

Carbon Market Australia-New Zealand

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NEWS

CER price collapse too early for Australia to benefit

Market observers believe it is still too early for Australian companies covered by the carbon pollution reduction scheme (CPRS) to take advantage of the recent collapse in international carbon prices.

Secondary certified emissions reductions (CERs) for December 2009 delivery closed in the brokered market in Europe on 15 January at €11.75 (A\$23.20). Meanwhile Australian emission units (AEUs) for the 2012/13 financial year are offered at A\$24.25.

The government has proposed allowing Australian firms an unlimited amount of CERs to be used to meet their domestic emissions reduction targets under the CPRS. The present price structure could make it profitable for compliance buyers to purchase CERs now and bank for the future instead of betting on purchasing AEUs later.

But the situation has occurred too early, some market observers say.

"We are definitely seeing increasing interest in the CDM, but as a whole there is a fairly low level of understanding of the CDM in Australia," said Michael Wiener with Perenia Carbon, a joint venture between Pacific Hydro and SMEC which identifies and originates Kyoto protocol projects.

"Buying CERs is a sensible risk mitigation strategy for Australian corporates, especially at a price that is now at a significant low-point in the cycle," Wiener told Point Carbon. "But I think for the majority of the CPRS participants, it is still a little early. Those with a large liability and experience in trading are probably the most advanced in their decision making to purchase CERs," he said.

The government proposal to remove the limit on CER use was only made in mid-December, and most companies are still assessing the consequences of this proposal along with the rest of the rules outlined in the 15 December white paper.

"There is a lot of preparation work to do, but most people have a lot of other things to look at before they turn to CERs," one broker said.

However, another broker reported that several traders recently have started to show specific interest in CER options deals.

But while generators of CERs in China, Brazil, India and other developing countries would appreciate an Australia-led boost in global CER demand amid retreating energy prices and the financial crisis, significant buying interest from Australia looks unlikely to appear anytime soon.

"I don't think there will be any real interest from here until early 2010 at the earliest," said Lisa Wade with Arkx Carbon Fund.

People are yet to start worrying about their obligations under the carbon trading scheme, she said, and the obligations don't kick in until the end of financial year 2010/11.

The Europe-based Kyoto market was boosted in its infancy by large investment banks keen to take positions in the fledgling market. However, with the economic crisis casting its shadow over banks and other financial institutions, several of those banks have recently pulled out of the carbon market. Even though some of them have set up trading desks for environmental products in Australia, caution remains the order of the day.

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Market comment

Quoted bids and offers for Australian emission units (AEUs) have retreated by around A\$1 since mid-December, although no new trades have been reported in the market since 27 November.

Market liquidity has been hampered by Christmas celebrations and the January summer holiday for many traders, but the government proposal to allow an unlimited amount of Kyoto certified emissions reductions (CERs) for compliance purposes in the Australian scheme has contributed to the trend, according to market observers.

"I think a lot of people were caught unaware about the amount of CERs, and they are currently trying to get their head around what that means," one broker said.

The difficult economic situation has also caused hesitation in terms of taking positions in carbon until companies know exactly how many AEU's they will be given by the government.

The government plans to announce the emission caps for the 1,000 facilities that will participate in the Australian carbon trading scheme in early 2010, leaving firms in the dark as to their liabilities for at least another year.

Meanwhile, the collapse of international carbon prices continue to cap the domestic price in Australia. The December 2009 CER contract closed in the brokered European market on 14 January at €11.78 (A\$23.54), effectively making it unprofitable for Australian companies to pay more than that for AEU's.

"The fall in CER prices is ensuring the Australian market is not going up any time soon. There is not a great deal of positivity out there," one broker said.

The government will publish a draft legislative package for the emissions scheme in March. Most observers expect the market to remain quiet until the contents of that bill has been digested.

AEU OTC closing prices (A\$/t)

Delivery	Bid	Offer	Close
AEU 2010/11	-
AEU 2011/12	22.25	23.00	22.63
AEU 2012/13	23.50	24.25	23.88

The prices reflect OTC levels on 15 January. AEU's are quoted in A\$. Prices provided by brokerages Newedge, Nextgen and TFS and market traders. For methodology, see www.pointcarbon.com.

Australia's energy-related emissions increase

Energy-related carbon emissions in Australia's three eastern states rose 1.3 per cent in 2008, according to data released by non-profit organisation The Climate Group on 12 January.

New South Wales, Queensland and Victoria emitted a combined 279.2 million tonnes of carbon dioxide equivalent from energy-related activities last year, according to the group's Greenhouse Indicator.

