries, only the United States has not joined the Kyoto Protocol signatories.<sup>41</sup> The program includes a broad, overall goal for the entire group of signatory nations and goals for each individual party to be achieved over the period of 2008-2012.<sup>42</sup>

The Kyoto Protocol allows for several methods of carbon reduction.<sup>43</sup> In negotiations, the United States actively worked for the inclusion of a market-based system to encourage the reduction of carbon emissions, something similar to the cap and trade mechanisms that have been put into place selectively since Kyoto.<sup>44</sup> Kyoto sets out emissions trading as one of four “flexible mechanisms” for emitters to achieve pollution reductions at a lower cost.<sup>45</sup> Emissions trading allows for a signatory party

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33. *Id.*

34. Peter Lehner, Executive Dir., Natural Res. Def. Council, Keynote Address at the Boston College Environmental Affairs Law Review Symposium: *Changing Markets to Address Climate Change* (Oct. 25, 2007), in 35 B.C. ENVTL. AFF. L. REV. 385, 385 (2008).

35. *Id.*

36. *Id.* at 388.

37. *Id.* at 385.

38. *Id.* at 387.

39. Smith, *supra* note 11, at 151.

40. Dernbach & Kakade, *supra* note 17, at 9-10.

41. *Id.* at 10.

42. Bowden, *supra* note 10, at 100.

43. *Id.*

44. Dernbach & Kakade, *supra* note 17, at 10.

45. Bowden, *supra* note 10, at 100.

to set an overall national cap on emissions allowances and then for these allowances to be distributed to emitting parties through methods like allocation or purchase.<sup>46</sup> Carbon emissions may also be offset by Clean Development Mechanisms, whereby a polluter may take on projects in developing countries to reduce its emissions and use those reductions as its own credits.<sup>47</sup> A third mechanism is Joint Implementation, which allows operations in signatory countries to implement projects in other signatory countries and use those reductions as credits.<sup>48</sup> The final mechanism is Carbon Sinks, by which a corporation may offset its emissions “by increasing the amount of greenhouse gases removed from the atmosphere through forestry, land use and land use change.”<sup>49</sup>

The Kyoto Protocol creates a break between developed and developing countries; corporations in developed countries tend to need to buy carbon and developing countries have carbon to sell.<sup>50</sup> For example, currently about 42% of all credits and carbon reduction projects are based in China, and it is likely that India will soon be included into this trend as well.<sup>51</sup> This feature allows for corporations based in countries like France and Germany to overproduce their fair share of carbon emissions, but to discount those numbers with projects and goals implemented in other countries. In developing countries the price of reducing carbon is less, so this is a cost-efficient mechanism for corporations to decrease their overall emission of carbon. Though, as other scholars have pointed out, this becomes a problem when there is a question of shifting values of the carbon asset and whether that value should be equal from one country to the next.

### C. MARKET FORCES AND EMISSIONS

This Comment focuses its attention on cap and trade programs, but there are other market options for managing emissions as well. First, there is the potential for a credit-based mechanism that would give credits to emitters who reduce their emissions more than what is required by a regulatory base.<sup>52</sup> An averaging program would allow high-volume emitters to offset their total emissions output by reducing emissions from other sources and so lowering the overall total.<sup>53</sup> This method has the advantage of allowing corporations to make their own determinations with the flexibility of choosing not to reduce emissions from sources

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46. *Id.* at 101.

47. *Id.* at 100-11.

48. *Id.* at 101.

49. *Id.*

50. Bill Westerfield et al., Panel Discussion at the Energy Bar Association Presentation, *EBA Climate Change Primer: Cap and Trade* (Nov. 30, 2007), in 29 *ENERGY L.J.* 173, 190 (2008) (statement of Jeff King, Credit Suisse) (discussing “design elements for a national cap trade system”).

51. *Id.*

52. David Harrison, Jr. & Daniel Radov, *Materials on Emissions Trading*, in *CLEAN AIR: LAW, POLICY, AND PRACTICE* 201, 238 (ALI-ABA Course of Study, 2007).

53. *Id.* at 239.

where doing so might be undesirable or cost-prohibitive.<sup>54</sup>

Cap and trade programs have been met by the greatest approval from the general policy community, though opinions on the details of such a program do vary to some extent.<sup>55</sup> A cap and trade program works by setting an overall cap on emissions for the state, region, country, or international consortium.<sup>56</sup> From this cap, a total number of emissions allowances are determined with each allowance representing the right to emit however much of a certain pollutant—in this instance, carbon.<sup>57</sup> Allocations may be distributed among corporations or emissions sources by a government-set distribution mechanism or by auction.<sup>58</sup> Once the right is held, it is an asset which a corporation may sell or trade freely in the marketplace, allowing the entity to determine whether to emit or sell the right to do so based on its own needs.<sup>59</sup> This kind of program capitalizes on encouraging corporations to make their own decisions.

#### D. POLICY PROBLEMS IN A CAP AND TRADE PROGRAM

When market mechanisms are the methods for minimizing emissions, market forces also provide incentives for corporations to go outside of the program. As Joseph Allan MacDougald has explained, one of the major problems that policymakers must deal with is leakage.<sup>60</sup> Leakage occurs when power is imported from outside the regulated region from an uncapped source, where energy production does not have the added cost of compliance.<sup>61</sup> Energy is purchased, brought into the regulated region, and then sold in a price-inflated market to the advantage of the non-complying source.<sup>62</sup> Leakage may also occur in a slightly less conniving situation, when the demand far exceeds that which the power grid is able to provide but upgrading the system would be untimely, impracticable, or too expensive.<sup>63</sup>

Safety valves have also been implemented in the new RGGI system because they have proven to be an important design issue in determining the success of the program.<sup>64</sup> A safety valve sets the maximum price at which allowances will be sold, limiting the potential for prices to escalate

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54. *Id.*

55. Westerfield, *supra* note 50, at 174.

56. *Id.* at 176.

57. Harrison & Radov, *supra* note 52, at 239.

58. *Id.*

59. *Id.*

60. MacDougald, *supra* note 14, at 1437.

61. *Id.*

62. *Id.* at 1436-37.

63. *Id.* at 1437.

64. David Harrison, Jr., et al., *Using Emissions Trading to Combat Climate Change: Programs and Key Issues*, in CLEAN AIR: LAW, POLICY, AND PRACTICE 155, 171 (ALI-ABA Course of Study, 2008); Memorandum of Understanding from RGGI to the States of Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York, and Vermont (Dec. 20, 2005), available at [http://rggi.org/docs/mou\\_12\\_20\\_05.pdf](http://rggi.org/docs/mou_12_20_05.pdf) [hereinafter Memorandum of Understanding].



in times of intense power need or growth.<sup>65</sup> As David Harrison, Jr. and Daniel Radov explain, this feature allows for the political expediency of minimizing costs in times when companies would be most affected by cost increases.<sup>66</sup>

#### E. AMERICAN CAP AND TRADE SYSTEMS

Part of the Kyoto plan allows for the institution of a cap and trade system as an effort to allow market forces to control and minimize the future emission of carbon.<sup>67</sup> As stated above, the United States deemed this facet important in the Kyoto negotiations and was largely based on the United States' own success with cap and trade programs as a mechanism to decrease pollution.<sup>68</sup> Though the United States has been slow to enter the world stage to deal with carbon emissions, with no federal response mirroring the levels seen in Europe, the United States has previously implemented plans against other pollutants.<sup>69</sup> The United States, specifically, and members of Kyoto have recognized the benefits of trading over other possible methods of reducing emissions.<sup>70</sup> Trading allows for flexibility since corporations may choose to use the right to emit carbon or sell that right at a profit to someone else.<sup>71</sup> Carbon trading reduces the overall cost of the program, allowing market forces to manage the pollution rather than creating government bureaucracy to control a rigid standard.<sup>72</sup> The program also does not require a bureaucracy to determine the right to exceptions, again using the market process to provide efficiency in avoiding potential political hotbeds.<sup>73</sup> Previous experience shows that a cap and trade program will work and that it, in fact, provides a heightened level of certainty that the specific goals will be attained.<sup>74</sup> Most importantly, each emitter is allowed to make its own decision as to what is most cost efficient—using the allowance or selling the allowance—without interfering with state-mandated carbon emissions reduction goals.<sup>75</sup>

The Environmental Protection Agency (EPA) in the United States has recognized the potential benefits of cap and trade programs and has previously implemented them to deal with acid rain and NO<sub>x</sub>.<sup>76</sup> In total, five major cap and trade programs have been established in the United States,

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65. Harrison & Radov, *supra* note 52, at 263.

