Carbon Market Australia-New Zealand

A Thomson Reuters Point Carbon News publication

Volume 04 Issue 12 25 November **2011**

NZ faces ETS rule changes to link with Australia

New Zealand will likely have to change key rules of its emissions trading scheme if it is to link it with the Australian carbon market when it starts in 2015, risking higher compliance costs for emitters in the process.

The two countries expect to join their fledgling schemes within the next five years. But measures in the NZ scheme designed to keep costs down for emitters will likely have to be ditched if an Australasian market is to be realised.

"It is possible that rules don't need to be entirely harmonised, but you want as few differences as possible," said Bruce Mountain at consultancy Carbon Market Economics.

One change that will have to be made, according to Mountain, is the NZ rules on buying offsets from abroad.

The NZ scheme allows emitters to use an unlimited number of cheaper U.N.-backed carbon credits to meet targets, while Australian emitters will only be allowed to use foreign credits for 50 percent of their needs.

In any joined up market, without tougher NZ rules prices would fall to a minimum in Australia, something the government is unlikely to risk after it fought a hard domestic battle to get the scheme through parliament.

"If Australians can import a whole lot of New Zealand credits at low prices, that would drive the price up in New Zealand and down in Australia," Mountain said.

Another change that would need to be made is the price ceiling for carbon permits in New Zealand.

Under the NZ scheme permit prices are capped at NZ$25, but this is around A$4 above the minimum Australian price of credits, meaning trading would take place in a very tight range.

Continued on page 2

Australia passes emissions trading laws

Australia's Senate on November 8 passed the legislation that will put a A$23 tax on CO2 emissions for the country's 500 biggest emitters from July 1, 2012, and introduce the world's biggest carbon trading scheme outside of Europe from July 1, 2015.

The ruling Labor party and the Greens saw the 18-bill legislative package through the upper house of the parliament with a 36-32 majority, effectively making the carbon pricing scheme Australian law.

The vote put an end to a nine-month long intense and often truculent debate on how Australia is to meet its target of cutting greenhouse gas emissions 5 percent below 2000 levels by 2020.

However, some uncertainty remains as opposition leader Tony Abbott has pledged to repeal the scheme if he be-

Continued on page 3

Contents

NZ faces ETS rule changes to link with Australia	**1**
Australia passes emissions trading laws	**1**
Market comment	**2**
NZ ruling party vows to keep CO2 price cap	**3**
Australia to launch scheme operator in April	**4**
Eneco, RAMP Carbon target Australian CER buyers	**4**
ASX to launch carbon futures before 2015	**4**
CO2 New Zealand lands NZ$10m forestry deal	**4**
Australia should sign deals to secure offset supply: analysts	**5**
Guest commentary: Let's get this party started: Using international carbon units in Australia *By Sally Burns and Claire Byers, Sigma Global*	**6**

POINT CARBON

THOMSON REUTERS

Market comment

New Zealand emission permits crashed to a record low of NZ$12.10 on November 24, pulled down by collapsing CO2 prices in the European market.
Spot NZUs fell by NZ$1.45 the last four weeks, down 10.7 percent since October 27, when they closed at NZ$13.55.
For most of the period the NZ ETS bellwether contract traded in the NZ$13.30-13.50 range, but when EU carbon came crashing down towards the end of the period, the New Zealand market followed.
December 2011 CERs in the EU ETS closed on November 23 at 5.87 euros, a record low and down 14.7 percent over the past four weeks.
In the NZ market, December 2011 CERs fell 11.3 percent or NZ$1.35 over the period, to NZ$10.64.
"This is not good news for the New Zealand market and no one has any idea when it will stop," one trader said.
"Every morning you wake up it seems to get worse."
Murky economic outlook in the EU has caused growing concerns that industrial activity will suffer, making manufacturers sell off surplus carbon permits to raise cash.
The imminent sale of 300 million EUAs for the post-2012 trading period has added bearish sentiment to the already over-supplied market.
The New Zealand market garnered some 400,000 NZUs in traded volume over the month, slightly up from the September and October slumps in activity, but still only a third of average volumes in the first half of the year.
Traders said Europe will continue to dominate NZ carbon prices due to the New Zealand market's unlimited access to U.N.-issued CERs.
But traders said they would also keep an eye on this weekend's national election,.
A Nov. 24 Fairfax-Media Research poll suggested 54 percent of New Zealanders back the ruling party, meaning the incumbent government most likely will be able to continue its ETS policy unchanged.

