

**PROPOSITION 23 REJECTION LEGITIMIZES CLIMATE POLICY**  
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**V** **ERDANTIX**  
The Authority On Sustainable Business

# PROPOSITION 23 REJECTION LEGITIMIZES CLIMATE POLICY CALIFORNIA'S VOTERS SUPPORT GLOBAL WARMING SOLUTIONS ACT

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## EXECUTIVE SUMMARY

On November 2, 2010 61% of Californians voters rejected Proposition 23, a measure to suspend the implementation of California's Global Warming Solutions Act of 2006 until the State's unemployment rate fell below 5.5% . This report assesses the implications of the state-wide ballot on Proposition 23, which was funded by two Texas-based oil refiners, and opposed by cleantech investors, environmental groups and services firms. The rejection of the Proposition 23 legitimizes California's climate change policies. Key policies that will now go ahead include cap-and-trade regulation, targets to reduce transport-related emissions, clean car and clean fuel standards, expansion of energy efficiency programmes, and a target of 33% of state-wide energy from renewables. The Proposition 23 battle is a microcosm of the global debate over wealth redistribution triggered by a shift away from fossil fuels where special interest groups disagree on State-level climate policy, politicians in US States who represent different vested interests on climate policy, and national governments who fail to agree on global policy.

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## ORGANIZATIONS MENTIONED

A123 Systems, California Air Resources Board, California Energy Commission, California Public Utilities Commission, California Truckers Association, Environmental Defence Fund, US Environmental Protection Agency, Farallon Capital Management, Fisker Automotive, Flint Hills Resources, Kleiner Perkins Caufield & Byers, Mission NewEnergy, Sierra Club, Tiger Management Consulting Group, Tesoro, Tower Energy Group, Valero

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## CALIFORNIA'S VOTERS SUPPORT GLOBAL WARMING SOLUTIONS ACT

On November 2, 2010 7.1 million Californians voted at a state-wide ballot on Proposition 23, which proposed to suspend the implementation of California's Global Warming Solutions Act of 2006 (also known as Assembly Bill 32) until the State's unemployment rate fell below 5.5% for four consecutive quarters. California's unemployment rate has only been below 5.5% for four consecutive quarters three times since 1976. Proposition 23 was:

