

**Committee on Agriculture  
U.S. House of Representatives  
Biographical Form**

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**If you are responding on behalf of an organization, please list the capacity in which you are representing that organization, including any office or elected position you hold or if you are a volunteer.**

Robert G. Pickel is the Executive Director and Chief Executive Officer of the International Swaps and Derivatives Association, Inc. (ISDA). Previously, Mr. Pickel was the general counsel of ISDA, serving in that capacity since November 1997.

## Part I: Carbon Reduction Program Design

- 1) Members of Congress have introduced numerous bills to address the wide spectrum of climate change issues. Do you think Congress should enact a program that uses carbon taxes/fees, a cap-and-trade program, or a hybrid of these two approaches? Why?

*Please respond in 600 words or less.*

Incentive-based environmental regulation has been demonstrated to effectively and efficiently achieve emissions reductions while encouraging technological innovation. Both a carbon tax and a cap and trade (CAT) approach promote these benefits; however, a CAT approach is preferable for several reasons.

**Certainty of Carbon Reductions:** The purpose of regulating greenhouse gases (GHG) is ultimately to achieve actual reductions in emissions. A tax does not ensure that any reductions would actually occur. Given the prevalence of carbon emissions in every major sector of the U.S. economy, a tax that prices GHG emissions too low could result in an economy-wide inflationary effect, but have little effect on actual emissions. Fixing a tax at a high price is more likely to incentivize behavioral changes; however, actual reductions are still not guaranteed. In contrast, the “cap” in a CAT approach ensures that the overall amount of pollution emitted by the regulated sector is limited, providing some certainty that the goals of the regulatory program will be achieved. In addition, the establishment of an appropriately stringent cap in the beginning of a CAT program will ensure market demand for pollution reductions and help to avoid the problems faced in the first phase of the European Union Emissions Trading Scheme (EU ETS) and the initial allocation of the Title IV Acid Rain Trading Program (i.e., an over-allocation resulting in a collapse in the price of allowances).

**Lower Cost Reductions:** Different emitting sources face different actual costs for reducing pollution depending on variables such as size, age of facility, location, etc. Under a carbon tax approach, a uniform standard is applied to an industry regardless of those variable costs, whereas a CAT system provides regulated sources with the flexibility to adjust for those differences. For example, polluters with high costs of abating pollution may prefer to pay for allowances, while polluters with lower costs may implement control mechanisms if they can do so at a cost that is less than the cost of allowances. As a result of such decisions, a CAT system can lead to significantly lower total costs of compliance relative to a carbon tax regime and can achieve the same (or more) total reductions in pollution.

Carbon emissions are prevalent across sectors of the U.S. economy. Essential goods and services are more likely to become unduly expensive in a regulatory environment that mandates a specific approach or result rather than encouraging the adoption of the least costly solutions. As a result, a CAT approach should ensure that any adverse impact on the economically disadvantaged will be minimized.

International Cooperation/Linkage: The Kyoto Protocol and the European Union Emissions Trading Scheme utilize a CAT approach. Linking these programs with a U.S. program is likely to increase market liquidity and achieve the most efficient pollution reductions by opening markets to innovative practices and market participants. These benefits would not exist under a carbon tax regime if it were eventually linked with an existing CAT program.

- 2) Should the agriculture and forestry sectors be covered under a carbon reduction program? Why or why not?

*Please respond in 300 words or less.*

Clear standards for quantification and verification of emissions reductions in the agriculture and forestry sectors have not yet been established. Therefore, regulatory certainty will be better achieved if carbon reductions in these sectors are incorporated in a CAT program in the form of offsets. International efforts are underway to reach consensus for treatment of these sectors under an international CAT program. Conformity with approaches developed pursuant to these mechanisms will provide opportunities for linkage of a U.S. program and international programs. Linkage across programs will not only permit U.S. businesses to take advantage of lower cost reductions occurring in developing countries but also create new export opportunities for the U.S. agricultural and forestry sectors.

- 3) If a cap-and-trade program is chosen, how should emission allowances be distributed? For example, should they be at no cost, auctioned, or a combination of both? How should Congress prioritize the distribution of available allowances? Should allowances for the agricultural and forestry sectors be allocated at no cost, if so, should there be a limit on the number of no-cost allowances?

*Please respond in 600 words or less.*

No answer submitted.

- 4) Should a cap-and-trade program or a carbon tax/fee program be linked to existing or emerging U.S. regional or other carbon reduction programs (i.e. RGGI or individual state programs)? If so, which programs and why?