66. *Id.*

67. Richard M. Schwartz & Donna Mussio, *Environmental Due Diligence for Securities Offerings*, in CONDUCTING DUE DILIGENCE IN M&A AND SECURITIES OFFERINGS 2008, at 141, 165 (PLI Corp. Law & Practice, Course Handbook Series No. 14933, 2008).

68. Harrison & Radov, *supra* note 52, at 234.

69. *Id.*; Smith, *supra* note 11, at 151.

70. Harrison & Radov, *supra* note 52, at 234.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.* at 242-44.

excluding those thus far established in the carbon market.<sup>77</sup> Most of these have been administered by the EPA, with the exception of the Regional Clean Air Incentives Market (RECLAIM) in Los Angeles which was administered by the South Coast Air Quality Management District (SCAQMD).<sup>78</sup> The acid rain program managed the deposition of wet sulfate mainly resulting from the emissions of power plants.<sup>79</sup> The Northeast saw most of the problems that resulted from acid rain, which tends to have localized or "hot spot" effects.<sup>80</sup> The program set out with an overall cap based on how much they believed emissions needed to be reduced, which is stronger than a program that works backwards from allocation to cap.<sup>81</sup> This program, along with the NO<sub>x</sub> cap program, both ultimately cost the government less than expected.<sup>82</sup>

From these programs, the United States and other governments have recognized that a market-based program will incur less cost for business and government bureaucracies, without sacrificing any of the program's potential for success.<sup>83</sup> In fact, the previous programs were able to reduce the targeted emissions to desired levels.<sup>84</sup> Key to the success of these efforts were four elements: (1) involvement of the entire sector; (2) a cap set prior to allocating the pollutant; (3) monitoring; and (4) the power of market forces.<sup>85</sup> In order for market forces and efficiency plans to take hold, a cap and trade program must accommodate flexibility through methods like banking and trading of allowances that are balanced by fixed environmental targets and governmental refusal to raise the cap or to allow for exceptions.<sup>86</sup>

#### F. CARBON TRADING UNDER THE UN AND EU

With the American system of using market forces to regulate emissions and the growing assumption that these market forces are appropriate to manage pollutants as a backdrop, the European Union has implemented a system to manage carbon. The European Union Emissions Trading Scheme (EU ETS) is tied to more stringent standards than any American system because its members are also members of the Kyoto Protocol.<sup>87</sup> Particularly, in Kyoto the EU committed to reducing its greenhouse gas emission by 8% below 1990 levels between 2008 and 2012.<sup>88</sup> In 2003, the EU established the ETS to try to create a cost-effective mechanism to

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77. *Id.* at 242.

78. *Id.*

79. Westerfield et al., *supra* note 50, at 176 (statement of Brian McLean, Director, EPA Office of Atmospheric Programs).

80. *Id.*

81. *Id.*

82. *Id.* at 179.

83. Harrison & Radov, *supra* note 52, at 247.

84. *Id.* at 247, 249.

85. Westerfield et al., *supra* note 50, at 179 (statement of Brian McLean, Director EPA Office of Atmospheric Programs).

86. Harrison & Radov, *supra* note 52, at 250-53.

87. Westerfield et al., *supra* note 50, at 189 (statement of Jeff King, Credit Suisse).

88. Harrison & Radov, *supra* note 52, at 255.

manage carbon emissions.<sup>89</sup> Currently the scheme only manages carbon dioxide, but it may possibly extend to other greenhouse gases as well.<sup>90</sup> The European system is mandatory and set up to operate in phases that correspond with those laid out in Kyoto.<sup>91</sup> Due to its mandatory nature, operators of sources must hold GHG permits to emit carbon dioxide, such that: (1) the amount sources can emit is governed by the number of allowances they have; (2) sources are required to monitor and report their emissions activities; (3) sources must surrender the same number of allowances as that which they actually emit during each calendar year; (4) sources, though, may bank any unused allowances to be used during the phase in which they were accrued; and (5) a monetary penalty is assessed for any emission over that for which the sources have allowances and the sources must surrender that amount in allowances the following year.<sup>92</sup>

Certain nations and companies have challenged their allocations and credits.<sup>93</sup> Slovakia, for example, initiated actions against a proposed cut in its national cap.<sup>94</sup> Slovakia initially had a relatively high cap, but it had to close two nuclear power plants as part of joining the European Union.<sup>95</sup> Without those power plants, the country began using more fossil fuels, thus needing an even greater cap to accommodate those new emissions.<sup>96</sup> A Slovakian corporation affiliated with U.S. Steel also filed suit to challenge the decision, arguing that these kinds of variations instill the risk of uncertainty in the steel industry and could result in diminished investment.<sup>97</sup> Three German-based corporations also initiated actions in the European Court of First Instance, requesting that the court annul a Commission decision on allocations.<sup>98</sup> It argued that the decision had directly and uniquely affected their business so as to provide standing.<sup>99</sup> Further, they asserted that the Commission had missed relevant deadlines and had rejected their request for allocation guarantees advanced by Germany without good reason.<sup>100</sup> In the United Kingdom, Cemex challenged the allocation methods used, arguing that one of its plants would be uniquely disadvantaged by the determination.<sup>101</sup> They argued that their allocation was set so low as to infringe on "the principles of equality or non-discrimination under EU law."<sup>102</sup> This claim was ultimately re-

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89. *Id.*

90. Bowden, *supra* note 10, at 101.

91. *Id.*

92. *Id.* at 102.

93. *Id.* at 108.

94. *Id.*

95. The EU's Faltering Cap-And-Trade System, [http://roguepundit.typepad.com/roguepundit/2007/01/the\\_eus\\_collaps.html](http://roguepundit.typepad.com/roguepundit/2007/01/the_eus_collaps.html) (Jan. 29, 2007).

96. *Id.*

97. Bowden, *supra* note 10, at 108.

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*; *see generally* Case CO/8819/d2006, *Cemex UK Cement Ltd. v. Dep't for Env't, Food & Rural Affairs*, [2006] EWHC (Admin.) 3207 (QB) (holding that the method for allocating needs to consider "all commissioning phases in the baseline period").

102. Bowden, *supra* note 10, at 108.

jected and the court denied their argument of discrimination.<sup>103</sup>

### III. REGIONAL GREENHOUSE GAS INITIATIVE

#### A. PLANNING/IMPETUS/HISTORY

The Regional Greenhouse Gas Initiative (RGGI) was designed to function as “a cooperative effort . . . to reduce carbon dioxide emissions from power plants through the implementation of a linked CO<sub>2</sub> [b]udget [t]rading [p]rogram by each [p]articipating [s]tate.”<sup>104</sup> The RGGI is an agreement among a coalition of ten states in the Northeast to reduce carbon dioxide pollutants.<sup>105</sup> Discussions for the program began in April 2003, when New York Governor Pataki invited the states to develop a regional cap and trade program.<sup>106</sup> Seven states took part in outlining the Memorandum of Understanding, which lays out the framework for the RGGI and specifies an intention to draft a model rule in December of 2005: Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York and Vermont.<sup>107</sup> The Model Rule was published in August 2006, and created a guideline for any state seeking to join the program or implement something similar.<sup>108</sup> In 2007, Massachusetts, Rhode Island, and Maryland signed onto the Memorandum of Understanding.<sup>109</sup>

The RGGI program deals exclusively with electrical power plants.<sup>110</sup> But, like the European program, it allows for corporations to go out of the power sector to reduce emissions and use those reductions as offset credits.<sup>111</sup> The credit may then be used in lieu of an allowance.<sup>112</sup> Allowances may also be purchased at auction.<sup>113</sup> Corporations may only emit in the amount for which they hold allowances in order to meet the goals set by the joint efforts of the involved governments.<sup>114</sup> Rulemaking for the program is now complete, and the RGGI began its first compliance period on January 1, 2009.<sup>115</sup>

The RGGI intends to stabilize emissions at their current levels by 2014

103. *Id.*

104. Auction Notice, RGGI, Auction Notice for CO<sub>2</sub> Allowance Auction 2 on December 17, 2008, 1 (Oct. 13, 2008), available at [http://rggi.org/about/history/old\\_auction\\_notices](http://rggi.org/about/history/old_auction_notices).

