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FROM: John Palmisano

DATE: December 12, 1997

SUBJECT: Implications of the Climate Change Agreement in Kyoto & What Transpired

This memo summarizes the implications of the agreement reached in Kyoto and also describes what I was doing and provides some observations.

Implications

If implemented, this agreement will do more to promote Enron's business than will almost any other regulatory initiative outside of restructuring of the energy and natural gas industries in Europe and the United States. The potential to add incremental gas sales, and additional demand for renewable technology is enormous. In addition, a carbon emissions trading system will be developed. While the trading system will be implemented by 2008, I am sure that reductions will begin to trade with 1-2 years. Finally, Enron has immediate business opportunities which derive directly from this agreement.

On the policy-front: There will be a great number of country-specific and international meetings related to every aspect of this agreement. I do not think it is possible to overestimate the importance of this year in shaping every aspect of the agreement. Three issues of specific importance to Enron are: (1) the rules governing emissions trading, (2) the rules governing joint implementation within Annex-1, and (3) the rules governing the proposed clean energy fund (which promises to dwarf the GEF as a fund for wind, solar, and power plant conversions.)

On the business front: During the next year there will be intense positioning of organizations to capture an early lead in a variety of carbon trading businesses.

The endorsement of joint implementation within Annex-1 is exactly what I have been lobbying for and it seems like we won.

The clean development fund will be a mechanism for funding renewable projects. Again, we won. (We need to push for natural gas firing to be included among the technologies that get preferential treatment from the fund.)

The endorsement of emissions trading was another victory for us.

Highlights of the Agreement

38 developed countries are required to reduce greenhouse gas emissions to or below 1990 levels by 2012.

The US reduction objective is 7%, the European Union is 8%, and Japan is 6%; therefore, it is not possible (or at least credible) that Congress can say the United States is at a comparative disadvantage vis-à-vis its main trading partners or competitors since the EU and Japan have higher control targets and are more "carbon-lean" than are we.

Six gases are included (CO2, CH4, N2O, HFCs, PFCs, and SF6).

Emissions trading is included. Details of an international system are to be worked out in 1998.

A "clean development fund" is included. The fund would allow for emission offsets from projects in developing countries.

Joint implementation for Annex-1, developed countries and the transitional economies, is included. This means that Enron projects in Russia, Bulgaria, Romania or other eastern countries can be monitized, in part, by capturing carbon reductions for sale back in the US or other Western countries.

While I do not have the final version of the agreement, I do have the first and second versions. The latest version is not on the world-wide web.

What I Was Involved in

I gave three speeches and received an award on behalf of Enron. The speeches dealt with emissions trading, energy efficiency/renewables, and the role of business in promoting clean energy outcomes. The award came from the Climate Institute and was for Ken Lay and Enron for our work promoting clean-energy solutions to climate change. The other recipients were Sven Auken, MP and Minister for Energy and Environment in Denmark, and MP and former Environment Minister for the UK, John Gummer. I have met Gummer and Auken several time before and it was nice for them to hear Enron praised so much. (I gave a speech with Gummer last Saturday and it was the third time we have been on the podium together. He is someone who still retains considerable influence in the UK and Europe and someone Enron might want to cultivate.)

I was also involved in a press conference.

Observations

I believe that it will be impossible to separate electricity restructuring from climate change as a domestic political issue. The administration has signaled its view that the two issues are intertwined. At yesterday's White House press conference, this connection was underlined by the comments from Tom Kasten , President of Trigen Corporation who spoke in favor of the climate change agreement and its linkage to restructuring. His remarks had to be cleared by the White House. These remarks are entirely consistent with every other signal from the Administration's climate change team.

Through our involvement with the climate change initiative, Enron now has excellent credentials with many "green" interests including Greenpeace, WWF, NRDC, GermanWatch, the US Climate Action Network, the European Climate Action Network, Ozone Action, WRI, and Worldwatch. This position should be increasingly cultivated and capitalized on (monitized). (Parenthetically, I heard many times people refer to Enron in glowing terms. Such praise went like this: "Other companies should be like Enron, seeking out 21st century business opportunities" or "Progressive companies like Enron are ..." or "Proof of the viability of market-based energy and environmental programs is Enron's success in power and SO_2 trading.")

Developing countries have acquired substantial negotiating power. The shift in negotiating power to India, Brazil, China, and the G-77 has been gradual and pronounced.

The EU negotiated as a group. Until two years ago, they negotiated as individual countries. While there are still individual country interests, the EU retains substantial power when working together. It was this cohesiveness that lead to a more stringent agreement.

EU delegates asked for my input into the agreement to oppose some of the positions espoused by some US delegates. In particular, the US was advocating <u>no</u> rules governing the trading of carbon emissions because rules would "inhibit trading." My position is that rules defining who owns what reductions, how reductions are traded, how they are tracked, and liability rules will help promote trading since rules give both buyers and sellers more confidence in the commodity.

While some companies and trade associations continue to criticize developing countries for not doing more, no company wants to be specific on this issue. To the extent any company does, they will hide under the shield of a trade association. I think that shield will soon be pierced. I believe that some companies will soon break from the line that developing countries should do more. It is a weak position in terms of equity and suicidal in terms of their commercial interests in these countries.

An increasingly ugly trend has become evident to the environmental NGO community and the delegates from developing countries. They see the argument about developing country participation as a thinly disguised recycling of the early twentieth century fear-mongering characterized by the so-called "yellow-peril" or invasion of the US by Asian peoples. The developing country delegates see the argument of the carbon lobby that the US will lose markets to developing countries as empty and racist -- they see energy-intensive imports to the US coming from Japan and Germany in terms of automobiles (and these are high cost energy areas) while economic growth in developing countries is fueled by local growth or Western industries requiring low cost of labor, low cost for land, or permitting flexibility for new plants. Enron should not participate in any argument like this because it hurts our credibility with developing countries, NGOs, and developed country governments.

I should have a copy of the agreement today.

The next year will be very intensive because the structure of the agreement exists, business opportunities are being defined, the rules governing emissions trading will be developed, and identifying, financing, and managing JI projects will be important.

One final point, Terry, if you remember, I predicted an agreement that would yield a 5% reduction by 2010; we got 7% by 2012. I now predict ratification within 3 years. I predict business opportunities within 18 months. I predict this agreement will have very significant influences on the energy sector within OECD and transitional economies and will accelerate renewable markets in developing countries. This agreement will be good for Enron stock!!