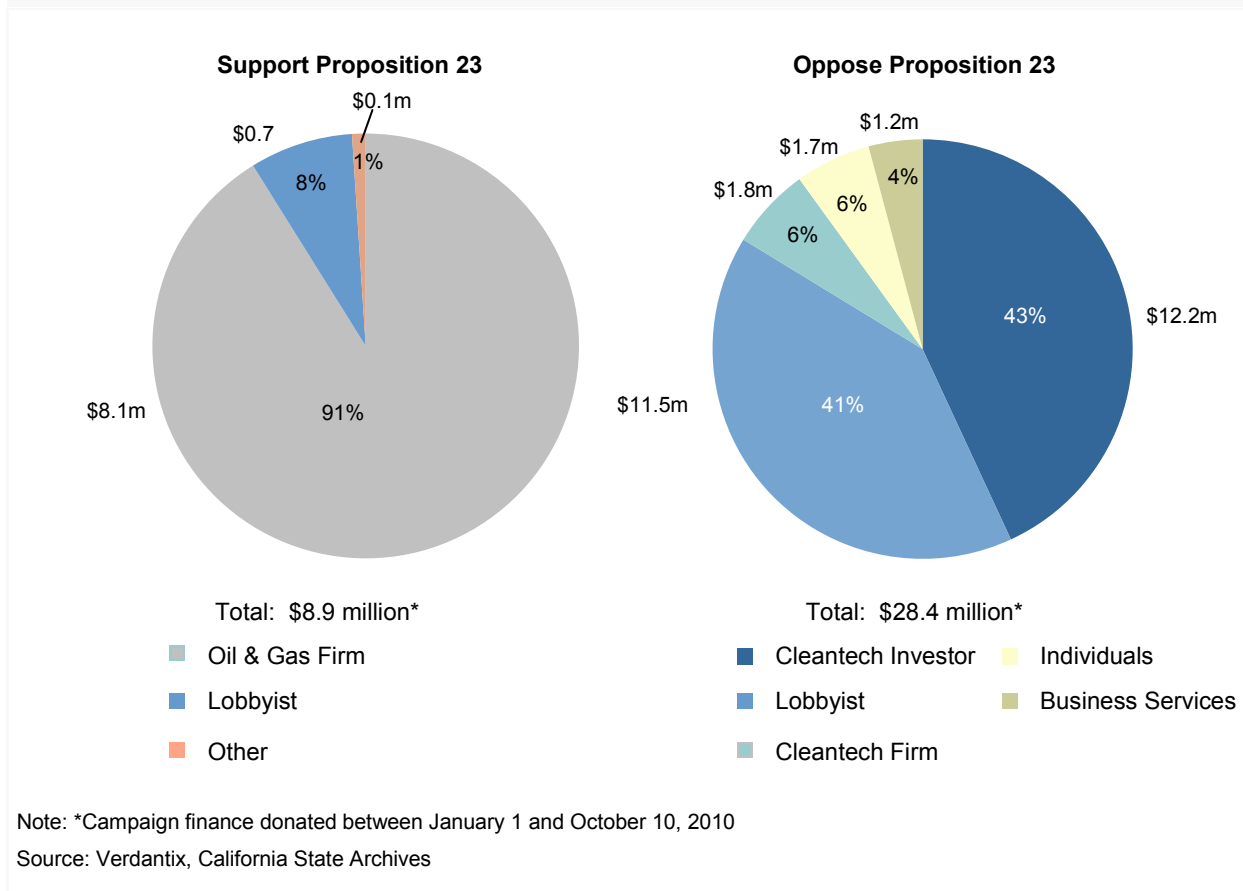
- Rejected by 61% of Californians who voted on the ballot.** Among the 7.1 million individuals who voted, 4.3 million rejected Proposition 23 and 2.7 million supported the ballot. The Proposition 23 ballot is the first single issue vote on climate change policy in the United States. This vote legitimizes California's renewable energy and climate change legislation which was called into question by the firms and special interest groups supporting the ballot.
- Funded by two Texas-based oil refiners.** Tesoro and Valero, provided \$1.4 million and \$4.1 million of funding respectively to support the Proposition 23 political campaign. The two oil refiners argued that the implementation of Assembly Bill 32 (AB32) will raise energy prices, increase unemployment in California, and should be suspended until the economy is more robust. In total oil and gas firms contributed \$8.1 million to the fund supporting the ballot, representing 91% of the \$8.9 million received by October 20, 2010 (see Figure 1).
- Opposed by cleantech investors, environmental groups and services firms.** Groups who opposed the bill included cleantech hedge funds and venture capitalists such as Farallon Capital Management (\$5 million donated) and Tiger Management Consulting Group (\$0.5 million), and special interest groups such as the Environmental Defence Fund (\$1 million) and the Sierra Club (\$0.8 million). The cleantech and environmental community believe that clean technology is a key growth sector for California and provided \$28.4 million in campaign finance against the proposition.

### Rejection Of Proposition 23 Legitimizes California's Climate Change Policies

The attempt by oil firms and special interest groups to indefinitely postpone the implementation of California's climate change and clean energy laws failed. This is the first single issue vote of its kind in the United States to support climate change policy. The California Air Resources Board's AB32 Scoping Plan which defines how the legislation will be implemented and includes a wide range of GHG reduction strategies (see Figure 2). Key initiatives that will go ahead include:

- Cap-and-trade regulation linked with US states and Canadian provinces.** Regulations for the California cap-and-trade programme are to be finalized by January 2011, with a January 2012 start date. The California cap-and-trade programme is being designed to link with other US states and Canadian provinces under the Western Climate Initiative, a regional collaboration to reduce GHG emissions. The preliminary estimate of the cap on GHG emissions for sectors covered by the cap-and-trade programme is 365 million

Figure 1. Campaign Finance Supporting And Opposing Proposition 23



metric tonnes of CO<sub>2</sub> equivalent (million tCO<sub>2</sub>e) in 2020 which covers 85% of California’s total GHG emissions, against the projected 2020 business-as-usual emissions of 512 million tCO<sub>2</sub>e.

