Carbon Monitor

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Voluntary Carbon Market

With the clear harvest liabilities under the Kyoto Protocol mirrored in the NZETS, for deforestation (harvest) forest owners are looking to Voluntary Carbon Markets.

At a recent ASIF function, EITG presented on the NZETS and Peter Brown presented an introduction to the Voluntary Markets.

In essence his view was that the parties agree to the issues surrounding all elements of the transaction, particularly what happens at harvest and in the event of problems such as fire. They also specify the actions required of each party and the validation and verification process.

Wrapped around this are several existing and emerging standards, the CCX standards, the Carbon Fix standard for European Reforestation and the recently announced Voluntary Carbon Offset Standard.

For the sake of robustness and withstanding criticism many of these standards incorporate elements of the process involved with the CDM or clean development mechanism of the Kyoto Protocol. In essence the CDM allows developed countries to sponsor projects in the developing world.

Critical to the CDM and the Voluntary Carbon Offset Standard is the concept of additionality. In essence the question is would the project have happened anyway (as business as usual - BAU) without carbon credits?

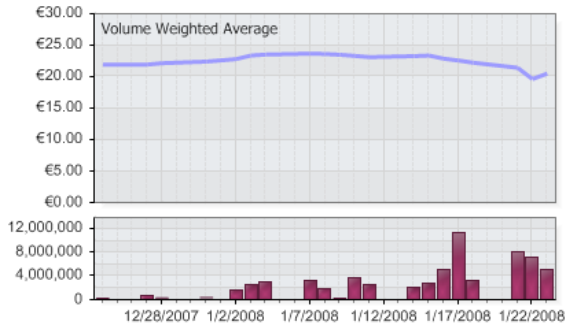
Most New Zealand exotic forest was planted for harvest and therefore would on initial assessment be business as usual and therefore NOT eligible for credits on the voluntary market if the Voluntary Carbon Offset Standard is used.

Care must be taken when looking at the voluntary market in selecting standards and assessing these against the market acceptance and actual trading occurring.

EU Price Update

The Dec08 softened at just over the 20 Euro mark in recent trading

Forward prices for 2009 are 21.14 Euro and for 2012 are 23 Euro!



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Climate Change (Emissions Trading & Renewable Preference) Bill

Introduced into the New Zealand Parliament in December 2007 this Bill implements the announced New Zealand Emissions Trading Scheme.

Notably the Bill is hard to understand as it functions as an amendment to the Climate Change Response Act 2002.

It also seeks to amend a number of other Acts that tie in including the Income Tax Act 2004 and Income Tax Act 2007 as well as the Forests Act 1949 and the Forestry Rights Registration Act 1983 as well as the Personal Property Securities Act 1999.

Other parts of the Bill amend the Electricity Act 1992, the intent of this part being a preference to renewable energy sources for baseline generation over fossil fuel based generation.

The large number of other Acts amended is indicative in our view of the depth the ETS invades the economic activity of the country.

Taxation and GST

Singled out for amendment are the two Income Tax Acts. These amendments seek to clarify the impact of the NZU units on the tax system and the tax treatment of these.

Essentially there is an exclusion from trading stock of an NZU meaning in our view that the threat of taxation on the unrealized gain from the issue of NZU units has been AVOIDED.

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In prior CM we have commented on the devastating impact on forestry investment if the accruals option in the policy document was implemented and a tax payment was due on the unrealized gain.

This is no longer an issue and for post 1989 credits tax is payable on the proceeds of sale.

Transferring the NZU to an AAU is also dealt with where the sale price is deemed to be the cost price meaning that no net income is generated.

The policy to us does appear moot on the subject of GST and no amendment to the GST Act is included.

Verifiers

Amendment to the Forests Act will allow the appointment of accredited forest managers as Verifiers.

Again the Act appears not to compel the use of verifiers. The Act is also moot on issues of conflict of interest. However we believe those verifiers who act with a conflict of interest may be subject to the penalties under the Act and certainly civil claims due to the severity of the penalty regime.