105. Note, *The Compact Clause and the Regional Greenhouse Gas Initiative*, 120 HARV. L. REV. 1958, 1958 (2007) (examining the potential problems for the RGGI under the Compact Clause as a question of states functioning jointly in the stead of Congress).

106. *Id.* at 1959.

107. Regional Greenhouse Gas Initiative (RGGI) CO<sub>2</sub> Budget Trading Program-History, <http://rggi.org/about/history> (last visited Oct. 31, 2009).

108. *Id.*

109. *Id.*

110. Westerfield et al., *supra* note 50, at 187 (statement of Franz Litz, Senior Fellow, World Resources Inst.).

111. *Id.*

112. *Id.*

113. Harrison & Radov, *supra* note 52, at 260.

114. Westerfield et al., *supra* note 50, at 187 (statement of Frank Litz, Senior Fellow, World Resources Inst.).

115. Regional Greenhouse Gas Initiative (RGGI) CO<sub>2</sub> Budget Trading Program-History, *supra* note 107.

and then to begin to reduce them 10% by 2018.<sup>116</sup> The program plans to use the cap to reduce emissions; currently, the cap is set at 188 million tons of carbon dioxide for the ten participating states.<sup>117</sup> The states will then use the revenues from the auctions to support investment in a green economy, relying on the notion that “[c]lean-technology innovation and deployment will increase energy independence, keep wealth in local economies and create green-collar jobs. RGGI will provide a market signal that the cost of emitting carbon must now be incorporated into energy pricing.”<sup>118</sup> As such, one of the main goals for the program is to “[p]romote energy independence” by cutting back on energy use and encouraging energy efficiency, “[b]ecause the cheapest power plant is the one that never gets built . . . .”<sup>119</sup> RGGI also plans to serve as a “model for a national program to reduce CO<sub>2</sub> emissions.”<sup>120</sup>

### B. MEMORANDUM OF UNDERSTANDING

The Memorandum of Understanding (MOU), which outlines the basic principles and goals of the program, was signed in December 2005.<sup>121</sup> First, it recognizes that each state involved has an individual environmental policy, acknowledging that the regional program only affirms and advances, rather than replaces, any existing state policy efforts.<sup>122</sup> It also recognizes the “scientific consensus” that human activity has an impact on temperature through greenhouse gas emission and the risks thus implied.<sup>123</sup> The MOU also reaffirms the goals of the program—energy efficiency, energy independence, policy leadership, and quick action.<sup>124</sup> It creates a system in which the allowances may be traded between entities in the participating states.<sup>125</sup>

The MOU further deals with the issues of safety valves and offsets. The safety valve is “triggered” by a market event which causes the price of allocations to exceed a predetermined value, extending the compliance period to accommodate these shifts.<sup>126</sup> Similar to the EU ETS, the program allows for corporations to earn offset allowances when they engage in projects for emissions reductions.<sup>127</sup> Offset projects must be in the United States, with projects in the signatory states valued twice as highly.<sup>128</sup> Offset credits, however, may only be used to a maximum of

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116. Harrison & Radov, *supra* note 52, at 260.

117. RGGI Executive Summary, [http://rggi.org/docs/RGGI\\_Executive\\_Summary.pdf](http://rggi.org/docs/RGGI_Executive_Summary.pdf) (last visited Oct. 31, 2009).

118. *Id.*

119. *Id.*

120. *Id.*

121. Note, *supra* note 105, at 1960.

122. Memorandum of Understanding, *supra* note 64, at 1.

123. *Id.*

124. *Id.* at 1-2.

125. Note, *supra* note 105, at 1960.

126. Memorandum of Understanding, *supra* note 64, at 3.

127. *Id.* at 4.

128. *Id.*

3.3% of the reported emissions.<sup>129</sup>

The document sets out each state's emissions cap.<sup>130</sup> It makes clear that each state may then determine the distribution of allowances within its own borders.<sup>131</sup> Although, 25% of allowances must be for a consumer benefit or strategic energy purpose, including promoting energy efficiency, mitigating rate impacts, promoting renewable and greener energy technologies, encouraging investment in carbon abatement technologies, and funding the costs of membership in the RGGI program.<sup>132</sup> The MOU also provides that "[t]he banking of allowances, offset allowances and early reduction credits will be allowed without limitation."<sup>133</sup>

The MOU attempts to address the issues of electrical importing and leakage, recognizing one of the issues that has proven most important, and potentially detrimental, in previous cap and trade programs.<sup>134</sup> The attempt to minimize emissions by creating a cost in carbon is rendered ineffective by the ability to cross convenient state lines to create a power source and then ship that power into a member state.<sup>135</sup> The MOU creates a working group to study the issues of leakage, potential ways to address the problem, and the factors that may contribute to leakage.<sup>136</sup> The states also will attempt to monitor electricity imports during the program.<sup>137</sup> The MOU further gives the signatory states the power to take steps to address and mitigate leakage problems during the life of the program.<sup>138</sup> In recognition of their role at the forefront of carbon trading in America, the states agree to advocate for a federal program that will "reward[ ] states that are first movers."<sup>139</sup> If a national plan is adopted, the states will transition into that program.<sup>140</sup> Lastly, the MOU ends with a charge to the states to maintain programs and policies within their own borders that will minimize emissions and promote energy efficiency "while maintaining economic growth."<sup>141</sup>

### C. MODEL RULE

The Model Rule was created as a legislative guide for states joining the RGGI to provide consistency in statutory process and guidelines throughout the program: "The model rule provides a set of regulations for the structure and function of RGGI. Each state that intends to participate in

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129. *Id.* at 5.

130. Note, *supra* note 105, at 1960.

131. *Id.*

132. Memorandum of Understanding, *supra* note 64, at 6.

133. *Id.*

134. *Id.* at 9.

135. See Note, *supra* note 105, at 1965 (discussing leakage).

136. Memorandum of Understanding, *supra* note 64, at 9.

137. *Id.*

138. *Id.* at 10.

139. *Id.*

140. *Id.*

141. *Id.* at 11.

RGGI must adopt this rule through legislation or regulation.”<sup>142</sup> The Model Rule reaffirms the goals of the program and, consequently, makes them a part of each member state’s own body of law.<sup>143</sup> Due to the scope of this Comment and the volume of the Rule, laid out below are the provisions that most directly apply to liability under the statute and ownership of the allocation asset. The Rule provides a section of definitions. It includes a definition for “allocation”:

[t]he determination by the REGULATORY AGENCY [of the signatory state] of the number of CO<sub>2</sub> allowances to be initially credited to a CO<sub>2</sub> budget unit, an allocation set-aside account, the consumer benefit or strategic energy purpose account, or the general account of the sponsor of an approved CO<sub>2</sub> emissions offset project.<sup>144</sup>

The Rule specifically defines “CO<sub>2</sub> allowance” as:

[a] limited authorization by the REGULATORY AGENCY under the CO<sub>2</sub> Budget Trading Program to emit up to one ton of CO<sub>2</sub>, subject to all applicable limitations contained in this Part. No provision of this regulation shall be construed to limit the authority of the REGULATORY AGENCY to terminate or limit such authorization to emit. This limited authorization does not constitute a property right.<sup>145</sup>

The Model Rule also addresses the issue of liability.<sup>146</sup> It states that no revisions to the Model Rule will be retroactive, so as to function to excuse prior violations of the enacted statute.<sup>147</sup> Additionally, it makes clear that any owner of an emissions source shall be liable, to the provisions of the program that would apply to the source in question.<sup>148</sup> Clearly, it states that complying with the RGGI does not supply any kind of safe harbor for corporations as to other laws or regulations.<sup>149</sup>

#### D. THE AUCTION

The style of auction chosen to initiate the cap and trade program under the RGGI was designed with several goals in mind—to be:

[l]ow [on] administrative costs, low [on] transaction costs for bidders; [p]erceived as fair, transparent, and understandable to participants and the public; [e]conomically efficient—that is, getting allowances to those who value them the most; [a]voiding collusive behavior by bidders and providing good signals about market prices; [h]elping to minimize price volatility; [r]aising reasonable revenues from the sale

142. Regional Greenhouse Gas Initiative Releases Final Model Rule: Pew Center on Global Climate Change, <http://www.pewclimate.org/node/4840> (last visited Oct. 31, 2009).

