

# Carbon Market **Australia-New Zealand**

A Thomson Reuters Point Carbon News publication

Volume 05 Issue 1

January 20 2012

## Australian fee proposal could thwart CER buying

An Australian government proposal to charge companies for using cheap foreign offsets to meet their ETS targets could cut near-term demand for the credits as well as increase costs for Australian emitters and limit investment in carbon projects abroad.

In early January the government circulated a discussion paper outlining four options for applying a price floor to international offsets, like it plans to do for domestic CO<sub>2</sub> permits.

For the first three years of the programme, set to launch in July 2015, permits to emit a tonne of CO<sub>2</sub> will be subject to a minimum price starting at A\$15 (\$15.50, 12 euros).

The scheme is set to become the world's second biggest carbon market after the EU, with offset demand on a par with the 27-nation bloc's cap-and-trade system at more

than 90 million units a year by 2020, according to Treasury estimates.

Yet some observers believe all four options in the discussion paper are likely to make it less attractive for Australian emitters to buy offsets ahead of the scheme's start, and they could add hundreds of millions of dollars to compliance costs for the 500 companies covered by the scheme.

"There would no longer be a financial incentive for liable parties to purchase international offsets," said Nick Armstrong, CEO of offset company COzero.

He said the proposals would discourage Australian firms from investing in carbon-cutting projects abroad because they wouldn't be compensated for the additional risks of funding such projects at an early stage.

"It is unlikely that liable parties

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## Australia cuts CO<sub>2</sub> from electricity generation 1.7%: report

Carbon emissions from Australia's National Electricity Market (NEM) fell 1.7 percent in 2011 as the financial crisis continued to have an impact on overall demand, according to a January 12 report by consultancy Reputex.

The sector's emissions fell for the second consecutive year, Reputex said, having recorded a drop in emissions of 2.7 percent in 2010.

"The decline is due largely to continued low demand across the market as a result of the global financial crisis and La Nina, combined with an increase in availability of renewable energy sources," Reputex said in a statement.

Australia's power generators belong to one of several sectors that will be subject to a A\$23 (\$23.84) tax on emissions from July 1, and could save millions of dollars if they are able to continue the downward trend.

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### Market comment

Carbon emission permits took yet another beating over the past four weeks as over-supply and a struggling economy continued to depress carbon prices in the European Emissions Trading Scheme, the world's biggest carbon market.

The sluggish EU market pushed carbon down elsewhere: Spot permits in the New Zealand market closed Jan. 19 at NZ\$7, which was up 4.5 percent week-on-week but down 20.9 percent from Dec. 22, when they closed at NZ\$8.85. Spot prices reached a record low of NZ\$6.70 Jan. 12.

U.N.-issued CERs fared even worse. Spot CERs in New Zealand closed on Jan. 19 at NZ\$5.90, the lowest level ever, and a staggering 32.6 percent drop from four weeks earlier.

Over the same period spot CERs in Europe fell 29.1 percent to 3.55 euros.

NZUs resisted the downward pressure better than the CER market towards the end of the period, as traders returning from summer holidays provided some fresh demand.

"People are still coming back from New Year's breaks. I think they came back from holidays, saw the price had fallen and decided to buy some," one trader said.

The NZU-CER spread, which was almost wiped out in December, widened again in January, and stood at NZ\$1.10 on Jan. 19, which stopped CERs from going into free-fall.

"There has been a bit of a pickup of interest in selling NZUs and buying CERs," one broker said.

But liquidity remained low throughout the holiday season, with only 165,000 NZUs changing hands.

In 2011, a total of 10.1 million NZUs traded, according to Point Carbon News data.

The broker added that some forest-owners had been seen buying NZUs in the market which they had previously sold to emitters at higher prices.

"They now have a profit and zero liability," he told Point Carbon News.

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would directly enter the primary market due to the risks involved and the high fees, which are unlikely to be reimbursed by the Australian government," Armstrong added.