Transfer to International Markets

The Bill specifically provides for the transfer of the NZU units to AAU's and also allows interface with other off shore ETS platforms.

Restrictions on Transfer into the NZETS

CER's and ERU's from Nuclear projects are specifically excluded in the Bill. CER's cannot be generated from Nuclear power so here we are seeing the Government ensuring this restrictions endures in the NZETS.

Further restrictions are permitted by recommendation of the Chief Executive and it appears such restrictions cannot be retrospective.

General Comment

Much of the Bill can be implemented by the Chief Executive making recommendations to the Minister.

Most of the detail of the measurement regimes and related information are timetabled to become available after the select committee hearings.

This places limits on public submission on detailed contents of the actual execution of the Bill itself. This may not be that suitable as the detail is important as much as the structure in our view.

While consultation documents related to the price of NZU from $15 to $25 the Bill discusses NZU prices of up to NZD$50!

NYMEX/EVOMARKETS Announce Green Exchange

The Green Exchange will provide the world's most comprehensive marketplace for environmental commodities such as global carbon credits and allowances, US emissions allowances, and renewable energy credits.

This is an all inclusive marketplace that will serve as a major step forward in creating robust and liquid trading markets designed to address our greatest environmental challenges such as global warming, clean air, and sustainable energy.

The Green Exchange will be a standalone company. Its products will be traded on the NYMEX Globex Trading Platform and trades will be cleared through the NYMEX clearinghouse. It will provide a compliment to Evolution Markets? existing OTC brokerage operations much in the same way NYMEX does for natural gas or coal markets, including increased liquidity through online or screen trading and a robust OTC clearing platform.

Trading on the Green Exchange is scheduled to begin Q1'08

You can learn more about The Green Exchange by visiting its Web site at: www.greenfutures.com.

Australia – Ratified

With the election of the Australian Labor Party as the Government in Australia the Prime Minister Mr Rudd moved quickly to ratify the Kyoto Protocol.

Following this the ASX announced its intention to provide an emission trading platform.

Anthony Collins, General Manager of Emerging Markets at the Australian Securities Exchange (ASX), looks at how emissions trading is likely to evolve and how Australia's financial markets are well placed to meet the challenge.

By 2010 Australia will have its own national emissions trading scheme (ETS). Ratification of the Kyoto Protocol has given Australia a seat at the table to negotiate the international framework for emissions trading post the initial Kyoto period (2008 - 2012) and, subject to the design of the scheme, access to various Kyoto trading mechanisms. However, it will not be until the Australian Government has provided legislative certainty and emission reduction targets for

its ETS that the futures markets will be able to generate the carbon price signal, risk transfer and settlement mechanisms required for firms to make informed investment decisions and manage their carbon exposures.

The Australian Securities Exchange has been positioned to provide its market infrastructure to facilitate emissions trading since 1999. It has not proceeded with its plans due to the lack of regulatory certainty.

At the core of ASX's plans is the introduction of a futures market on emission permits and fungible credits that will generate the 'carbon signal' that firms need to make informed investment decisions. As the experience of the European Union (EU) ETS shows, liquidity in Australia's ETS will reside within the forward markets, namely exchange-based futures and over-the-counter (OTC) markets. In fact, forward markets will be operating in advance of the formal start of the ETS.

In addition to the forward markets, it is imperative that a settlement service exists to support Australia's ETS. The late development of stand-alone registries in the EU ETS, without an interface to a settlement service for over-the-counter trading, led to inefficiencies in the related spot and forward markets. The lack of settlement infrastructure has also been detrimental to the existing environmental schemes in Australia such as the Mandatory Renewable Energy Target scheme and the NSW Greenhouse Gas Reduction Scheme.