143. REGIONAL GREENHOUSE GAS INITIATIVE MODEL RULE R. XX-1.1 (2007), *available at* [http://rggi.org/docs/model\\_rule\\_corrected\\_1\\_5\\_07.pdf](http://rggi.org/docs/model_rule_corrected_1_5_07.pdf).

144. R. XX-1.2(d).

145. R. XX-1.2(k).

146. R. XX-1.5(f).

147. R. XX-1.5(f)(1).

148. R. XX-1.5(f)(2).

149. R. XX-1.5(g).

of a valuable public asset; and [c]ompatible with existing electricity and energy markets.<sup>150</sup>

An applicant must be approved to bid at an auction. Previous approval will authorize a bidder for future auctions, though their approval must be ratified by any states who have joined the program since their approval.<sup>151</sup> A new applicant must complete and submit the Qualification Application and Intent to Bid forms;<sup>152</sup> meet all financial security requirements prior to the auction;<sup>153</sup> and is allowed to bid when the applicant maintains a general or compliance account with the RGGI auction allowance tracking system.<sup>154</sup> All purchased allowances are transferred to this account.<sup>155</sup> Once accounts are established, an account representative may freely move allowances between both general and compliance accounts.<sup>156</sup>

Bidders must have a Primary Authorized Auction Representative (PAAR) to represent the applicant through the auction process and serve as the primary contact for the auction process.<sup>157</sup> The PAAR must be an employee of the applicant and it is recommended that the applicant use the same person for the CO<sub>2</sub> Allowance Tracking System (COATS) as well.<sup>158</sup> An applicant may also have a Secondary Authorized Auction Representative (SAAR), who need not be an employee, but may represent the applicant during the auction process.<sup>159</sup> An account representative may also represent more than one potential bidder.<sup>160</sup> When dual representing, the applicants must disclose either any corporate or bidding associations.<sup>161</sup> Also, representatives “must ensure that only authorized persons act on behalf of an [a]pplicant.”<sup>162</sup>

Prior to auction, an applicant must present financial security.<sup>163</sup> The financial security sets the maximum the applicant is allowed to bid for allowances.<sup>164</sup> There are three acceptable forms of security: “(1) a bond issued by a financial institution with a United States banking license, (2) cash in the form of a wire transfer or certified funds, such as a certified bank check or cashier’s check, or (3) an irrevocable letter of credit.”<sup>165</sup>

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150. J. Jared Snyder, *Auction Design for Selling CO<sub>2</sub> Emission Allowances Under the Regional Greenhouse Gas Initiative*, in *GLOBAL WARMING: CLIMATE CHANGE AND THE LAW* 223, 239-40 (ALI/N.Y. State Dep’t of Envtl. Conservation, 2007).

151. Auction Notice, *supra* note 104, at 3, 6.

152. *Id.* at 3.

153. *Id.*

154. *Id.* at 4.

155. *Id.*

156. *Id.*

157. *Id.* at 5.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 7.

164. *Id.*

165. *Id.*



An applicant for the auction cannot release confidential information relating to the auction and its position therein, including "qualification status, bidding strategy, bid price and/or bid quantity information, and information on financial security to the extent such information is not generally available to the public."<sup>166</sup> The applicant has the obligation to make sure that its advisors maintain the same confidence.<sup>167</sup>

A market monitor is retained by the RGGI.<sup>168</sup> The monitor serves as an independent watchdog over the auction and provides ongoing monitoring of allowance holdings and transactions.<sup>169</sup> The monitor also watches over bidder behavior and must report what "may have a material impact on the . . . performance of the auction" to the member states.<sup>170</sup> In conjunction with that monitoring, "[a]ny fraudulent, misleading, manipulative, collusive, or noncompetitive behavior in a CO<sub>2</sub> [a]llowance [a]uction or in the CO<sub>2</sub> allowance market may be investigated and prosecuted in accordance with any and all applicable regulations and laws."<sup>171</sup>

The format of the auction is uniform-price and sealed bids.<sup>172</sup> "[B]ids are . . . ranked by bid price from high to low," with "demand . . . noted at each bid" price.<sup>173</sup> With this information, a determination is made as to the clearing price, and the carbon dioxide allowances are awarded according to specific scenarios.<sup>174</sup> The clearing price becomes the reserve price if total demand can be accommodated by the supply of allowances offered up in the auction, and all bids within that range will be awarded their requested allowances.<sup>175</sup> If the supply of available allowances cannot meet the demand at auction and there is a bid level at which the amount of requests equals the demand, allowances will be given to those who bid greater than the clearing price.<sup>176</sup> But, if the demand at no point equals the available allowances, "the clearing price is the bid price of the marginal bid(s)."<sup>177</sup> Allowances will then be awarded to all offers greater than that.<sup>178</sup> Further, any available allowances will be given to marginal bids when there is a single marginal bid at the clearing price and the supply available to satisfy it, or by a random process when there are multiple bids in that situation.<sup>179</sup> Any offers that are in the system at the time the auction closes will be considered "binding offers and eligible for

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166. *Id.* at 10.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.* at 12.

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* at 13.

177. *Id.*

178. *Id.*

179. *Id.*

award.”<sup>180</sup> As such, the program does not allow contingent bids.<sup>181</sup>

Bidders can submit as many bids as they feel are necessary to meet their emissions needs, but should submit a single bid at each given price.<sup>182</sup> Until the window for bidding closes, bidders may cancel or change their bids at will.<sup>183</sup> Bids should be submitted in multiples of 1,000 and in U.S. dollars and cents.<sup>184</sup>

There are a number of situations that will result in a rejected bid.<sup>185</sup> The bid must be at or above the reserve price.<sup>186</sup> The amount of the bid must be completely backed up by the bidder’s offered financial security—the maximum available amount that the bidder may offer.<sup>187</sup> No corporation, on its own or in conjunction with relevant associates, may bid for more than 25% of the allowances offered for sale.<sup>188</sup>

Associations are relevant as to this requirement when the relationship is one where the parties may act in concert and when that relationship would preclude them from competing against each other at auction.<sup>189</sup> Therefore, “corporate associations must be reported in the [Qualification Application].”<sup>190</sup> “An applicant has a ‘direct corporate association’ with another” potential bidder, when the latter has “more than 20% of any class of listed shares, the right [or option] to acquire such shares” or when the latter “[h]olds or can appoint more than 20% of common directors, holds voting power, or controls the [a]pplicant’s affairs through some other means.”<sup>191</sup> An indirect corporate association is established if a bidder has a direct relationship “with another party that has a direct corporate association with [an a]pplicant,” or through other such indirect lines of associations.<sup>192</sup> Applicants must also disclose relationships where a party is “concerned” with the applicant’s bidding.<sup>193</sup> This is established when the party:

[a]greed to provide assistance with financing [i]s partnered with the Applicant for bidding purposes [h]as entered into any explicit or implicit agreements, arrangements, or understandings of any kind relating to the CO<sub>2</sub> allowances offered for sale at an auction [h]as agreed to provide assistance in any other way with the exception of investment or auction advisory services.<sup>194</sup>