While limited prospects for domestic offsets mean firms will need to buy foreign credits, the rules could leave companies more exposed to global price swings by forcing them to buy only in the secondary market or on a spot basis.

The government appears to favour one option in the paper that imposes a charge based on the market price of the offset at the time of surrender.

It would mean that if, on the day of surrender, the offset market price is A\$14 and the scheme's floor price is A\$15, the firm would be required to pay an additional A\$1 fee, regardless of the price it actually paid for the credit.

"(This) would most likely kill the forward sales under an Australian ETS unless other risk-based products were also introduced by the market at the same time to counter the price risk," said Nathan Dale with Brokers Carbon, an online offset trading platform.

Another option, a variation of the above, would let firms enter into a legal agreement with the regulator to hand over credits on a future date and pay a pre-specified levy based on the offset's current market value, adjusted for the time value of money.

The two remaining options propose charges based on the offset's cost, whether it be at origination or the price paid in the secondary market, but the paper warned that such measures could be hard for the government to administer.

The paper said the government's favoured option would avoid creating a preference for international credits, a prospect that riled some market participants.

"This does not seem to confer with the original intentions around the scheme design," said Sally Burns with Sigma Global, a carbon asset management firm, referring to a part of the Clean Energy Bill which argued that Australians should be allowed to buy foreign carbon credits if they were cheaper than domestic units.

"By regulating the use of international units to this degree, the effectiveness of the market mechanism may be lost which may lead to higher costs of compliance for liable entities jeopardising the scheme's success," she added.

COzero's Armstrong agreed, saying the regulations would turn the focus of the offset market to domestic projects and warned that only a few million credits are likely to be generated from Australian projects by 2020.

Companies have until February 9 to submit their comments on the proposal to the government.

### Australia cuts CO2 (cont.)

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Reputex did not disclose the total emissions figures it has for the NEM generators, saying the data, which it collects on a monthly basis, are proprietary.

According to government data, total electricity generation related emissions in Australia reached 206.7 million tonnes of CO2 in 2009, 37.9 percent of the country's total greenhouse gas emissions.

The NEM serves all Australian states except Western Australia and the Northern Territory, and accounts for some 90 percent of the electricity sector's total emissions, according to Reputex.

If the Reputex 2010 and 2011 estimates are correct, generators have slashed emissions some 8.4 million tonnes over the two years, worth A\$193.2 million under the new carbon tax.

However, the sector's emissions remained over 50 percent higher than in 1990, the base year for the Kyoto Protocol.

Reputex noted a slightly cleaner energy mix in Australia, with more than 2,650 MW of wind and solar capacity coming online since mid-2010.

Renewables comprised a modest share of generation - 1.1 percent for wind power last year - but the report said new wind farms had brought down South Australia's carbon emissions by some 20 percent to just over 10 million tonnes of CO2.

Meanwhile, black coal's share of the NEM mix fell to 53.5 percent in 2011, from 55.5 percent the previous year.

Brown coal was stable at 27 percent while natural gas rose 1 percent to 11.4 percent of the total, the report said.

### NZX disappoints with sale of carbon registry

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New Zealand stock market operator NZX has completed the sale of its environmental registry, the firm said on January 16, but will earn NZ\$20 million less than anticipated as hopes for a global carbon market have faded.

UK-based financial information provider Markit will pay NZX US\$21.4 million by the end of the month to complete

the deal for the TZ1 registry, a database of projects that generate voluntary carbon offsets and other environmental credits, NZX said in a statement.

This puts NZX's sale proceeds at NZ\$33.7 million, well below the NZ\$53.6 million booked when the deal was first announced in June 2009.

The exchange operator had previously written down the loss, blaming a reduced focus on carbon trading in the aftermath of the global economic slowdown and several disappointing rounds of U.N. climate talks.

TZ1 has since been renamed the Markit Environmental Registry.

It currently contains over 500 projects that have issued more than 65 million environmental credits, including those from CO2 reduction, water management and biodiversity programmes.

