
Carbon Monitor

Volume 16 Issue 11

December 2011

Will the Durban talks Rescue the Carbon Market?

Much has been placed on the outcome of the Durban talks on climate change. Before discussing the potential outcomes the broad facts need to be looked at.

1. The EU is committed to its own ETS to 2020 at least, and will allow non industrial gas CER post 2012 and new CDM from LDC registered post 2012. There are no caps or floor on price but limits to how many CER can be used
2. The Australians have a carbon charge to 2015 and an ETS thereafter with 50% of compliance to be met by non industrial gas CER
3. The NZETS is likely to continue with a delayed introduction of agriculture (50% of GHG emissions) and a price cap. Long term the need to surrender permits for every tonne of GHG may move up from the current one for two to full matching of emissions will likely come into play. Post 2020 the 'wall of wood' resulting from the concentration of the age of NZ plantation forests maturing should create upwards of 40mt of emissions per annum
4. Japan is looking for an alternate to the CDM to allow project based credits
5. California and a number of other states have ETS or intend to create them, although Eastern states have recently moved away from an ETS, making the US ETS landscape diverse.
6. China is starting to implement its own regional based emissions trading schemes

Post 2012 the on going function of Kyoto in a new form appears dependent on India and China becoming part of the scheme in that they accept an emissions cap. These two countries in the past have been the source of the vast majority of the CER created under the CDM albeit most of these were industrial gas CER.

The global financial climate has certainly dampened emissions but also more importantly diminished the cash and the will to limit GHG whilst trading partners are seen to take jobs and create potential political problems in developed countries.

Notwithstanding that CM expects the EU to negotiate and trade off some of its position for a larger club of

nations with a successor to Kyoto. The Chinese managed to delay agreement two years ago, and with their appearing unwillingness to bail out Europe financially will they see merit in bailing out Kyoto?

We can only wait and see.

Reader Questions NZETS Forestry Rules and the Carbon Markets

A Carbon Monitor reader provided us some feedback on their view of forestry in the NZETS and emissions trading. Their points and CM reply are below:

Reader: Averaging would have been the best system from the start and should be applied now but I guess the resulting job losses at MAF etc will block it.

The air carbon problem & forestry are both very long term. Plantations which are reforestation, are rewarded for their one-off storage of carbon and so it is only the average amount stored in the long term that counts. Measuring them constantly as they grow and giving the owners credits all the way up to harvest is expensive in bureaucracy and management time and we have the silly concept that harvest is as sudden emission. It is not, and it is only the long term average carbon stored on a forest site that matters, so only that should be given to us. And of course only once. That average amount across the country will rise if more reforestation occurs, so that should be the priority in all policy affecting forestry. Averaging would certainly encourage planting, as you would have certainty:

Credits would be given for the first half (in carbon) of the first rotation, which would be sold to pay for it and the only rule needed would be the forest has to be replanted at harvest. Only one measurement would be required, to determine a reliable average.

CM Response: Forest averaging was looked at in the international negotiations. However the Kyoto Protocol dictates how the process must be applied and that is net carbon stock change over the commitment period, that is five yearly. VCS REDD however does use averaging and has a 20% insurance 'reserve' to cover losses across the portfolio of REDD projects such as fire.

VCS requires carbon stocks are measured regularly minimum every 5 years – even the NZETS is five yearly minimum. Only the



increase in carbon stocks are granted credits – simply giving a forest owner half the expected credits for their forest is not credible and will not contribute to a functioning market

Reader: Under current rules many plantation owners are afraid to sell carbon at \$13 in case they have to buy it back at \$130 in 10-15 years time.

Unless we move to averaging, forest growers will get disillusioned with the ETS & reject it before long.

CM Response: Forest owners were afraid to sell at \$20 as most did not understand the risks, and now with the publicity most do. I know a few who sold at \$20 and have purchased credits back at \$13.

We don't see the cost of credits reaching \$130 in the future – there are too many technology solutions to avoid emissions at around \$45 USD. If the SO2 story is anything to go by once that level is reached the technology will intervene and prices drop significantly. This is the climate change end game, not reforestation or forest credits (as they exist to develop liquidity). Also bear in mind forest owners who don't register are giving their credits to the government to use for NZ compliance free of charge, with a promise (a politicians promise) to provide the owners credits at harvest free of charge. With the wall of wood post 2020 the forest industry will arguably be the largest single sector for GHG emissions.

Averaging can be achieved by better methods than you suggest whilst still complying with the UN rules. Pooling is one idea publicly mooted.

Reader: At the same time it looks like the ETS & all carbon trading is doomed anyway, now the greens of the world (and it will be the mainstream left next) have moved to oppose trading carbon. Plus Europe is entering a long period of economic trouble, and they will have a surplus of credits to dump on the market, thereby ruining it. Markets and their merits will be a political victim of crisis.