ASX intends to use its existing Austraclear infrastructure to provide settlement services to support the settlement of spot and forward trades in emission permits and fungible credits. ASX Austraclear is already fully integrated into the back office processes and systems of almost all of the likely participants in Australia's ETS, including the banks and brokerage houses that currently service the retail market.

The cost of emitting greenhouse gases, as signaled by the forward markets for emission permits and fungible credits, will impact decision-making across the entire economy. This will include the level of investment in cleaner electricity generation and projects to generate 'carbon credits' from approved offset mechanisms or, at a consumer level, our mode of transport and choice of consumer appliances. For business, the cost of emitting greenhouse gases can be managed through financial markets in the same way that exposures are managed to fluctuating interest rates, foreign exchange, commodity and energy prices.

Most banks already have dedicated teams to prepare their customers for the onset of a carbon-constrained world. For example, the provision of finance has and will increasingly become contingent upon banks understanding the 'carbon' risks of their business customers. Once the pre-requisites for a forward market have been met, banks will also provide their own hedging products to help customers manage their exposure to 'carbon risks', be they products embedded in lending structures or existing as outright derivative agreements such as swaps and options. Banks will in turn need to off-lay their risks to participants, including other banks and hedge funds, in the OTC and exchange-based futures markets.

A significant proportion of trading activity in Australia's ETS will gravitate to a futures exchange and clearing house. Futures exchanges provide market participants with the benefits of standardisation, centralised liquidity and anonymity. Additionally, futures clearing houses mitigate counter-party default risks. Such risks are exacerbated in OTC markets when credit spreads are wide and/or volatile as is presently the case.

What bodes well for Australia's national competitiveness is the existence of the financial market infrastructure required to support an ETS. This is particularly evident with the emergence of a highly liquid electricity futures market operated by ASX to support participants in the National Electricity Market (NEM), the largest sector within the Australian economy to be impacted by an ETS. The success of this market provides a solid foundation for trading in futures contracts based on emission permits and fungible 'carbon credits' generated from offset mechanisms.

The OTC market for emission permits in Australia, given its likely size and the credit standing of its participants, will inevitably be constrained by counter-party credit limits. To alleviate these counter-party credit constraints ASX will accommodate the registration of OTC trades into its futures clearing house, just like it currently does for its electricity futures and options market.

A fledgling voluntary market for carbon already exists in Australia. Participants in the voluntary market, however, should be cognisant of issues such as double counting and that not all credits will be recognised in the forthcoming Australian ETS. In other words: buyer beware.

There is no shortage of brokers or aggregators of carbon credits in advance of the legislative certainty and emission reduction targets needed for the financial markets to support the transition to an ETS. The mainstream financial community, however, is unlikely to become involved in any 'grey market' until regulatory certainty and emission reduction targets are in place.

In summary, Australia has financial market infrastructure, including the futures exchange, clearing house and settlement services operated by ASX, to ensure the success of Australia's forthcoming ETS. The transparency and reliability of the forward market

will also support capital raising in Australia's debt and equity markets to fund low emission technologies and generate a new universe of investment and trading opportunities for fund managers and individual investors.

Additional information on ASX's plans to facilitate emissions trading, including media releases, briefing notes, discussion papers and previous submissions, is available on the ASX website.

New Blog Released

Let your thoughts be known at www.ghgemissionstrading.wordpress.com

This blog is designed to discuss all aspects of emissions trading and GHG as well as the Kyoto Protocol

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'Carbon Monitor' is a client service of EITG.
EITG develops, facilitates and engineers Carbon Mitigation projects and strategies.

EITG corporate advisory provides high-level briefings and advice on building robust responses to emerging regulatory structures.

EITG Carbon Pool provides forest owners with a robust platform to access local and international markets while dealing with harvest and other liabilities.

EITG provides trading platforms and strategies based on extensive mitigation and avoidance platforms under JI and CDM, with matched offset packages for emitters.

EITG is part of an international consortium with representation in Asia/Pacific, UK, USA and South Africa

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