*Verdantix take.* The rejection of Proposition 23 provides new impetus to the development of State-level and regional cap-and-trade regimes to limit greenhouse gas emissions in the United States. Californian leadership will help the implementation of the Western Climate Initiative’s broader cap-and-trade plans.

- **Targets to reduce transport-related emissions.** On-road vehicles accounted for 36% of California’s demand-side emissions based on the 2002 to 2004 average (see Figure 3). Efforts to reduce GHG emissions from California’s passenger vehicles include the September 2004 and 2009 Pavley I and II Light Duty Vehicle GHG Standards and the planned implementation of standards for the introduction of zero-emissions vehicles in California. These measures will reduce GHG emissions by 31.7 million tCO<sub>2</sub>e by 2020 against business as usual activities.

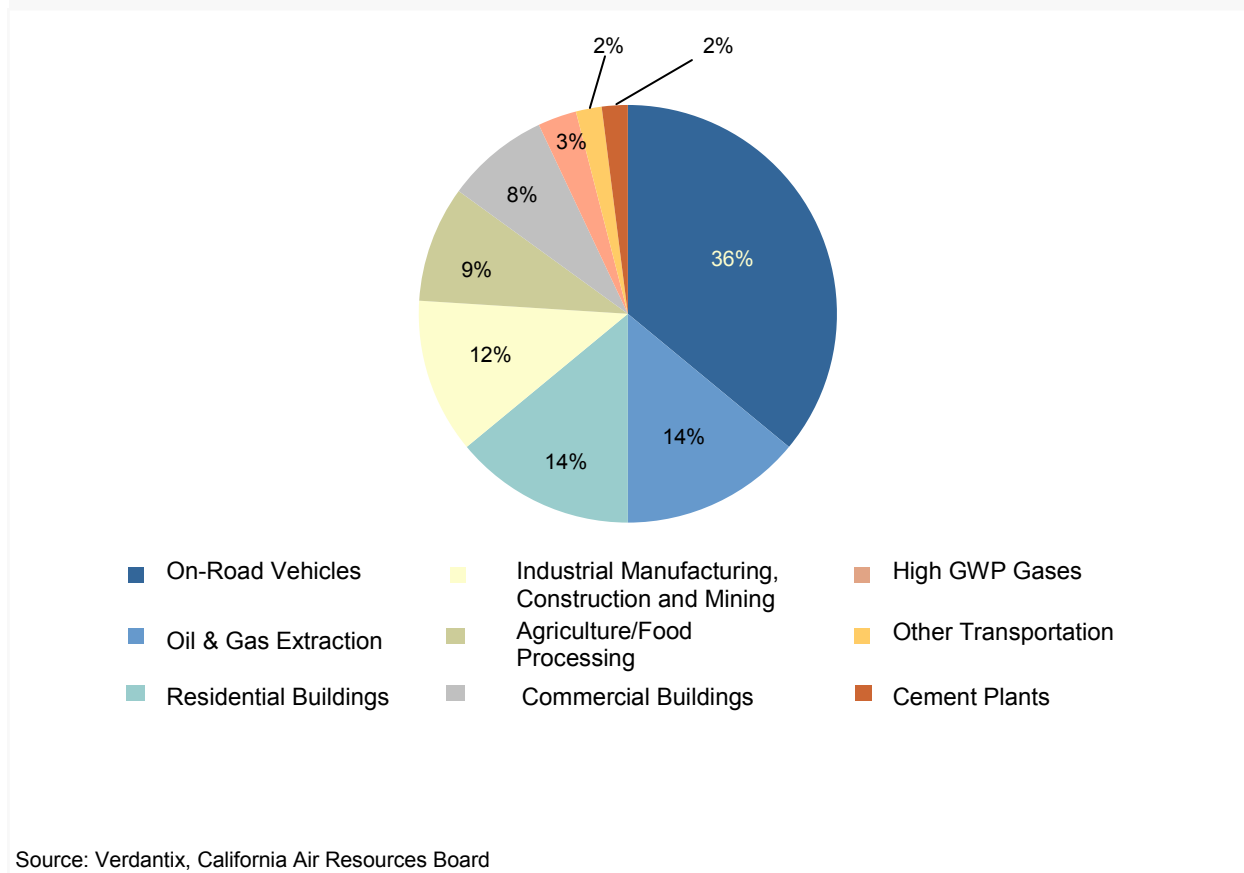
*Verdantix take.* Silicon Valley investments in battery technology and electric vehicle firms like A123 Systems and Fisker Automotive face less regulatory risk as one of the key early-stage markets is given a lift by the rejection of Proposition 23. California will move in line with market opportunities in other geographies such as Denmark, Hawaii, Israel and Japan for commercial scale roll outs of zero emission and low emission vehicles. Automotive firms will maintain expectations for US demand for electric vehicles such as the Nissan Leaf. Hybrid vehicle sales