That is an increase of 3.6 million tonnes on 2007.

Emissions rose in Queensland and Victoria, while a cut in petroleum use saw emissions in New South Wales drop 0.5 per cent on the previous year.

Burning of coal remains the main source of emissions, causing 166.7 million tonnes of CO₂ equivalent to be released into the atmosphere from the three states last year, an annual increase of 2.1 per cent.

"The Indicator clearly demonstrates that our reliance on coal for electricity is our biggest problem when it comes to cutting our greenhouse gas emissions. We need to change this pretty quickly if we want to cut greenhouse emissions," said Rupert Posner, the Climate Group's Australia director.

Australia's federal government said last month it will aim to cut greenhouse gas emissions 5 per cent from 2000 levels by 2020.

The country's dependence on coal has seen energy-related emissions spiral in recent years.

Queensland's energy-related emissions currently stand 34 per cent above 2000 levels. New South Wales has seen an increase of 25 per cent since the turn of the century, while output in Victoria has grown 6.2 per cent.

Compared to 1990 levels, the base year for Australia's Kyoto target, the increase in energy-related emissions is even higher.

Queensland now emits 116 per cent more than it did in 1990, New South Wales 30 per cent and Victoria 32 per cent.

Australia is still roughly on track to meet its Kyoto target of

limiting emission growth to 8 per cent above 1990 levels in the 2008-2012 period due to vastly reduced emissions from land-use.

ETS to cost Australia A\$1 billion per year: lobby

The carbon pollution reduction scheme will cost Australia's coal exporters A\$5 billion over the first five years, according to the Minerals Council of Australia.

The A\$1-billion per year cost is despite the fact that the sector will receive between 60-90 per cent of its emission permits for free.

"It may not yet be widely understood, but Australian business will face the highest carbon costs in the world. By a very large margin," Brendan Pearson, deputy chief executive of the Minerals Council of Australia, wrote in The Australian newspaper on 8 January.

He said that between 2010 and 2014, Australian firms face a carbon cost 18 times higher than that of European companies covered by the EU's emission scheme.

The Australian government was widely criticised last month when it announced its target to cut greenhouse gas emissions 5 per cent below 2000 levels by 2020.

Environmentalists said the target falls seriously short of the UN Intergovernmental Panel on Climate Change's conclusion that rich nations must cut emissions 25-40 per cent below 1990 levels by 2020 if dangerous climate change is to be avoided.

Pearson dismissed the criticism, arguing instead that Australian business will have to pay dearly for the government's over-ambitiousness.

"Those who believe that this burden won't harm the competitiveness of our most important export sector also believe in the tooth fairy, monkey fishing and that Elvis Presley is living in a caravan in Tumut," he wrote.

He argued that in 2020, Australia will need to cut 250 million tonnes of CO2 equivalent from its business-as-usual projections to comply with the government target.

He said that the additional costs to the export coal sector means production is being scaled back in Australia, while

the UK is planning 58 new mines.

This is a result of European miners not having to worry about carbon trading as the EU scheme does not cover methane emissions, the main greenhouse gas from coal mining, Pearson said.

Opposition rips into carbon scheme

Carbon trading proponents are like eco-totalitarians, Barnaby Joyce, senate leader of the opposition National party, said on 14 January.

"Climate change denier, like Holocaust denier, this is the sort of emotive language that has become stitched up in this (emissions trading) issue," Joyce told ABC radio.

He said the carbon emission reduction scheme, which the government plans to introduce next year would merely be another tax and would not have an environmental impact.

"The idea that this scheme can go forward and no one's allowed to question because there's a new form of eco-totalitarianism that demands blind obedience, I think that is wrong," the senator said.

The Labor government proposed rules for the scheme in December, and hopes to guide an emissions trading bill through parliament by mid-year.

Joyce's comments suggest the scheme will be subject to close scrutiny by opposition politicians.

Malcolm Turnbull, leader of the Liberal party and the opposition coalition, denied that the opposition is split on the issue of emissions trading.

"The coalition's position on this issue is very well known - it's the same that we had in government," he told ABC.

"We're very committed to action on climate change that is economically responsible and environmentally effective," he said.

The federal government responded with Agriculture Minister Tony Burke saying "I would hope that even (opposition leader) Malcolm Turnbull would say that comparisons to Nazi Germany ... are out of line and should be publicly refuted."

But the National party stood by Joyce, criticising instead

the government for trying to stifle the debate.