Essentially, “[a]n Applicant has a ‘bidding association’ with another party

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180. *Id.*  
 181. *Id.*  
 182. *Id.*  
 183. *Id.*  
 184. *Id.*  
 185. *Id.* at 16.  
 186. *Id.*  
 187. *Id.* at 18.  
 188. *Id.* at 19.  
 189. *Id.*  
 190. *Id.*  
 191. *Id.*  
 192. *Id.*  
 193. *Id.* at 20.  
 194. *Id.* at 20-21.

if [that] party is concerned with the Applicant's bid."<sup>195</sup> The RGGI suggests that whether a bidding association is necessary to disclose on the application may be discovered by answering the following questions: "(1) Does the Applicant have a bidding association with another party? (2) Does another Applicant have a bidding association with the Applicant? (3) Does another entity or person have a bidding association with the Applicant?"<sup>196</sup>

After the auction is completed and the allocations thus determined, a bidder is notified of its award through e-mail.<sup>197</sup> The total cost of the allocation must be paid or the financial security will be used to meet the obligations, so payment commences immediately.<sup>198</sup> The allocation is transferred into the RGGI COATS account.<sup>199</sup> The contract is then complete and fulfilled, except in Maryland where there must be a contract for sale in conjunction with the auction writings.<sup>200</sup>

### E. TYPICAL CONTRACT—THE ERPA

Within the commodities trading scheme, carbon allowances are currently trading "over the counter," not via any form of formal exchange.<sup>201</sup> The contract used is an Emissions Reductions Purchase Agreement (ERPA), which establishes the relationship between the bank trading the allocation and the party purchasing it.<sup>202</sup> Like in other market relationships, the bank is functioning as a "middle man" and the party is the "end user."<sup>203</sup> The ERPA was created by the International Emissions Trading Association (IETA) "to establish a functional international framework for trading greenhouse gas emissions reductions."<sup>204</sup> The "IETA focuses on the creation of systems and instruments that will ensure effective business participation."<sup>205</sup> The ERPA and the IETA's work has focused largely on "the objectives of the United Nations Framework Convention on Climate Change and ultimately climate protection"<sup>206</sup> and, though its mission has focused globally and in conjunction with the international jurisdiction of the United Nations, its work has not had the opportunity to take hold in the United States.

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195. *Id.* at 21.

196. *Id.*

197. *Id.* at 22.

198. *Id.*

199. *Id.* at 23.

200. *Id.* at 24.

201. Westerfield et al., *supra* note 50, at 189 (statement of Jeff King, Credit Suisse).

202. *Id.*

203. *Id.*

204. Emissions Reduction Purchase Agreement, Int'l Emissions Trading Ass'n (Sept. 11, 2006), available at <http://www.ieta.org/itea/www/pages/index.php?idSitePage=203>.

205. *Id.*

206. About IETA, <http://www.ieta.org/ieta/www/pages/index.php?IdSiteTree=2> (last visited Oct. 31, 2009).

## F. CURRENT ISSUES

The RGGI program and the programs initiated on the West Coast highlight the void of federal action in the area of climate change legislation and carbon emissions controls.<sup>207</sup> Though the United States signed onto the United Nations Framework Convention on Climate Change,<sup>208</sup> the failure to sign onto the Kyoto Protocol and to create a mandatory emissions reduction program<sup>209</sup> has left states and local governments to try to address the issue themselves.<sup>210</sup> Kevin Doran and Alaine Ginnochio point out that there are some advantages to state-directed efforts, but without a coherent federal policy, corporations and policymakers are forced to work under a “patchwork” of programs.<sup>211</sup> More risky is the problem of leakage creating a “race to the bottom” where states that do not regulate emissions end up having an economic advantage over those that follow regulations.<sup>212</sup> Joseph Allan MacDougald describes the situation as state regulations “perversely” giving an advantage to unrestricted sources that do not have the added cost of complying with the regulations.<sup>213</sup>

Because of the clear variation in state and federal policies on greenhouse gas emissions, some scholars, including Joseph Allan MacDougald, have questioned whether states have the right to form programs like the RGGI at all.<sup>214</sup> By joining together and creating a coalition of states with a unified policy, the states are stepping into the powers guaranteed to Congress under the Commerce Clause.<sup>215</sup> Congress has the power “to regulate commerce among the states.”<sup>216</sup> Generally, the Supreme Court has invalidated laws of one state that penalize or tax the goods imported from another state.<sup>217</sup> The problem for RGGI and similar programs arises with the issue of managing leakage.<sup>218</sup> To prevent leakage, it would be helpful to be able to tax or otherwise penalize those who purchase “uncapped power.”<sup>219</sup> The entrance of unregulated power into the regulated market disturbs the allocation of allowances and their price.<sup>220</sup> The market for allocations would be destroyed if a cheaper and less regulated alternative was available.<sup>221</sup> A carbon allocation is a good—electrical power is electrical power, regardless of its source and the location of that

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207. MacDougald, *supra* note 14, at 1422-34.

208. Doran & Ginnochio, *supra* note 16, at 51.

209. *Id.* at 52.

210. *Id.* at 53-54; MacDougald, *supra* note 14, at 1433-34.

211. Doran & Ginnochio, *supra* note 16, at 55.

212. *Id.* at 55-56; MacDougald, *supra* note 14, at 1435.

213. MacDougald, *supra* note 14, at 1431.

214. *Id.* at 1450.

215. *Id.*; see also U.S. CONST. art. I, § 8, cl. 3.

216. MacDougald, *supra* note 14, at 1439.

217. *Id.*

218. *Id.* at 1437.

219. *Id.* at 1444.

220. *Id.*

221. *Id.* at 1445.

source.<sup>222</sup> Like the cases where the Supreme Court has struck down state regulations as violating the Dormant Commerce Clause, the Court would likely find that a monetary penalty for leakage is unconstitutional because the tax is imposed merely because of the origin of the good and not because of its character.<sup>223</sup> However, the counter-argument may be that power produced at a regulated source is inherently different from power produced at an unregulated source. Perhaps consumers are not willing to endure the costs of unregulated emissions, and the states are trying to protect their populations from the unseen costs.

The burgeoning American carbon market may not suffer under such differing programs for much longer, since at the time of publication, the American Clean Energy and Security Act of 2009 has been passed by the House and is under consideration by the Senate.<sup>224</sup> This Act would create a federal cap and trade system for managing carbon emissions.<sup>225</sup> The initial focus of federal regulation would be on power plants, like the RGGI, but it would also include factories and refineries.<sup>226</sup> Though the program was built on the foundation previously laid by the RGGI, previous American systems, and the European model for carbon cap and trade, it will also impact the RGGI if passed.<sup>227</sup>

#### IV. THE CARBON ASSET

The invisible nature of the carbon or emissions asset is what makes determining its nature and costs so difficult. Some have advocated that the costs associated with pollutants and invisible assets such as electricity, fossil fuels, and emissions are much greater than what we actually see in the marketplace.<sup>228</sup> These advocates believe that energy prices should include a calculation of the other costs to societal health and well-being and to the environment.<sup>229</sup> But even with some remotely concrete formula, it is difficult to determine the ultimate costs, especially when there is not a consensus on what should be considered a part of that cost—what should go into the formula. It also remains undetermined what the asset actually is—whether it is a property right, a good, a service, a tax, a government permit, a commodity, a currency, or a security. It is necessary to determine what the allocation will be in order to under-

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222. *Id.* (noting the logic of *City of Philadelphia v. New Jersey*, 437 U.S. 617, 629 (1978)).

223. *Id.* at 1446 (citing *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 204 n.20 (1994)).

224. *See* American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong. (2009). A similar bill was initiated by the Senate.

225. The American Clean Energy and Security Act (Waxman-Markey Bill): Pew Center on Global Climate Change, <http://www.pewclimate.org/acesa> (last visited Oct. 31, 2009); Posting of Brian Nearing to Green Blog, <http://blog.timesunion.com/green/this-weekend-on-capital-green-scene-22/992/> (July 3, 2009, 13:43 EST).

226. Posting of Brian Nearing, *supra* note 225.

227. *Id.*

228. *See, e.g.*, Lehner, *supra* note 34, at 389 (discussing the costs associated with coal and gasoline).