### China undecided on carbon tax

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China remains undecided whether to tax carbon emissions, as the government weighs how it could impact plans to launch an emissions trading scheme and whether it is feasible given current high domestic tax levels, a senior official said on January 11.

The statement contrasts with earlier media reports saying China will introduce a tax before 2015 and underscores global interest in how China plans to address climate change in the years ahead.

China emitted a quarter of mankind's greenhouse gas pollution in 2010 and emissions are expected to keep rising in line with growing energy demand.

Speaking at the World Resources Institute in Washington, Su Wei, China's chief negotiator on climate change, said a tax on carbon was one of several policy options for China to reduce its greenhouse gas emissions, the highest of any nation.

But China plans to launch a carbon trading scheme, and adding a tax on major emitters could complicate legislation.

"There may be some overlap between the two systems. Of course, the two systems are not mutually exclusive. We need to have a very careful consideration," Su told reporters at WRI, an international think tank.

A decision on a carbon tax would be delayed until there was clarity on whether and how the two instruments could

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co-exist.

Chinese state media reported earlier this month that a government-affiliated think-tank, the Financial Science Research Institute, had proposed to the Ministry of Finance that China implement a 10 yuan (\$1.58) per tonne tax on emissions from big energy users before 2015.

That report stirred debate in Australia, which will launch a national carbon pricing scheme from July this year set at an initial A\$23 (\$23.70) a tonne for the top 500 polluters. Some opponents said Australia's much higher starting price for the tax would hurt the global resource exporter's competitiveness.

However, Fu Zhihua, a researcher at the institute denied the reports on January 9, saying a carbon tax is not yet on the agenda of lawmakers at the ministry.

The National Development and Reform Commission (NDRC), where Su Wei is director general of the climate change department, has the main responsibility for carbon policies in China.

The NDRC has picked seven cities and provinces to launch pilot emissions trading schemes from 2013, and aims to launch a nationwide CO2 market later in the decade.

But in parallel, major emission sources such as coal and natural gas could become subject to regulations by the Ministry of Environmental Protection, which is designing an environment tax.

Chinese think-tanks have been studying carbon taxation for several years, but so far there has been little coordination between them.

Speaking in Washington, Su Wei also noted that China already had a high taxation level, and in the current difficult economic climate the government would be careful to launch new taxes.

Su led a delegation of officials from five Chinese cities on a trip to the United States to learn about low-carbon sustainable development.

Among others, the delegation met with officials from the Regional Greenhouse Gas Initiative (RGGI), a north-eastern U.S. carbon scheme covering nine states, California and the Western Climate Initiative.

Meanwhile, the NDRC on January 13 published a letter in which it told seven cities and provinces that will host pilot emissions trading schemes to impose absolute caps on emissions and draw up allocation plans as soon as pos-

sible, in a bid to launch the markets in 2013 as planned.

The regions were not given a deadline to comply with Beijing's order, but were urged to ensure a "smooth" implementation of the schemes, according to a letter issued by the NDRC.

Though short in detail, the order makes it clear that China's pilot carbon markets would be based on total CO2 caps for scheme participants, dismissing an earlier proposal to launch markets based on carbon or energy intensity.

## U.N. panel girds for tug-of-war over large CDM projects

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The main U.N.-appointed panel that regulates global supply of carbon credits is likely next month to consider a highly-contentious proposal that could block hundreds of cleaner energy projects from earning offsets under the Kyoto Protocol.

The Executive Board of the Clean Development Mechanism (CDM) will meet at the end of February to discuss whether big projects, such as hydro schemes and large infrastructure projects, should be allowed to earn credits - a move that is likely to split the 10-member panel.

"Though I will no longer be chair I have no doubt we will continue to discuss the adequacy of additionality testing in capital intensive projects, particularly those by state-owned companies or the public sector," said the CDM panel's current head Martin Hession.

The issue "is crucial to the credibility of the CDM", said Hession, who will step down as chair after next month's meeting.