"Mr Burke should be trying to fix the emissions trading scheme rather than be critical of those who ask legitimate questions about the way in which the scheme will operate," Warren Truss, the National party leader, said, according to AAP.

"It is unfortunate that those who question the majority view should be treated as though they were somehow related to people who were deniers of the holocaust," he said.

If approved by parliament, the carbon trading scheme will go into operation 1 July 2010, capping the emissions of some 1,000 Australian facilities.

Energy-intensive industries facing competition from abroad have said additional costs from the scheme will cause thousands of Australian jobs to be lost.

The federal government has sought to address this by awarding energy-intensive industries and coal-generators 60-90 per cent of their allowances for free.

The actual cap on emissions for participating companies will not be known until early 2010, but the Labor government last month pledged to cut Australia's greenhouse gas emissions 5 per cent below 2000 levels by 2020.

If a far-reaching international agreement on climate change is in place, Australia could raise its reduction target to 15 per cent.

Australia makes ITL link

Australia in December became the 34th country to link its carbon registry to the International Transaction Log (ITL), the UN software overseeing international transfer of Kyoto protocol carbon credits.

Australia, which ratified the Kyoto protocol just over 12 months ago, successfully made the link with the international transaction log, according to a notice on a UN website.

The link will allow Australian project developers to import carbon credits from the clean development mechanism as well as let the government buy emission rights and carbon credits to help it meet its target under the Kyoto protocol.

Under the Kyoto protocol, Australia has a target to limit

emissions growth to 8 per cent more than 1990 over the 2008-2012 period.

In 2007, Australia emitted about 585 million tonnes of carbon dioxide equivalent, 5.9 per cent more than in 1990.

The link up marked the end of a successful year for the international transaction log, in which it linked together 31 carbon registries.

Belarus, Canada, Croatia, Iceland and Monaco are the only registries still to make the link.

NZ stalls on repealing ETS

New Zealand's government has not frozen the emissions trading scheme like it said it would. The National party-led coalition government pledged in after its November election victory to introduce legislation that would put the country's carbon trading scheme on hold.

But currently the scheme is still in operation, with the forestry sector the only participant. The sector protested against the scheme delay in November, claiming it would lose millions of dollars in investments from carbon credit buyers.

"The emissions trading act is in place and has not been amended yet," a government official confirmed.

The government in December established a select committee to review the scheme, adopted by parliament last September.

The committee is expected to report in late March, leaving little time or point in formally freezing the scheme.

Stationary energy and industry will be added to the scheme in 2010, with liquid fossil fuels and transport following the year after.

Expectations currently are that the scheme will be running throughout the select committee's revision period, and potential changes made before the end of this year.

The government official said the most likely outcome of the current process, if the scheme is indeed changed at all, would be to either increase the amount of free allowances or delay the entry date for some sectors.

One of the things up for consideration in the committee is

to replace the scheme by a carbon tax, although sources talking to Point Carbon did not think the government would opt for that.

Initially the committee was also meant to take a new look at the science behind climate change policy, but this point has since been dropped from the committee's terms of reference.

Grim future seen for Australia's voluntary market

Australia's voluntary carbon market is petering out, as the creation of a mandatory market and a governmental carbon offset standard mean there are increasingly limited opportunities to create voluntary carbon credits in Australia, according to market observers.

Voluntary credits saw a relatively lively market emerge in 2007 with prices at around A\$15 (US\$9.90) from forestry projects, but interested parties are now looking abroad.

"It is difficult to see how the voluntary market will fit in when such a large share of the economy is covered by a mandatory scheme," said Tim Burrows, director of Climate Managers, a consultancy.

"The forestry sector can opt in to the emissions trading scheme to create permits, which leaves agriculture. Some voluntary credits could be created in agriculture up to 2015, beyond that there is no certainty. I don't think the voluntary market will play a large role," he told Point Carbon.

The carbon pollution reduction scheme (CPRS) is expected to come into effect 1 July 2010, and will cover 75 per cent of Australia's emissions, significantly limiting the opportunities for voluntary reductions to take place.

The Labor government is currently working to establish a domestic offset standard for voluntary emission cuts, in order to boost consumer confidence in such credits.

It recently published a discussion paper on the subject, which will be out to public consultation until late February.

One of the issues for debate is whether it should retire an assigned amount unit (AAU) – the governmental carbon credits counting towards Australia's Kyoto compliance – each time a voluntary credit is registered.

The government plans to cover any shortfall in meeting its Kyoto target by purchasing AAUs from other governments.