*Please respond in 600 words or less.*

Any federal program should supersede and pre-empt relevant state or regional programs. Clear federal preemption will ensure the integrity of the market and create a fungible product leading to increased liquidity and market efficiency. However, any federal program should take account of and incorporate existing mandatory CAT programs at the state and regional level as appropriate in order to promote continued constraint on emissions and increased technological investment in reducing emissions. For example, hundreds of millions of dollars have been invested in programs such as RGGI. Therefore, any mandatory CAT programs that have been implemented by local and regional

governments should be transitioned into any federal program in order to ensure the integrity of the existing government-sponsored regimes and avoid market disruption or collapse. The administration of the underlying local or regional program should be phased out so as to avoid unnecessary regulatory complexity; however, the allowances created pursuant to these programs should be incorporated into a federal program.

In contrast, linkage between a mandatory federal program and existing private and voluntary programs is likely to present substantial challenges. The methodologies for verifying emissions reductions under voluntary/private programs do not conform to the stringent standards required under a mandatory program. Inclusion of these programs could significantly undermine the cap of a CAT program if it were to result in flooding the market with allowances that do not represent actual reductions in pollution. Therefore, participants in voluntary programs should only be considered for early action credit if they have achieved verifiable emission reductions.

- 5) If a cap-and-trade program is established, should an existing government agency regulate it or should a new agency be created? Please explain.

*Please respond in 300 words or less.*

No answer submitted.

- 6) If a derivatives or futures market in carbon reduction arises in the wake of the creation of a cap-and-trade program, should the Commodity Futures Trading Commission (CFTC) continue its role as the regulator of this derivative carbon market, or should there be a different regulator? Please explain.

*Please respond in 300 words or less.*

Administration of a CAT program should be distinguished from regulation of GHG derivative markets. The CFTC should maintain its current regulatory authority over derivatives, including the derivative GHG market, and should use its authority to protect against market manipulation and abuses. The CFTC has the experience and mechanisms in place for monitoring emission allowance futures trading. In addition, the CFTC already regulates emissions futures markets, including RGGI futures and options contracts traded on the New York Mercantile Exchange and the Chicago Climate Futures Exchange.

The CFTC's large trader reporting system effectively monitors large market positions for evidence of position concentration in one entity, or related entities, and other indications of market power. Market data from these sources should be sufficient to enable the oversight authority to monitor participant behavior to determine if there is improper conduct. A transparent marketplace permits market participants to make informed decisions, while providing the government regulator with needed information to prevent undue price volatility and manipulation.

Regardless of which regulator is ultimately chosen, clear lines should be drawn so as to avoid overlapping or duplicative regulatory authority. Currently many energy markets are potentially subject to overlapping regulation by FERC, the CFTC, and in some instances the FTC. Such a regime creates confusion and undermines the certainty necessary for market participants to be willing to invest the significant financial resources necessary in a new market for GHG. Any GHG regulatory regime ultimately adopted by Congress should clearly distinguish the regulatory obligations of any regulator in order to streamline the system and encourage participation.

- 7) Currently, derivatives of energy-based commodities can be traded through: a) highly structured instruments on regulated, transparent futures markets accessible to anybody and anyone; b) flexible instruments on lightly regulated, transparent derivative markets accessible to only major market participants, or; c) flexible instruments on unregulated, opaque over-the-counter markets accessible only to major market participants.

Should derivatives markets in carbon reduction arising in the wake of the creation of a cap-and-trade program also be permitted to develop under similar options as for energy-based commodities?  
*Please respond in 600 words or less.*

A pre-requisite for the success of a CAT system is permitting full recourse to market-based risk management practices. The scale of investment required to transition to a low-carbon economy requires a broad suite of carbon price and risk management approaches. Bilateral, over-the counter contracts are an essential element of a functioning emissions market.

In order to secure financing for power plants and offset projects, infrastructure developers often must demonstrate that they have managed to hedge GHG price risk over the term of the financing (likely 7-10 years in duration). Therefore the existence of GHG risk management products of this duration are essential to the successful functioning of the market and deployment of capital. However, these products are not available through exchanges because they cannot be standardized. Currently project developers manage fuel price risk to secure financing for today's conventional power projects through long-term bilateral contracts—not exchange-traded products—because there are no exchange-traded fuel products of sufficient duration. The benefits of a market-based approach to achieving GHG reductions cannot be fully realized without similar recourse to long-term, non-standardized contracts for GHG commodities.