So trading carbon will die out as a 'good idea' quite soon and carbon taxes may then be sold as the replacement, by a new younger generation of politicians. China & the US will not trade carbon, but they may tax fossil fuels instead, selling the idea by saying they will recycle that money directly to the people, as well as spent some on research to replace fossil fuel & adapt to climate change.

CM Response: The EUETS does operate the same way as the NZETS. It revolves around a cap on companies in specific sectors. Permits are then auctioned for those emitting over their cap, or alternately credits such as CER can be purchased for compliance (within specified limits).

It is correct to say the NZETS market may be flooded with credits but in another way. The EU has banned post 2012 CER from industrial processes or some 65% of all CER issued. Unless the NZ Government also bans these they will be sold in NZ and the NZETS price will drop significantly. This is a risk whether the EUETS collapses or otherwise unless policy intervenes.

Seven regions in China and ten states in the USA already have cap and trade systems operating or in planning. California the worlds 8th largest economy has a cap and trade system and will include forestry. The Australian system is a fixed price ETS to 2015 when the price can float between a floor and a cap. It is an ETS in that participants can avoid a carbon charge by abatement or purchasing ACCU credits from its commencement in 2012.

In summary comments on forest averaging are technically correct, but in the context of the UN rules are not able to be applied. Moreover the opportunity for fraud without regular compliance and monitoring is incompatible with a trading scheme. Finally forest carbon credits in essence inject liquidity into the New Zealand ETS so a flow of credits is essential. Unfortunately applying a forest only perspective to the scheme results in an incomplete analysis.

As to the conclusion that trading markets are at an end and Europe will flood the market with cheap credits, again the facts suggest the contrary. We agree if the EU collapses it would be a whole new game for carbon trading, but such a collapse would be unprecedented. Industrial gas CER are the biggest threat to non EU trading schemes and are being either excluded or intended to be excluded. Emissions trading is globally accepted as the only means to reduce emissions, the other policies have long been abandoned after many years of debate.

Is the Future of the EU Critical to Carbon Markets?

Carbon Match www.carbonmatch.co.nz recently provided this interesting update on the European situation

What Would Breakup of the Single Currency Zone Mean for Carbon?

Such a scenario appears to pose a small, but potentially catastrophic risk to the carbon market, which the EU ETS dominates to the tune of more than 85%.

To add to the woes of a market unnerved by the eurozone crisis and in any event already depressed by fundamental oversupply, the European Investment Bank has announced that it will push on regardless with the sale of the NER300 (New Entrant Reserve).

Many had expected that the EIB might defer the sale of these 300 million allowances onto the market, given how European allowances have fallen recently.

On a more positive note, there have been some louder voices joining the call for the EU to shift up a gear and adopt a 30% by 2020 target, given that they have almost reached the 20% by 2020 target with another 8 years still to run.

The hope is that the step-up could be championed afresh by environmentally ambitious Denmark, who take EU presidency in the first half of 2012.

Unfortunately it's hard to imagine this idea gaining much momentum when European Leaders have other much more urgent issues to contend with.

New Leaders Hurry to Implement Reforms While Germany Holds Back from Agreeing to Further Assistance

Recent weeks have seen Greece's Papandreou replaced with Papademos, Italy's Berlusconi supplanted by Mario Monti and now a new centre-right government for Spain, to be led by Mariano Rajoy.

The question now is whether these three can hold onto the reigns of their distressed horses and guide them into more stable terrain.

Greece is a mere trifle compared to what Italian or Spanish defaults could mean for the much larger France, which is hugely exposed to both countries and whose credit rating is already at risk of being downgraded.

Italy alone is estimated to need up to a trillion euros of backstop financing and it's unclear where this might come from.

Something Has to Give

Currently the European Central Bank is a central bank without legs. Some have suggested that what's required is for the ECB to be allowed to be lender of last resort by being empowered to issue bonds in its own right and use the proceeds to secure potentially solvent but seriously ailing governments (Italy).

But as it stands, the ECB isn't empowered to do this. To change this, core Europe, especially Germany, would have to agree. Propping up peripheral Europe to avoid the collapse of the Euro is a tough sell.

The more palatable option would be for the ECB to print money and continue with bond buying in an effort to keep interest rates manageable. But the risk of inflation is one that won't appeal to the German public either.

Yet the alternative could be just as damaging. Were there to be a break up of the single currency, the harder currencies of the North would rapidly appreciate, making exports and manufacturing sectors less competitive, and running the risk of triggering contractionary cycles in those countries. A deeper recession or even a depression could result.

Germany, in particular has been, and continues to be, the biggest beneficiary of the common currency. It does seem that it's in their interest to allow some kind of quantitative easing before another stalwart of the Euro zone, France, begins to come under attack as seriously as Italy has.

We can only wait to see what happens. While still very unlikely, a break up of the single currency could spell catastrophe for the EU ETS, and the wider carbon market

Apology to Readers of Carbon Monitor

We are sorry that the delivery of the carbon monitor via email has been interrupted over the last couple of months. This is due to circumstances beyond our control. Our provider "email now" ceased service without warning leaving us without our data bases and a service provider.