If it does not retire its own AAUs whenever a private entity voluntarily cuts a tonne of carbon dioxide, the voluntary efforts will only have the effect of reducing the amount of AAUs the government must buy.

But if it does retire AAUs in a corresponding number to voluntary cuts, it worries the price of mandatory permits may increase, as it will be more difficult for CPRS participants to find viable emission reduction opportunities in Australia.

If the government decides to retire AAUs when voluntary reductions are made, it "would give a similar outcome as buying a mandatory permit, where the only purpose is to take the permit out of circulation," said Burrows.

"If voluntary credits are backed by AAUs, the voluntary market will basically be a subset of the mandatory market," he added.

The government estimates that Australian and New Zealand buyers combined in 2007 bought around 2.9 million voluntary carbon credits, representing some 0.5 per cent of their total emissions.

"Generally, interest in carbon neutrality has dropped away. Traditional emission-intensive firms like mining companies have more than enough to deal with just complying with mandatory requirements."

Some Australian firms are still looking at going carbon neutral through voluntary efforts, however.

One broker said companies mostly look abroad when purchasing voluntary credits, although volumes rarely exceed 30,000 credits per transaction.

The government proposed in its discussion paper to allow certified emissions reductions (CERs), emissions reduction units (ERUs) and removal units (RMUs) from the Kyoto protocol under the domestic offset standard. It would not however accept foreign AAUs or CERs from forestry projects.

It has sought advice on which international voluntary standards should be accepted in Australia.

Guest commentary: Auctioning in the CPRS

By Jesco d'Alquen, CEO, Tradeslot, jesco.dalquen@tradeslot.com

The Australian Department of Climate Change made it abundantly clear in its recent White Paper: Australia is rapidly moving towards a full-blown cap and trade system. The design includes forward sale of permits making it the most advanced carbon auction design globally.

It doesn't surprise therefore that these auctions will differ from more common formats companies and consumers are used to. If your organization looks set to buy permits, understanding the mechanics and doing your homework will definitely be worth your while:

A different type of auction

Carbon permits will be sold in so-called ascending clock auctions. Bidders will not indicate the price they are willing to pay but the number of permits they would buy at a price indicated by the seller. In practice, the government will put a set number of carbon permits on the market and ask bidders how much they would be willing to buy at a certain price level. If demand at that price level is higher than the supply of permits, the auction goes into a next round, the price is slightly increased by the seller and bidders respond again. The process ends when supply and demand are equal. At that point the uniform price for a carbon permit is established.

A complex market

For large emitters buying carbon permits is going to be a must. The auctions starting in July 2010 are the primary channel to procure permits. Companies will also be able to purchase permits on exchanges (e.g. ASX or Envex) or submit "substitutes", e.g. carbon credits produced by forestry operations domestically or certified emission reductions (CERs) from projects overseas.

Apart from companies that need permits to comply, there will be bidding intermediaries (such as financial institutions) and voluntary buyers. Companies enjoying free permit allocation will also have the option of selling back permits via the auction.

Interesting dynamics

Participants in the auctions will be able to bid for current year permits and simultaneously for permits for the following three years ("vintages"). This creates an

extended carbon price horizon for corporate investment decisions. As the rules allow pulling forward some permits and banking permits for later years, there could also be arbitrage opportunities should prices between vintages diverge substantially.

With twelve auctions per year we can expect some interesting dynamics:

- The cost of capital may drive some companies to bid at later auctions (earlier auctions create wider gaps between payment for permits and the annual reporting deadline)
- Companies may choose to watch and learn from earlier auctions before engaging in later auctions, in turn driving up demand in later auctions
- Overseas credits (CERs) may move into the Australian permit price bandwidth, creating potential step changes in permit demand

Homework

The auctions will trigger some serious homework for companies and a need for Heads of Sustainability, CFOs and CIOs to collaborate: At what price do alternatives such as carbon abatement opportunities become more attractive than permits? Do we have reliable and auditable data? Should we buy future vintages or use hedging instruments instead? Are primary or secondary CERs an option?

A few service providers are shaping up to assist companies in creating "marginal abatement cost curves" and preparing clients for auctions. Off-the-shelf software can be a good way to create necessary data and provide decision support. Consider training: your CFO will appreciate you looking out for opportunities to train in mock auctions - before betting real company money.

Ultimately, our experience shows that doing better or worse at high-stakes auctions (or any other competitive process) comes down to the right preparation.

Are you interested in contributing a guest commentary for Carbon Market Australia-New Zealand? Please contact the editor, Stian Rekle, at sr@pointcarbon.com.

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