Furthermore, standardized contracts are traded in pre-determined minimum amounts. For example, a typical exchange-traded contract might trade in minimum 100-unit increments. Smaller market participants will not be able to effectively hedge their risks and are thus put at a distinct disadvantage compared to larger participants.

Financing for the transformation of our national energy infrastructure either will be unavailable or vastly more expensive if carbon and fuel risk cannot be effectively controlled through bilateral hedge contracts. In addition to the impracticality of looking

to exchanges for long-term, large-scale commodity contracts, collateralizing such contracts with a second lien, as is commonly done today, is simply impossible on an exchange because exchanges, rightly, require cash or cash-equivalent securities (e.g., US Treasuries) as collateral.

A related concern is the practicality of “clearing” of OTC carbon derivatives through a clearinghouse. In practice, clearing presents significant obstacles since the carbon derivatives needed to effectively hedge the emissions risk of new power plants will vary substantially from project to project, thus making the virtually instantaneous risk assessment required by a clearinghouse to calculate margin nearly impossible. In addition, the inherent illiquidity of second lien collateral further complicates clearing for carbon derivatives. Clearinghouses must require cash or cash-equivalent collateral to effectively manage the risk of default of one of the parties to a transaction. To effectively manage its systemic risk, a clearinghouse must also be able to immediately judge the risk inherent in the transaction it is attempting to clear and to hold extremely liquid collateral (i.e., cash or cash-equivalent instruments) to manage that risk.

Carbon market participants will likely use exchanges for a large portion of spot trades, forwards, futures and options as well as secondary or issued offsets. However, many carbon offset transactions and structured allowance trades are non-standard and cannot be listed as contracts on a commodity futures exchange.

For these reasons, we strongly recommend keeping standardized contracts on formal exchanges while allowing non-standardized contracts to be traded off-exchange. Mandating all carbon offset and allowance trades to be cleared and transacted on a designated exchange platform would result in significantly fewer clean energy and carbon-reducing projects being developed and impair the ability of companies to customize contracts to suit their compliance needs.

We support legislation that would require exchanges to register with an appropriate regulatory authority. Proper training and licensing of carbon traders may be appropriate for certain activities. Designated contract markets offering environmental commodities are already required to be registered with the CFTC. If a market participant fails to duly register with the CFTC or operates without required training, it would be appropriate for the CFTC to impose those sanctions applicable to similar circumstances in established commodity markets—such as permanent injunctions, civil monetary penalties, rescission of all related transactions, disgorgement and restitution.

- 8) Will enactment of a carbon reduction program have negative impacts for regions or populations whose welfare is of special interest to the agriculture community? Such groups could include: residents of rural areas; populations served by USDA nutrition programs; agricultural producers and forest landowners; or input, transportation, and processing sectors of agriculture and forest products.

*Please respond in 600 words or less.*

No answer submitted.

- 9) How might revenue generated under a carbon reduction program be best used to offset any negative impacts?

*Please respond in 300 words or less.*

No answer submitted.

- 10) Should businesses that are affected (either indirectly or directly) by higher overall costs due to a carbon reduction program receive transitional assistance?

*Please respond in 300 words or less.*

No answer submitted.

- 11) What role should public lands play in helping to sequester carbon and/or reduce greenhouse gas emissions?

*Please respond in 300 words or less.*

No answer submitted.

- 12) Should carbon prices be determined exclusively by market forces or should limits on carbon prices be established? Please explain.

*Please respond in 600 words or less.*

Price discovery and a strong carbon price signal are a fundamental benefit of a CAT program. The ability to value carbon monetarily will incentivize emissions reductions. Ensuring that market participants can be confident that the price is accurate will drive investment in the CAT program. Artificially low prices imposed by price controls would undermine both of these objectives. The costs of bringing new technologies to market are often higher in the initial stages; as a result, artificially low prices may not provide the incentive necessary to overcome this initial hurdle. Plus, if prices are too low, markets are more likely to simply absorb the additional costs, potentially resulting in higher prices of essential consumer goods or economy-wide inflation. Further, artificial price caps undermine a CAT system by preventing the market from recognizing increased demand and responding to scarcity.

Technological innovation is usually driven by market forces. A number of technologies for reducing, capturing and/or storing carbon emissions are currently under development. Setting a stringent cap and permitting the market to function freely will move these technologies more quickly from laboratories to the public domain.

However, concerns about cost containment are legitimate and can be addressed through market-based mechanisms such as the use of high quality offsets, banking of allowances

and linkage across CAT programs. Offsets can provide real, verifiable and permanent reductions while containing costs and avoiding significant economic dislocation.