Continued from page 1

A third area up for discussion, according to analysts, is how each country's caps are set.
The number of permits handed out in NZ is based on efficiency, while Australia has a hard cap on emissions. The difference means NZ firms could actually increase CO2 while Australian firms would have to cut pollution.
"There is a question of whether those specifics may need to be amended," Julia Hoare, a partner with consultancy PwC said, referring specifically to the offset access.
Hoare was a member of a government-appointed panel that reviewed the ETS this year. She said some of the differences between the two schemes cannot be bridged, due to their vastly different emission profiles.
Half of NZ emissions come from the agriculture sector, while agriculture plays such a limited role in Australia that it has been left up to farmers themselves whether to opt-in to the scheme or take advantage of a domestic farming offset scheme to cash in on emission reductions.
Australia's biggest emission reduction potential - and challenge - lies in the energy sector.
It relies on coal for over 80 percent of its electricity generation, compared to New Zealand, which gets almost that much from renewable sources.
"Realistically, there will need to be differences between the two schemes because of their different emission profiles," she told Point Carbon News.
Linking of regional and national carbon markets has been a popular topic of debate among climate policy-makers and market participants worldwide for almost a decade, but little actual experience has been gained so far.
The only links achieved so far have been expanding the EU ETS to swallow up small local schemes in Liechtenstein, Iceland and Norway.
Few observers believe an Australia-NZ link would be as extensive as the European experience.
"Whilst possible, it is highly unlikely that the New Zealand and Australian emission trading scheme would over time merge into one," said Mike Tournier, executive director at the Melbourne-based Carbon Market Institute.
The differences in scope and design of the two schemes would make a complete merger difficult, he said.
Instead he thought it likely that permits issued by the two governments could be converted into a different type of credit that could then be traded.

Australia passes emissions trading laws (cont.)

comes prime minister after the 2013 election, although an increasing amount of observers think this will be infeasible.
From financial year 2012-2013 some 500 companies across most of the sectors of the economy will have to pay A$23 per tonne of CO_2 they emit, although up to 5 percent of their emissions may be covered by offset permits from the Carbon Farming Initiative (CFI).
In the three-year fixed period of the scheme there will be no total cap on the carbon emitted by participating companies.
When Australia moves to an ETS with a floating price in mid-2015 scheme participants will be allowed to use credits from U.N.-regulated schemes such as the Clean Development Mechanism (CDM), while access to CFI credits will be unlimited.
Treasury has estimated that by 2020, Australian firms will use just over 90 million CDM credits annually to be in line with their target.
The Australian legislation puts the same qualitative restrictions on the use of CDM credits as the EU scheme, meaning offsets from HFC 23 and nitrous oxide projects, which have generated more than half of all credits issued under the CDM so far, will not be eligible for use.
The government will announce the CO_2 cap for the first five years of the ETS no later than Q1 2014, and will auction some 15 million permits ahead of that date to allow electricity generators to start hedging against their future carbon risk.
Analysts expect forward trading to start sometime in 2013 when the first government auctions have been carried out and there might be more clarity about the scheme's future in case of a change in government.

NZ ruling party vows to keep CO2 price cap

NZ Prime Minister John Key on November 9 pledged to slow down the expansion of the country's emissions trading scheme, keep a NZ$25 cap on emission permits and work with Australia to build an Australasian market from 2015.
Key said that if his National party won the November 26 election it would keep the price cap and limit the share of emissions that companies are responsible for in a bid to protect the NZ economy from high CO_2 prices.
A government-appointed committee reviewing the ETS had proposed in September to gradually increase the price cap by NZ$5 per year, but Key dismissed the proposal without further explanation.
"Our climate change policies carefully balance the costs to households and businesses with the need to reduce greenhouse gas emissions," Key said in a statement.
"That is why we intend to slow the phasing in of the emissions trading scheme from 2013 to 2015, at which point we will look to align our scheme with that adopted by Australia. Any change to our emissions trading scheme will be fiscally neutral," he said.
Carbon permits in the scheme, known as New Zealand Units (NZUs), are currently capped to ensure that price hikes in the international carbon market would not adversely affect NZ firms.
Broker Nigel Brunel with OM Financial said the decision was unlikely to have a big impact on the market as spot NZUs currently trade well below the price cap.
The prime minister said he would take the review committee's advice to gradually raise the amount of companies' emissions that are covered by the scheme.
Currently NZ emitters only have to surrender permits to the government for half their greenhouse gas emissions, but their obligation would be increased in three steps from 2013 to reach full coverage in 2015, according to Key.
The National party supported the inclusion of synthetic greenhouse gases in the ETS from 2013, but would decide only in 2014 whether to bring agriculture into the scheme.
Agriculture is New Zealand's biggest-emitting sector, accounting for nearly half of all the country's emissions.
The opposition Labour party is keen to bring agriculture into the scheme from 2013, but is trailing in the polls and does not look able to win office.
A Fairfax Media-Research International poll published November 24 showed 54 percent support for the incumbent National party, compared to 26 percent backing Labour.
The National party policy announcement also reaffirmed New Zealand's intentions to link its scheme with neighbouring Australia.

Australia to launch carbon scheme regulator in April 2012

The independent body that will administer Australia's emissions trading scheme will begin operations April 2 next year, Climate Change Minister Greg Combet announced Nov. 15.
The Clean Energy Regulator will start working three months before the Labor-led government launches the A$23 carbon tax mid next year.
"Work is already underway to identify the chair and other members of the board for the Clean Energy Regulator," the minister said.
Combet said the timeframe would allow the government to develop the administrative, financial and governance arrangements needed for the body to operate.
The Clean Energy Regulator will be in charge of allocating and auctioning emission permits under the carbon scheme. It will also enforce compliance of CO2 targets for the 500 companies involved, administer the permit registry, oversee reporting and approve verifiers for the Carbon Farming Initiative, a domestic offset scheme.