229. *See id.*

stand the repercussions that owning and trading the asset will have from a legal and, in particular, a contractual point of view. The nature of the asset will also be key for corporations trying to make investment choices.

Determination of the type of asset sets the parameters of ownership, methods of enforcing ownership, and methods of challenging ownership. The unique qualities of the asset and the legal parameters in existence must be used to determine its nature and legal value. Furthermore, adequate protections for the rights and values associated with the asset must be supplied in order to provide the incentives necessary for the market-driven cap and trade program to function. Though its goals may be associated with environmental standards, this mechanism, its impetus, and driving forces are essentially purely market reliant. Market forces must be preserved, though regulated, in order for the system to attain its goal.

#### A. POLLUTANTS AS AN ASSET

Emissions allocations are a government-created “right.”<sup>230</sup> The notion of “right” in this context, though, disguises some of the issues inherent in discovering what type of asset is created by the government-implemented cap and trade system. It could, possibly more accurately, be called a “permit” or the typical “allowance” or “credit.” “Right,” however, follows the nomenclature often used, which reiterates that once a carbon allowance or cap and trade program is implemented, there is no way to legally emit those pollutants without conforming to the rights and interests created by the system.<sup>231</sup> Further, the interest created has value in the marketplace.<sup>232</sup> The notion of “right” in this situation, though, is confounded by the fact that prior to the introduction of a regulation or statute determining that allocations are necessary, sources may, presumably, emit freely into the un-owned atmosphere.<sup>233</sup> So, in one way, the statute creates a right that did not previously exist—the right to emit legally under the newly implemented statute. From this point of view, it is a completely new government-created right when limited in terms of the statute imposing the system. On the other hand, though, the government is taking away a right by requiring permission and even financial outlay or exchange to perform an act that was previously without government or regulatory interference.

Interestingly, the Model Rule states specifically that an allocation should not be seen as a “property right,” limiting the potential interpretations of the asset without supplying other nomenclature or categorization for the interest created.<sup>234</sup> This statement may, instead, be an attempt to

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230. See generally Jillian Button, *Carbon: Commodity or Currency? The Case for an International Carbon Market Based on the Currency Model*, 32 HARV. ENVTL. L. REV. 571 (2008) (providing excellent background on the nature of the carbon as an asset and ultimately advocating the carbon asset as a form of currency).

231. *Id.* at 571.

232. *Id.*

233. *Id.*

234. REGIONAL GREENHOUSE GAS INITIATIVE MODEL RULE R. XX-1.2(k).

deny the way the right is already developing as a kind of property. Currently, those in the business of trading commodities are trading allowances on familiar ground, as commodities.<sup>235</sup> In fact, the allocations are being handled by the commodity departments of banks and investment houses,<sup>236</sup> which supports the notion that people with expertise in the field of commodities are the appropriate people to handle the negotiations involving emissions allocations trading. Also, this appears to assume that the market for allocations will evolve into a market that is more closely related to the market for commodities than to the markets for typical consumer goods, UCC goods, securities, stocks, or currencies.

### B. THE AMERICAN QUESTION: CARBON TAX

Before the question of the carbon asset is addressed, it is necessary to address the argument now raging in American politics—carbon tax versus cap and trade. As the likelihood of an American cap and trade system has increased under the Obama administration, the cap and trade debate has hit the mainstream. Many opponents of the system have sought to recast the debate into a question of tax. Some advocates believe that a carbon tax is the appropriate mechanism for limiting carbon emissions.<sup>237</sup> One commentator believes that a carbon tax would provide a clearly defined mechanism necessary to successfully regulate emissions.<sup>238</sup> Moreover, a carbon tax would provide a defined and definite source of revenue, whereas the cap and trade system lacks certainty and instead, is dependent on market whims.<sup>239</sup> The resort to a carbon tax is also based on the seeming inability to determine the nature of the carbon asset and the desire to try to placate political opponents.<sup>240</sup> But the carbon tax suggestion also comes from an effort to head off the potential boom and bust cycles that come with the creation of a new market.<sup>241</sup> Lastly, this commentator points out that the carbon tax may help the American market avoid the problems that have confronted the European cap and trade system.<sup>242</sup> Those who advance the carbon tax program also

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235. Button, *supra* note 230, at 575. *Black's Law Dictionary* provides the following definition for commodities:

Those things which are useful or serviceable, particularly articles of merchandise moveable in trade. Goods, wares, and merchandise of any kind; articles of trade or commerce. Movable articles of value; things that are bought and sold. This word is a broader term than merchandise, and, in referring to commerce may include almost any article of movable or personal property. Staples such as wool, cotton, etc. which are traded on a commodity exchange and on which there is trading in futures.

BLACK'S LAW DICTIONARY 274 (6th ed. 1990).

236. Button, *supra* note 230, at 575.

237. Posting of Timothy B. Hurst to Red Green and Blue, 6 Reasons a Carbon Tax is Better than Cap and Trade, <http://redgreenandblue.org/2009/07/17/6-reasons-a-carbon-tax-is-better-than-cap-and-trade/> (July 17, 2009).

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.*

242. *Id.*

point out the failings in the European cap and trade system, noting that the prices for carbon permits have not maintained a level sufficient to make the carbon permit appropriately scarce or punitive.<sup>243</sup> Perhaps, though, the advantage to a straight carbon tax is best explained by Representative John B. Larson: “The American people want us to level with them . . . . We create price certainty without any new bureaucracies or complicated auction schemes.”<sup>244</sup>

Though the argument for a carbon tax has some advantage in terms of clarity, the simple nature of a carbon tax, or “cap and tax,” sabotages the system by its nature. It lacks political muster in two ways: (1) passing large-scale taxes is consistently politically impossible, and (2) failing to provide a market mechanism for regulation.<sup>245</sup> Representative Edward J. Markey noted that there are arguments in favor of a carbon tax, “but [that] politics is the art of the possible, and [he] think[s] cap-and-trade is possible.”<sup>246</sup> Certainly, at some level this argument is superficial. First, there is the mere question of semantics—calling cap and trade a “carbon tax” because it is politically expedient to tie an opponent’s system to the universally-hated notion of taxes. There is also the question of political feasibility: a cap and trade system capitalizes on American notions of capitalism while a carbon tax sends hints of socialism and domineering environmentalism to the electorate. Generally, it indeed would seem that a cap and trade system for practical and political reasons is more likely to find firm footing than a, perhaps clearer, carbon tax. Moreover, as pointed out by some analysts, a tax system is easily gamed and will not lead to the solid and consistent regulation created by a market-based cap and trade system.<sup>247</sup> In order for a cap and trade system to truly work, it must create an asset that is defined and that carries inherent, but negotiable, value in a transaction.

### C. THE USUAL DEBATE: CURRENCY OR COMMODITY?

Previous arguments about the nature of the carbon asset have failed to focus on the ownership privileges innate in the asset, to allow for the development of contractual relationships, and to relate to the current attitude towards legal control over economic markets. For example, Jillian Button argues that we should not jump to the pure “commodification of carbon;” rather, we should look to carbon as a currency as well as, or even in lieu of, a commodity.<sup>248</sup> Button cautions that without a given determination as to the nature of the carbon asset and the nature of the market, those buying and selling the allocation will seize the opportunity

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243. *Id.*

244. John M. Broder, *House Bill for a Carbon Tax to Cut Emissions Faces a Steep Climb*, N.Y. TIMES, Mar. 7, 2009, at A13.

245. *Id.*

246. *Id.*

247. *Id.*

248. Button, *supra* note 230, at 571, 573.



to determine its nature themselves.<sup>249</sup> I agree with Button that there should be a defined nature to the asset created by the carbon allowance, but I suggest examining the contractual advantages of seeing the carbon asset under the classification of commodity and even as a UCC-defined good.