- 13) What, if any, lessons can be learned from the European Union's Emission Trading System (ETS) or any other carbon reduction program already underway or being developed? Do any international carbon reduction programs currently exist for agriculture and forestry?

*Please respond in 600 words or less.*

**Accuracy of Data:** It is essential that Congress and the EPA have an accurate emissions baseline against which to determine the appropriate cap. An inaccurate baseline may lead to an over-allocation of allowances, which in turn will flood the market and undermine the market incentive to reduce emissions. The accuracy of the baseline will be enhanced by early and accurate reporting of company/installation-specific emissions.

**Handling of Data:** It is also essential that government regulators handle emissions data with due regard to potential market impact. Verified emissions data is central to market pricing, and the environmental compliance regulator must handle such information with the same care that financial and securities regulators handle sensitive proprietary information. Program administrators should take great care to ensure that data gathered on actual emissions, allowances issued and surrendered, etc., are handled in a manner that ensures all market participants have access to the collected data simultaneously. The U.S. Department of Energy's handling of aggregation and release of natural gas storage statistics could serve as a model.

**Stringent Cap:** Program design must ensure that the amount of allowances issued is actually lower than historical emissions. For example, there was an over-allocation of allowances in the first phase of the EU ETS, so the intended "cap" on emissions actually resulted in the issuance of more allowances than there were emissions during the covered period. The emissions registry currently being formulated by the EPA should ensure this problem is not repeated.

**Banking:** Allowances in the EU ETS did not carry over from Phase I to Phase II – i.e., they were not "bankable". As a result, the price of Phase I allowances collapsed at the latter end of the Phase I compliance period. If the allowances had not expired, and instead could have been carried into the second phase, this price collapse would not have occurred. Program design should avoid any variant where allowances expire (i.e., it should allow appropriate levels of "banking"). Taking this approach will reduce price volatility, which in turn will increase investor certainty and encourage early emissions abatement.

**Regulatory Clarity:** With respect to offsets, any carbon reduction program needs to signal clearly what types of activities will generate offsets. By providing adequate time for project development and verification of offsets prior to the initial compliance deadline, a CAT program will better ensure that offsets can be used to mitigate price volatility in the

early phases of the program. Without such clarity, investments will be limited and the full benefits of offsets will not be realized.

## **Part II: Carbon Reduction Program Administration and Implementation**

The administration and implementation of an offset or allowance program will be a major topic during any potential climate change discussion. Please answer the following questions regarding the scale, scope, and limitations of any program as part of the larger carbon reduction debate.

- 14) What options or combination of options would be most effective for agriculture and forestry sectors in a carbon reduction program: a voluntary offset program, bonus allowances for selected agriculture and forestry activities, or agreed upon performance standards for segments of the agriculture and forestry sectors?

*Please respond in 600 words or less.*

No answer submitted.

- 15) Should the total number of offsets issued annually by the government be limited? If so, how much?

*Please respond in 300 words or less.*

No answer submitted.

- 16) How should Congress prioritize the distribution of available offsets (who gets them and how much)?

*Please respond in 600 words or less.*

No answer submitted.

- 17) What should the criteria be for measuring (quantification, verification, and monitoring) and accounting for the legitimacy of offsets under the program?

*Please respond in 600 words or less.*

No answer submitted.

- 18) What should be the criteria for assessing offset projects?

*Please respond in 300 words or less.*

No answer submitted.

- 19) How should Congress design a system for verifying offset projects?

*Please respond in 300 words or less.*

No answer submitted.

- 20) Should Congress establish a standards-based approach with pre-calculated values or a project-based approach that measures field results for establishing eligible offsets under the program?  
*Please respond in 600 words or less.*

Congress should use a standards-based approach for offset regulation and approval. Experience with the Clean Development Mechanism under the Kyoto Protocol demonstrates that the project-based approach has both structural and bureaucratic flaws that make achieving necessary requirements overly costly and difficult. In addition, as a practical matter, sectors such as agriculture and forestry have offset opportunities that are more suitable to a standards-based approach. Nonetheless, verification of actual carbon reductions should occur before offsets are granted or allocated by the program administrator. In some instances this approach may require a graduated allocation whereby offsets are awarded periodically pursuant to the continued success of the project creating the offsets.

- 21) What should be the relationship between offsets and allowances?  
*Please respond in 600 words or less.*

No answer submitted.

- 22) Describe the most important factors in establishing the permanence and duration of offsets under the program, including contract length and flexibility?  
*Please respond in 300 words or less.*

No answer submitted.