Last year, the board agreed to investigate whether to bar some projects where revenues from selling carbon credits make up a tiny proportion of the project cost.

U.N. rules state that a project must rely on some form of carbon finance for it to earn credits, and that carbon finance makes up less than 1 percent of the cost of some projects has led some to question whether the CDM is being exploited.

Board members will consider not only the extent to which revenue generated from the CDM is decisive, but also whether there are good reasons for public sector CDM projects to go ahead, said board member Lex de Jonge, who last year succeeded in his bid to get the issue adopted onto

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the CDM panel's formal agenda.

The world's fastest growing developing countries, such as Brazil, China and India, are spending trillions on upgrading infrastructure in power generation, transport and key industries such as chemicals, mining and steel.

According to De Jonge's analysis, this frenzy of investment, much of it funded by the government or state-owned companies, calls into question whether large hydroelectric power stations, efficient fossil-fuel power stations, and mass transit systems are surplus to business as usual.

Together, these categories account for almost 200 projects that have yet to be registered, and have the potential to earn almost 100 million credits a year, according to design documents.

Although De Jonge will relinquish his seat on the EB after the next meeting, the issue could be one of the most divisive this year.

Delegations from some developing countries in Durban, including China and India were said to have been hostile to any sweeping curbs on large, capital intensive CDM projects. Japan, which is pushing ahead with its own bilateral offsetting scheme, is also thought to be wary of such changes.

Despite record low prices for offsets, the board is under pressure to register projects ahead of an end-of-year deadline imposed by the EU. From next year, only schemes in least developing countries would be eligible to supply credits for compliance in the EU ETS.

### Canada faces legal challenge over Kyoto withdrawal

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The Canadian government's withdrawal from the Kyoto Protocol is illegal, alleged a suit filed in federal court by a law professor and former Canadian MP on Jan. 13.

Daniel Turp, professor of law at the University of Montreal and former MP of the Bloc Québécois party, said Prime Minister Stephen Harper's government has violated national law by withdrawing from the 1997 climate treaty last month without first consulting Parliament.

On Dec. 12, Environment Minister Peter Kent announced Canada would become the first country to invoke its legal right to withdraw from Kyoto, arguing it would save the country around C\$14 billion (\$13.7 billion) by not having to comply with its emissions target under the pact.

"I think we have a good case and I hope the court of law can decide the government cannot ignore Parliament and legislation to adopt the Protocol," Turp told Point Carbon News by phone ahead of the Jan. 13 hearing.

Turp argued the ruling Conservative party has violated Canada's 2007 Kyoto Protocol Implementation Act, a bill that forced the government to take measures to implement the global climate pact.

Under Kyoto, Canada pledged to reduce its greenhouse gas emissions 6 percent below 1990 levels between 2008 and 2012.

A government report last year predicted Canada's emissions would be nearly 30 percent over its Kyoto target by 2012, but Harper and his officials have said Canada would not attempt to meet its goal under the treaty.

Green groups have launched legal challenges against the federal government in the past few years for failing to enforce the Implementation Act.

Turp said the environmental group Association Québécoise de Lutte contre la Pollution Atmosphérique (AQLPA) would join him in the lawsuit.

He said should the federal judge rule in his favour, he would anticipate an appeal by the government and added that he would continue his efforts until the case reaches the Canadian Supreme Court.

### California, Quebec to link CO2 markets this year

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California and Quebec are negotiating an agreement that will formally link their carbon markets.

Speaking in San Francisco at a meeting of the Western Climate Initiative (WCI) on Jan. 13, the entity working to harmonize North American carbon markets, officials said that despite regulatory challenges and a tight timeline, they are optimistic the linkage agreement will be ironed out and approved as early as mid-year.

That would mean the link could be established in time for August 15, allowing California and Quebec to hold a first auction of CO2 permits together.

"We are planning to participate and have a common auction with California on August 15," Robert Noel de Tilly, Quebec's liaison to the WCI, told the gathering of about 50 stakeholders.

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