Figure 2. California ARB Recommended Greenhouse Gas Reduction Measures

Recommended Reduction Measures	Reductions Towards 2020 Target (million tCO <sub>2</sub> e)
<b>ESTIMATED REDUCTIONS RESULTING FROM THE COMBINATION OF CAPAND TRADE PROGRAM AND COMPLEMENTARY MEASURES</b>	146.7
California Light-Duty Vehicle Greenhouse Gas Standards	31.7
Energy Efficiency	26.3
Renewables Portfolio Standard (33% by 2020)	21.3
Low Carbon Fuel Standard	15.0
Regional Transportation-Related GHG Targets	5.0
Vehicle Efficiency Measures	4.5
Goods Movement	3.7
Million Solar Roofs	2.1
Medium/Heavy Duty Vehicles	1.4
High Speed Rail	1.0
Industrial Measures (for sources covered under cap-and-trade program)	0.3
Additional Reductions Necessary to Achieve the Cap	34.4
<b>ESTIMATED REDUCTIONS FROM UNCAPPED SOURCES/SECTORS</b>	<b>27.3</b>
High Global Warming Potential Gas Measures	20.2
Sustainable Forests	5.0
Industrial Measures (for sources not covered under cap and trade program)	1.1
Recycling and Waste (landfill methane capture)	1.0
<b>TOTAL REDUCTIONS COUNTED TOWARDS 2020 TARGET</b>	<b>174.0</b>
	<b>Estimated 2020 Reduction (million tCO<sub>2</sub>e)</b>
<b>Other Recommended Reductions</b>	
State Government Operations	1-2
Local Government Operations	TBD
Green Buildings	26
Recycling and Waste	9
Water Sector Measures	4.8
Methane Capture at Large Dairies	1.0

Source: Verdantix, California Air Resources Board

Figure 3. California’s Greenhouse Gas Emissions - A Demand-Side View (2002-2004)



*will be relatively unaffected due to their existing market position and low cost value proposition.*

- Moving forward clean car and clean fuel standards.** Transportation is the largest single source of GHG emissions in California and the low carbon fuel standard helps to tackle emissions reduction in this sector by committing to reduce GHG intensity of transportation fuels by 10% by 2020. The California ARB is also developing regulations governing emissions from vehicle design and maintenance, including tire pressure, air conditioning and engine load. Additionally, regulations for improving heavy duty vehicles engine efficiency have been proposed that would go beyond goods movement regulated under the federal Clean Air Act and the state’s Goods Movement Emission Reduction Plan. The Low Carbon Fuel Standard will deliver reductions of 15 million tCO<sub>2e</sub> by 2020.