- 23) How should Congress address existing offset projects or credits established through a voluntary market or system (e.g., the Chicago Climate Exchange or an emission registry)?  
*Please respond in 600 words or less.*

No answer submitted.

- 24) The terms "additionality" and "stackability" are often used when discussing the details of an offset program. How should producers and forest landowners who may have been early-actors and already undertaken activities that sequester carbon or reduce greenhouse gas emissions be treated? Should activities undertaken to reduce carbon emissions also be allowed to count towards other environmental market activities, such as water quality or wildlife habitat creation, therefore allowing landowners to "stack" credits?  
*Please respond in 600 words or less.*

No answer submitted.

- 25) How should activities that may have been paid for in part by assistance from Federal or state government programs (i.e. cost share, technical assistance) be treated? How should those activities be treated if the practice was not specifically implemented to address carbon sequestration or greenhouse gas emission reduction?

*Please respond in 300 words or less.*

No answer submitted.

- 26) Should a producer be required to return revenue or be held liable if an offset project does not sequester carbon or reduce greenhouse gas emissions? How about in the event of a natural disaster or another event uncontrolled by the producer and/or landowner?

*Please respond in 300 words or less.*

A provision calling for the return of revenue will likely impede the development of a robust carbon reduction program and market. A strict verification regime should better address situations in which a project does not sequester carbon or reduce emissions as anticipated. In particular, the institution of a reserve margin or appropriate offset replacement obligations can help to address the impact of a natural disaster or uncontrolled event.

For example, with respect to potentially non-permanent project types like forestry, offsets should only be granted retrospectively based on sequestration reserved and subject to a reserve margin. The reserve margin may vary from place to place according to the riskiness of the specific project site. The reserve margin offsets could then be pooled together, diversifying the permanence risk from a single source, with the intention of covering any carbon released from a specific project.

- 27) Should the protocols and procedures for the offset program be detailed in legislation, or should authority be delegated to the appropriate government agency to develop regulations? If so, which agency or agencies should be responsible for devising protocols and procedures?

*Please respond in 300 words or less.*

No answer submitted.

- 28) What are the obstacles faced by agricultural producers and landowners to implement practices and technologies?

*Please respond in 600 words or less.*

No answer submitted.

- 29) Do existing conservation and forestry programs provide sufficient incentives to encourage the adoption and implementation of practices that mitigate climate change impacts, sequester carbon and/or reduce greenhouse gas emissions? If not, what might Congress consider offering as additional financial incentives and technical assistance to speed up adoption/implementation?

*Please respond in 300 words or less.*

No answer submitted.

**Part III: Carbon Reduction Program Additional Thoughts**

**Please use the next 1000 words to provide additional comments on subjects which may not be have covered by the questionnaire, such as a low-carbon fuel standard, life-cycle analysis, leakage, or biofuel incentives.**

No answer submitted.

Please list specific types of <i>forestry practices</i> that should be available as offsets, and then use the terms provided to evaluate the practices.				
Type of Practice	Effectiveness at sequestering carbon or reducing GHG emissions ( <i>Excellent, Good, Moderate</i> )	Ability to verify carbon sequestration or GHG emission reductions ( <i>Excellent, Good, Moderate</i> )	Cost for agricultural producers and private forestland owners to implement ( <i>High, Medium, Low</i> )	Capacity of agricultural producers and private forestland owners to implement immediately ( <i>High, Medium, Low</i> )

Please list specific types of <i>practices associated with livestock operations (e.g. manure management, grazing/pastureland practices)</i> that should be available as offsets, and then use the terms provided to evaluate the practices.				
Type of Practice	Effectiveness at sequestering carbon or reducing GHG emissions ( <i>Excellent, Good, Moderate</i> )	Ability to verify carbon sequestration or GHG emission reductions ( <i>Excellent, Good, Moderate</i> )	Cost for agricultural producers and private forestland owners to implement ( <i>High, Medium, Low</i> )	Capacity of agricultural producers and private forestland owners to implement immediately ( <i>High, Medium, Low</i> )

Please list specific types of <i>crop production practices</i> that should be available as offsets, and then use the terms provided to evaluate the practices.				
Type of Practice	Effectiveness at sequestering carbon or reducing GHG emissions ( <i>Excellent, Good, Moderate</i> )	Ability to verify carbon sequestration or GHG emission reductions ( <i>Excellent, Good, Moderate</i> )	Cost for agricultural producers and private forestland owners to implement ( <i>High, Medium, Low</i> )	Capacity of agricultural producers and private forestland owners to implement immediately ( <i>High, Medium, Low</i> )