The currency model suggests that in order to maintain government predominance and control over the carbon asset and to insure that the environmental goals of cap and trade programs are met, the carbon asset should not be regulated like a commodity, but rather, like a currency.<sup>250</sup> Button's notion is echoed in a *New York Times* article making the assumption that "[t]o build a carbon market, its originators must create a currency of carbon credits that participants can trade."<sup>251</sup> The jump to a currency qualification does not seem to address the fact that government mechanisms for commodities trading already exist in the United States and abroad. The United States provides for the Commodities Futures Trading Commission (CFTC) to "regulate commodity futures and option markets."<sup>252</sup> Though it was initially focused on agricultural products, the CFTC has since expanded to include other industries and even created an Energy and Environmental Markets Advisory Committee (formerly the Energy Markets Advisory Committee) in 2008.<sup>253</sup> This committee has been mandated to advise the CFTC "on important new developments in energy and environmental futures markets that may raise new regulatory issues[ ] and the appropriate regulatory response to ensure market integrity and competition[ ] and protect consumers."<sup>254</sup> Here, there is the potential for an existing mechanism to expand in order govern the rights exchanged in emissions transactions. Additionally, this method would be provided in a way that is familiar to the entities involved in emissions trading—the corporations, the bankers, and the traders—and would take advantage of clear precedent and developed understanding of enforcement opportunities. Overall, it is more consistent with the mission of the cap and trade system to use existing market forces to enforce an environmental benefit.

Button argues that there are advantages to a currency model that cannot be captured by a commodities classification.<sup>255</sup> She looks to a currency model to avoid pricing discrepancies across different markets and to drive "down the price of units across the market, . . . resulting in lower overall GHG mitigation."<sup>256</sup> Using a currency model would allow for carbon allowance prices to be traded across national lines with variation

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249. *Id.* at 573, 575.

250. *Id.* at 573.

251. Hannah Fairfield, *When Carbon is Currency*, N.Y. TIMES, May 6, 2007, § 6, at 6.

252. About the CFTC, <http://www.cftc.gov/aboutthecftc/index.htm> (last visited Oct. 31, 2009).

253. Energy Markets Advisory Committee, <http://www.cftc.gov/aboutthecftc/EnergyandEnvironmentalMarketsAdvisoryCommittee/index.htm> (last visited Oct. 31, 2009).

254. *Id.*

255. Button, *supra* note 230, at 583-95.

256. *Id.* at 584.

allowed in each allocation's price difference representing the cost differences in minimizing emissions.<sup>257</sup> This model would also include more parties in the emissions program instead of excluding those who do not meet a single standard or sacrificing the overall goals.<sup>258</sup> Button further argues that using a currency model would help in "creating a race to the top" as opposed to a race to the bottom.<sup>259</sup> She suggests that "[i]n a homogenous commodity model, market forces would pose the risk of causing a race to the bottom, because regulators would be lobbied by companies to make it easier to create excess credits."<sup>260</sup>

The currency market adds some form of protection to the carbon allowance market to guarantee that the goals of the system are met. The currency approach certainly is focused on increasing the regulatory actions in governments and the participation of global emitters at any level.<sup>261</sup> However, a considerable measure of market freedom is sacrificed, and the power of existing government regulation practices in the commodities arena is overlooked. It makes little sense to rely on a market-created mechanism to solve a problem and to bring along corporate players, while at the same time limiting those market forces. Additionally, a currency model does not acknowledge that the more complex and limiting the regulatory schema, the less politically expedient the program. In the current economic climate, corporations certainly are quickly becoming accustomed to increased government involvement, but this involvement is more easily accepted and compliance is more easily obtained when that regulation flows naturally from that which existed before. By continuing with the commodities analogy, investors are able to continue their involvement in the cap and trade program with minimal increased costs and, hopefully, maximum understanding and willingness.

#### D. A NEW WAY OF SEEING THINGS: FROM COMMODITY TO GOOD

Limiting the addition of currency qualities to the carbon allocation does not preclude the government from controlling the asset. Instead, such limitation allows for the possibility of government control while allowing for the predominance of contract law and the responsible weight of market forces. Even Button recognizes the innate similarities between carbon allowances and commodities:

[C]arbon units can be traded like generic *goods* . . . [and] are generally made in very large volumes . . . . The prices of commodities are fluid across time, but at any given time the price for a particular commodity will be generally uniform across the marketplace . . . . Carbon futures markets have also emerged, similar to those tied to tradi-

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257. *Id.* at 585-87.

258. *See id.* at 586 (discussing a "binary" approach to carbon trading).

259. *Id.* at 588-90.

260. *Id.* at 589-90.

261. *See id.* at 581 (explaining that private organizations in unregulated markets will pressure governments to actively combat the problem of "leakage").

tional commodity markets.<sup>262</sup>

Here, she has not only recognized the potential for carbon allowances to be treated like commodities, but also that they may be treated like “generic goods.”<sup>263</sup> It is important, however, to recognize the potential for carbon allowances to be treated as a good and to examine the potential benefits of such a treatment.

Providing a useful analogy to this discussion, some American circuits have held that electricity is a good as defined by the UCC.<sup>264</sup> Like carbon dioxide emissions, electricity is an invisible asset.<sup>265</sup> It is naturally occurring, yet harnessed by man. In fact, the two are naturally coupled in the realm of emissions regulated by the RGGI because electricity and carbon dioxide emissions are produced in the same place by the same sources. Electricity is the product desired by the marketplace, and emissions are the negative externality released into the air as a consequence.<sup>266</sup>

The UCC applies to “transactions in goods.”<sup>267</sup> Once a contract or transaction is deemed to be governed by the UCC, there are certain advantages and disadvantages with contractual interpretation and enforcement.

The UCC defines “goods” as:

all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action. “Goods” also includes the unborn young of animals and growing crops . . . .<sup>268</sup>

Courts, though, generally are split on whether electricity is a good or a service.<sup>269</sup> The District Court for the Southern District of New York, while construing Utah law, recognized that Utah courts “have held that other states’ interpretations of identical UCC provisions are relevant” in determining undefined provisions of electricity contracts.<sup>270</sup> The Utah courts, though, have not explicitly held that electricity is a good under the

262. *Id.* at 576-77 (emphasis added).

263. *Id.* at 576.

264. See generally Morrison & Foerester LLP, *Electricity: A “Good” under the UCC. Should be a Simple Question—Right?*, FREE LIBRARY Apr. 21, 2005, <http://www.thefree library.com/Electricity:+At%22Good%22under+the+UCC.+Should+be+at+Simple+Question+...+aol131874846> (providing a comparison of cases delving into the issue of whether electricity is a good under the UCC). This article provided the original comparison of cases addressing electricity as a UCC good that inspired this section.

265. *Id.*

266. Button, *supra* note 230, at 571; Lehner, *supra* note 34, at 388.

267. U.C.C. § 2-102 (noting also that the UCC shall not apply to securities transactions).

268. U.C.C. § 2-105(1).

269. Morrison & Foerester LLP, *supra* note 264.

270. Enron Power Mktg., Inc. v. Nev. Power Co., No. 03 Civ. 9318, 9332 (BSJ), 2004 U.S. Dist. LEXIS 20351, at \*4 (S.D.N.Y. Oct. 12, 2004) (reviewing a bankruptcy court decision granting summary judgment on breach of contract claims for Nevada Power Co.).

UCC.<sup>271</sup> The New York court has also applied the UCC, particularly UCC section 2-609, the “Right to Adequate Assurance of Performance.”<sup>272</sup> In so doing, it is able to use a unique “mechanism[,] . . . a UCC innovation designed to solve the problem of anticipatory breach.”<sup>273</sup> The court is then able to employ the methods of interpretation and remedies provided by the UCC that would have not been available to it had it determined that electricity was not governed by the UCC. Using these kinds of UCC “mechanisms” will allow for greater contract enforcement and for increased predictability in carbon allowance contracting and litigation. Most importantly, a carbon allowance must be given a real and legally protected value in order for corporations to engage in their trade and market mechanisms to control the carbon asset.