***Verdantix take.** The implementation of AB32 will have limited positive impact on clean fuel firms due to the existing subsidy regime for ethanol production in the United States and global regulation on fuel standards as well as potential action by the US Environmental Protection Agency (EPA). Valero, the largest oil refiner in the US which funded Proposition 23, has itself made investments in ethanol and biofuel production. In April 2009, Valero purchased seven VeraSun Energy plants and one development site for \$477 million. In December 2009 Valero signed a five year deal with Australia’s Mission NewEnergy to buy up to \$3.5 billion worth of biodiesel produced from palm oil and jatropha grass.*

- **Expanding energy efficiency programmes.** From a demand-side perspective, residential buildings accounted for 14% of emissions in the 2002 to 2004 period, commercial buildings represented 8% and industrial manufacturing, construction and mining 12%. In 2005 and 2006, the California Public Utilities Commission’s (CPUC) and the California Energy Commission’s 2003 Energy Action Plan was codified into legislation, requiring electric utilities to meet their resources needs first with energy efficiency. Achieving these targets is forecasted to deliver reductions of 26.3 million tCO<sub>2e</sub> by 2020 from business as usual.

*Verdantix take.* The burgeoning market for energy cost savings will continue apace with the confirmation of the AB32 measures. Introducing new incentives for power utilities to market and subsidize energy efficiency programmes will increase demand in California for firms providing energy performance contracts, insulation, energy efficient heating and cooling equipment, and smart meters. Since electricity prices are regulated, spend in these areas is not sensitive to fluctuations in market prices in the way that automotive purchases are impacted by shifts up and down in oil prices so a delay to the AB32 measures will have a strong positive impact on energy efficiency spending.

- **Targeting 33% of state-wide energy from renewables.** Electricity accounts for 23% of GHG emissions according to the 2002 to 2004 data. When AB32 legislation was enacted in 2008, 12% of California’s electricity mix was composed of renewable resources. In October 2010, the California ARB adopted the regulation to boost the renewable portfolio standard (RPS) from the current target of 20% by 2010 to 33% by 2020, giving the state’s utilities the toughest renewable requirement in the US. Meeting this target will reduce the state’s GHG emission by 21.3 million tCO<sub>2e</sub> by 2020 from business-as-usual activities.

*Verdantix take.* Investment in renewable energy requires a supportive policy environment due to the unfavourable economics compared to coal-fired power stations and sunk costs in existing power generation infrastructure. The rejection of Proposition 23 sends a powerful signal to firms selling renewable energy equipment into the Californian market and service providers installing and managing wind farms. Federal support for renewable energy investments under the “green stimulus” plans of 2009 and supportive regimes in other States will continue to drive demand in the US market as a whole. The key challenge for the renewable energy sector is a lack of project finance not policy limitations.

## California’s Proposition 23 Clarifies Global Fossil Fuel-Cleantech Battle Lines

Demand for energy efficiency products and services, renewable energy equipment and electric vehicles will be boosted by the legitimization of California’s climate change policy (see Figure 4). The Proposition 23 battle is a microcosm of the global debate over wealth redistribution triggered by a shift away from fossil fuels. This battle operates at the level of:

- **Special interest groups who disagree on State-level climate policy.** Proposition 23 pitted fossil fuel interests such as the California Truckers Association, Flint Hills

Figure 4. Economic And Policy Consequences Of Proposition 23 Ballot Election Results

Area of Impact	“Yes” Vote	“No” Vote
<b>CO2 Emissions</b>	Increase GHG emissions	Decreases GHG emissions
<b>Corporate Spending</b>	Decrease corporate cleantech spending	Increase corporate cleantech spending from 2012
<b>Investment Strategy</b>	Regulatory uncertainty limits investment in cleantech sector	Regulatory certainty accelerates investment in cleantech sector from
<b>Business</b>	Business-as-usual	Likely higher electricity and fuel costs from 2012
<b>Beneficiaries</b>	Oil producers, refiners, Large electricity consumers, heavy users of petrol and diesel	Cleantech investors, renewable energy firms, energy efficiency providers, electric vehicle suppliers, fuel efficient vehicle suppliers
<b>State Government revenues</b>	Suspension of administration fee to repay \$83 million in past loans to California ARB from a variety of state funds	Administrative fee continued and another potential revenue stream from auction of allowances for the cap-and-trade programme in 2012
<b>State level climate change legislation</b>	State level climate change legislation dead	Legitimacy of California climate change legislation established long term
<b>Federal climate change legislation</b>	Halts short and medium term progress	Takes fear out of federal cap-and-trade programme
<b>US action on climate change</b>	EPA only US legislative power for climate change	EPA and California drive US momentum on climate change

Source: Verdantix

Resources and the Tower Energy Group against California’s cleantech industry represented by investors like Kleiner Perkins Caufield & Byers. Valero, one of the oil refiners funding the campaign to support Proposition 23 has its own multi-billion dollar investment plans for cleantech. In California, fossil fuel interest groups aimed to buy time to ensure they have a profitable path to a future business model which is less dependent on fossil fuels.