We have managed to recover an older version of our databases so apologies if you have already opted out. The opt out facility is on the new mail system we have selected Mail Chimp please click on the label in the email.

We hope to have the email template tidied up and fully operational in the New Year.

To all the readers who have given us feedback and to those who have criticised the CM we thank you for giving us the feedback and look forward to improving the quality and delivery of the CM in 2012. Meantime we wish you all happy holidays and a safe and prosperous 2012

Keep up to date on what is happening between issues of the CM by following EITG on twitter.

Australian Carbon Farming Initiative – will it Link to Other Markets?

The Australian CFI is a way of receiving carbon credits or ACCU (Australian carbon credit units) for certain activities.

There are two classes of credits, those that fit the Kyoto requirements and voluntary credits. Burning land fill gas is accepted and creates Kyoto ACCU, whilst soil carbon creates voluntary ACCU.

There is a commitment and budget for the purchase of voluntary ACCU by the regulator.

Additionality is applied to all projects. This ensures a project would not have happened without the CFI that is it is not business as usual (BAU)

There is a white list and black list of project types. Each project must be implemented using an 'approved methodology' There are a few of these in progress the most unique is the reported culling of feral camels.

Using the concepts of additionality, approved methodologies and other processes the CFI appears to be modelled from the United Nations clean development mechanism (CDM) and joint implementation (JI) – refer to our glossary the approved processes for generating credits from projects in countries outside the host country.

ACCU are defined as personal property to allow registration of interest against them and therefore the potential to raise finance.

ACCU and Kyoto units are defined under the Corporations Act and ASIC Act as financial products triggering the provisions relating to financial services and markets and product disclosure under the Corporations Act. The ASIC act will extend to cover dealings with ACCU and international carbon units.

ACCU are suggested to be fungible in the international carbon markets. It is suggested that with the provision of linkage with the EUETS and NZETS the ACCU will be tradeable in these markets. Such linkage is likely to be limited in EITG view.

The international carbon markets the ACCU may link to immediately is the AAU market or the Kyoto market, as AAU are used for country level compliance. The Australian Government proposes to swap an ACCU for an Australian AAU. The experience in the NZETS is forest based AAU have once been sold in volume for reasonable prices (1mt

and \$20NZD) However recently the weakening euro and large volumes of AAU on the market suggest prices of around 5 Euro or less for an ACCU converted to an AAU.

There may be a valid argument that an ACCU has high environmental integrity and is therefore more valuable than a so called 'hot air' AAU.

However in the absence of transparent market data (there is very little of this in the AAU market) it is very difficult to accurately suggest a price for an ACCU converted into an AAU.

Australian Clean Energy Act Now Law

Australia took another major step towards a clean energy future on November 8 after the Senate passed legislation which will pave the way for one of the most important environmental and economic reforms in the nation's history.

The passage of the Clean Energy Future legislative package will allow Australia to begin reducing emissions, developing and fostering new technologies in renewable energy, encouraging energy efficiency and creating opportunities in the land sector to cut pollution.

It will drive investment in clean energy and it will ensure that Australia plays its part internationally as a global citizen.

A fixed carbon price of \$23 a tonne will apply from 1 July, 2012, moving to a flexible price after three years. The carbon price is a tax on pollution and will only be paid by Australia's largest polluters.

For most people, the Government's comprehensive Household Assistance Package will cover, and in many cases exceed, any price rises.

In fact, nine out of 10 households will receive compensation from a combination of tax cuts and increases to family benefits.

<http://www.cleanenergyfuture.gov.au/>

Australian Business Clean Energy Law Checklist

Recent publications on the new Clean Energy Legislation suggest Australian business use the following check list when identifying if they are subject to the Legislation

Are emissions from my business covered?

Do facilities operated by my business emit direct

emissions that exceed the 25,000 t CO₂-e threshold?

Do I have operational control of the facilities or is there another operator on-site which could have operational control?

Does my business involve a joint venture arrangement which might limit my liability for emissions?

If my businesses' direct emissions are not above the threshold, do facilities my business operates nevertheless use large amounts of electricity, natural gas or other fuels?

As a supplier of goods and services can I pass the increased costs of compliance on in the cost of the goods I produce under my supply contracts?

If I am purchasing goods or services, can the supplier pass through its carbon costs under the supply contract?

Is the supplier entitled to free carbon units which would reduce its direct costs?

Can I take steps to reduce emissions at my facilities or reduce energy costs?

If I am a liable entity and have an obligation to purchase permits how do I purchase permits? Is there an opportunity to purchase from the Government at auction; can I purchase from third parties, other liable entities, brokers or project developers under the CFI? Will I be able to get a lower permit price that reduces my compliance costs?

Full details of the compliance obligations and various checklists can be found on our web site under the menu Australian Scheme.

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'Carbon Monitor' is a client service of EITG. EITG develops, facilitates and engineers Carbon Mitigation projects and strategies. Terms of use of this information are set out on our web site.

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 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, Europe, USA and South Africa



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