In *Puget Sound Energy, Inc. v. Pacific Gas & Electric Co.*, for example, the District Court for the Northern District of California also faced with the question of whether electricity would qualify as a good under the UCC.<sup>274</sup> The court ultimately determined that electricity does qualify as a good and that the UCC would rightfully apply, but recognized the split among circuits.<sup>275</sup> Some courts have been of the opinion that “[t]he distribution might well be a service, but the electricity itself, *in the contemplation of the ordinary user*, is a consumable product.”<sup>276</sup> The *Puget Sound* court also noted that a Texas court made a similar determination, stating that “[e]lectricity is a commodity, which, like other goods, can be manufactured, transported and sold.”<sup>277</sup> In looking at the facts in question, after surveying the determinations of other courts, the holding here summarized that:

[s]imply put, electricity in this instance is a thing movable at the time of identification to the contract for sale. That is clearly demonstrated by the fact that the Agreement calls for the shipment of specific quantities of electricity. The electricity is moved through the power lines and the amounts are metered and therefore identifiable. The court will apply the UCC.<sup>278</sup>

The Supreme Court of New York, however, took the opposite line of reasoning and determined that electricity was a service rather than a

271. *Power Sys. & Controls, Inc. v. Keith's Elec. Constr. Co.*, 765 P.2d 5, 10 n.2 (Utah Ct. App. 1988) (noting also that other jurisdictions recognize that “the sale of electricity is considered a good, and UCC Article 2 governs”); *Enron Power Mktg., Inc.*, 2004 U.S. Dist. LEXIS 20351, at \*4-5 (citing *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656 (N.Y. 1998); *Puget Sound Energy, Inc. v. Pac. Gas & Elec. Co.*, No. C-01-2451 MHP, 2002 U.S. Dist. LEXIS 1350 (N.D. Cal. Jan 4., 2002)).

272. *Enron Power Mktg., Inc.*, 2004 U.S. Dist. LEXIS 20351, at \*4.

273. *Id.* (citing U.C.C. § 2-609).

274. *Puget Sound Energy, Inc.*, 2002 U.S. Dist. LEXIS 1350, at \*16.

275. *Id.* at \*28.

276. *Id.* at \*29 (quoting *Pierce v. Pac. Gas & Elec. Co.*, 166 Cal. App. 3d 68, 82 (Cal. Ct. App. 1985)) (emphasis added).

277. *Id.* at \*30 (quoting *Grant v. Sw. Elec. Power Co.*, 20 S.W.3d 764, 771 (Tex. App. 2000) (emphasis added)).

278. *Id.* at \*32.

“‘product’ for purposes of strict products liability.”<sup>279</sup> The power company conceded that a damaging surge was caused when a limb fell on a power line and brought the distribution line down onto the transmission line.<sup>280</sup> The court here recognized that other jurisdictions have considered electricity as a product once it has “passed through the customer’s electric meter . . . because it has been placed in the stream of commerce and is no longer under the control of the supplier.”<sup>281</sup> The court disagreed with that notion, furthering a point made by the Ohio court that “[t]he utility does not ‘manufacture’ electrically charged particles, ‘but rather, sets in motion the necessary elements that allow the flow of electricity.’”<sup>282</sup> The court analogized electricity more closely to services in that consumers pay by the kilowatt hour and for the “use of the electricity.”<sup>283</sup> Here, though, the court limited its decision by considering the policy implications behind *only* strict products liability.<sup>284</sup> The decision did not look at other implications for considering electricity a good, especially the potential advantages in contracts litigation.

The decision did address one of the important caveats worth considering in determining the nature of the carbon asset. Quoting the Ohio court, the New York court “point[s] out that the public utility does not operate in a free market.”<sup>285</sup> Similarly, carbon emissions do not operate in a completely free market, but rather, contingent to government permit allocations.<sup>286</sup> Conversely, the ultimate goal of the program, though, relies on the power of free market forces. In order for the program to work, corporations must be encouraged, brought on board, and able to see the risks and benefits in the carbon transactions that they would see in normal market transactions. Essentially, there is a two-layer factor of political expediency here: the need to create a program that will actually be accurate and the need to encourage corporate involvement. The answer is innate to the cap and trade notion itself, simply put, using the natural play of the market.

To make the market function though, security must be added to the value of the asset, which is more likely to hold firm when the contracts treat the asset as something with a real tangible value, like a good. It is

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279. *Bowen v. Niagara Mohawk Power Corp.*, 183 A.D.2d 293, 294, 297 (N.Y. App. Div. 1992).

280. *Id.* at 294.

281. *Id.* at 296-97 (citing *Smith v. Home Light & Power Co.*, 734 P.2d 1051, 1055 (Colo. 1987)).

282. *Id.* at 297 (quoting *Otte v. Dayton Power & Light Co.*, 523 N.E.2d 835, 838 (Ohio 1988)).

283. *Id.* at 294.

284. *Id.* at 297-98 (“We also find the analysis of the Ohio court compelling insofar as it concerns the public policy considerations behind strict products liability . . . . It is doubtful whether the imposition of strict liability would lead to a safer distribution system.” (internal quotations omitted)).

285. *Id.* at 298 (quoting *Otte*, 523 N.E.2d at 841-42).

286. Brett Frischmann, *Using the Multi-Layered Nature of International Emissions Trading and of International-Domestic Legal Systems to Escape a Multi-State Compliance Dilemma*, 13 *Geo. Int’l Env’tl. L. Rev.* 463, 472 (2001).

not a stretch to imagine the secondary trading of carbon allocations would be similar to that seen in electricity transactions. In *Puget Sound*, the court looked to how the product would be used “in the contemplation of the ordinary user.”<sup>287</sup> Here, the ordinary user is not the average Joe buying the good at Wal-Mart but another corporation attempting to legally emit carbon. Two corporations involved in this sort of transaction would want to see it as something which falls within their normal realm of business trading—not the buying and selling of some currency, but the buying and selling of a good or a commodity with a stated value. Further, corporations would value the knowledge that their transactions are governed by something as regular or ordinary as the UCC. Such knowledge would enable them to predict the results of their interactions and how best to enforce their rights under these transactions.

Though some courts reject the idea of characterizing electricity as a good, they have not focused on typical contractual transactions, but rather on questions of liability. It seems that when they have looked to the enforcement of contract rights, they have been more willing to use or analogize from the UCC. As in those instances, it would be appropriate and beneficial to apply the rights and mechanisms available under the UCC to carbon allocation.

## V. CONCLUSION

As the world comes to terms with the reality of climate change, policy-makers will look to innovative programs to achieve efficient and effective progress. Utilizing market-based solutions will allow corporations to take part in the program, rather than making them enemies of the system. Creating methods that allow private parties to make their own determinations as to cost-effective emissions reductions probably will prove successful. When the government creates new programs and new rights, though, new rules of contract and litigation must evolve tailored to these new situations.

Determining what kind of asset a carbon allocation represents is key to understanding what rights are included therein, how those rights may be enforced, and how those rights may be challenged. There is another dimension to the nature of the asset, though, that may weigh more heavily on how the future of cap and trade programs progresses. Different assets are protected differently and subject to different kinds of government intervention. As Button points out, a currency is more tightly controlled by the government and is a creation of the government to begin with.<sup>288</sup> Most forms of property, however, are created by government grant. The government also has the power to take away rights to personal property, these seizures and grants sometimes being the entire basis for popular political movements. But ultimately, the state has the power not only to

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287. *Puget Sound Energy, Inc. v. Pac. Gas & Elec. Co.*, No. C-01-2451 MHP, 2002 U.S. Dist LEXIS 1350, at \*29 (N.D. Cal. Jan. 4, 2002).

288. Button, *supra* note 230, at 577.

determine what rights of ownership it will give its citizens and to take those rights away, but to craft those rights in whatever form necessary.

The importance of choosing the type of asset here may not lie completely in the personal rights of property, but may turn on how the type of property represented will be reflected in the market created. The trading of carbon allowances has created a new type of property in a new type of market—one with more government influence than most, to be sure. Governments involved in this endeavor, though, must be cautious in how much they interfere with the market. It seems that the goals of the programs have an inherent divergence: government regulation to reduce emissions and market mechanisms to effect that reduction. The asset chosen will manifest the ultimate weight put on each of those factors.