- Politicians in US states who represent different vested interests.** At a federal level, the US EPA faces legal battles on its GHG reporting rule. Thirty-seven US states have taken sides in a court battle with 17 asking the EPA to review the regulations and 20 supporting one or more of the EPA rules. Regulatory battles played out at US State level mirror the battles between States such as California and Massachusetts whose voters support US climate policy and States such as Alabama, Texas and Virginia that would stand to lose the most if GHG regulations imposed heavy costs on the economy. In 2010,

US States supporting tighter energy and climate legislation lost the debate resulting in at least a four year delay in economy-wide, federal policy on climate change.

- **National governments who fail to agree on global policy.** The Copenhagen Accord fell short of a legally binding deal to replace the Kyoto Protocol which expires at the end of 2012 (see Verdantix Business Implications Of Copenhagen Accord Copenhagen). The UN negotiations in Cancun, Mexico in November 2010 will not establish a global climate change framework comparable to the Kyoto Protocol. The problem? Internalizing the cost of carbon emissions at a global level has massive and complex implications for wealth reallocation for billions of people. These decisions on reallocation of wealth, away from fossil fuel firms, sectors, and regions must be made at a smaller scale.

## Sustainability And Climate Change Business Research

Verdantix is an independent analyst research firm. We help senior executives and change leaders with our unique strategic and commercial analysis of climate change, sustainability and energy issues. Our clients are managers, advisers and entrepreneurs in blue-chip corporates, services firms, new ventures and government agencies.

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We live in an age of inevitability and uncertainty. It is inevitable that your business needs to address climate change, sustainability and energy issues. But do you know when sustainable business issues will have a material impact on profitability? And do you know which factors - carbon regulations, customer perceptions, weather risk, energy costs and competitive actions - will affect your business? Our research helps climate change and sustainability leaders in corporates, professional services firms and carbon markets to manage the tension between inevitability and uncertainty. To succeed in the transition to a sustainable economy.

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*"We heard that 90% of industry experts believe it is extremely important or important that a Chief Sustainability Officer has business transformation expertise. Environment domain knowledge only scored 39% in the survey."*

*- Verdantix: Who Should Be The Chief Sustainability Officer? (Feb 2010)*

### How You Benefit

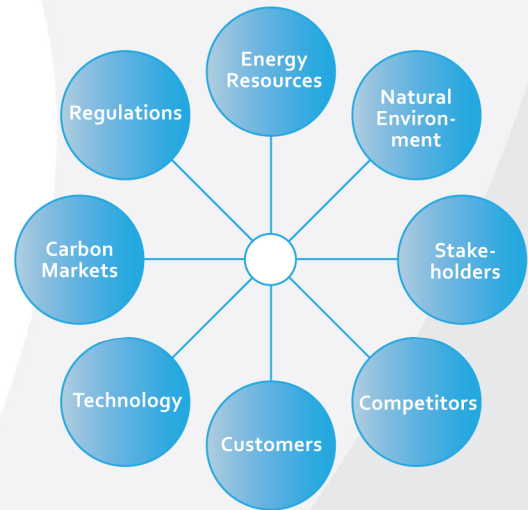
Our knowledge services help you to:

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- Keep pace with competitive actions.
- Make connections with new customers.
- Inform senior executives with evidence.
- Develop climate change propositions.
- Quickly shortlist suppliers.
- Spot hidden business opportunities.
- Validate your thinking and proposals.
- Speed up business case assessments.
- Track new customer trends.
- Benchmark your performance.

*"When asked what drives carbon management spending we heard that top of the list are: compliance (84%), competitive pressure (81%) and cost reduction (72%). Only 28% said carbon reductions were a factor." Best Practices Carbon Management (March 2010)*

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