Eneco, RAMP Carbon target Australian CER buyers

Dutch trading house Eneco and Australian project developer RAMP Carbon have joined forces to offer 1.6 million U.N.-issued carbon offset credits to buyers in the Australian market. The companies are in talks with Australian banks and compliance buyers about possible transactions, they told Point Carbon News on November 10.
"The projects in the portfolio involve the implementation of energy efficiency improvements in industrial facilities and households, renewable energy generation and waste management," the two companies said in a joint statement.
Under Australia's carbon scheme 500 big emitters will from mid-2015 be allowed to use Certified Emissions Reductions (CERs) and other U.N.-issued offset credits to cover for 50 percent of their emissions.
The 1.6 million CERs will come from Eneco's portfolio.
RAMP will be the counterparty for all Australian buyers in all the transactions, Philip Cohn, RAMP's director, said in an email.
Amid great uncertainty as to whether the carbon legislation would be approved by parliament, Australian companies have so far not been involved in the international carbon market, with the exceptions of a handful of specialist firms.
Observers expect local firms to gradually step up their trading activities over the next 12-18 months, and the treasury has estimated Australian companies will need to buy 94 million CERs in 2020 to achieve their targets.

ASX to launch carbon futures before 2015

Australia's main bourse plans to introduce carbon futures trading before the nation's emissions trading scheme begins in 2015.
Bourse operator ASX Group said on November 10 a secondary futures market for carbon permits would be the key to the success of the emissions trading scheme, due to kick off after three years of fixed prices on CO2 under landmark laws passed this month.
"These markets will generate the short- and long-term price signals and risk mitigation required to underpin investment certainty," ASX said.
It expects to be able to introduce a futures market before the scheme starts to help industry manage forward price risk, it said.
Looking to tout advantages over its new rival Chi-X Australia, a unit of Nomura, ASX said many likely users of the emissions trading scheme already use its infrastructure and would be looking for transparent price discovery.
ASX already offers trading in futures and options over Australian and New Zealand electricity and renewable energy certificates.

CO2 New Zealand lands NZ$10 million forestry deal

Offset provider CO2 New Zealand has won the right to develop a reforestation project in the country that could cut emissions by 700,000 tonnes over the next 30 years and boost supply to the NZ ETS.
The NZ$10 million contract was signed with a local Maori community on New Zealand's North Island to develop the

project, the company said on November 7.
"The project will be accredited under the NZ ETS and will generate NZUs (New Zealand Units)," Andrew Grant, CEO of parent company CO2 Group, told Point Carbon News.
CO2 Group, listed on the Australian Securities Exchange, owns 45 percent of CO2 New Zealand.
"This is a significant project for CO2 Group and further strengthens our New Zealand business," Grant said.
CO2 New Zealand said it has secured more than NZ$7 million in long-term deals with emitters covered by the ETS.
"CO2 New Zealand is currently involved in the mapping of more than 220,000 hectares (of forest) which will realise close to 5.7 million NZUs for clients," it added.
In December 2010, CO2 New Zealand announced it had sold 2.5 million NZUs on a forward basis to an unnamed ETS participant, the biggest publicly-announced trade in the scheme to date.

Australia should sign deals to secure offset supply: analysts

Analysts say Australia should be striking deals with its Asian neighbours to guarantee its companies supply of hundreds of millions of cheap carbon credits when it launches its ETS in 2015.
Globally, the Australian scheme will be second only in size to the EU system, but while Australia emits around one tonne for every eight pumped out by the EU, the Nov. 8 law puts the two on a par when it comes to buying offsets from the international carbon credit market.
Estimates vary wildly as to how much the scheme could cost the country's coal mining firms and power generators.
Yet analysts and investors want the government to minimise its impact by ensuring a steady supply of foreign offsets in case stuttering U.N. climate talks to build a global carbon market collapse.
"The long term role of the (U.N's) Clean Development Mechanism (CDM) in Australia's mitigation effort remains very unclear at this stage," said Andrew Wilson, an analyst with consultancy Carbon House.
"The one thing that is clear is that Australia will need to access international carbon credits in order to meet even our current modest targets. What we don't know and likely won't until closer to 2015 is exactly how that mechanism will work," he said.
Instead, investors in emission reduction projects want the government to start preparing for a life beyond the CDM – the main U.N. offset market that has produced almost 800 million credits in seven years.
They claim that the CDM's future is uncertain due to bickering over whether countries should take a second round of targets under the Kyoto Protocol and a predicted decline in demand from EU and Japanese companies – the two biggest buyers of the credits so far.
Nick Armstrong, CEO with carbon trading firm COzero, wants Australia to sign a deal with developing nations in Asia that would let Australian companies offset their emissions by buying carbon credits from CO2 cutting projects hosted abroad, possibly outside of the U.N. system.
"I am hopeful that this (vote) will encourage countries to engage bilaterally with Australia," Armstrong said after the Senate vote.
The Australian treasury has estimated that in 2020 the coal-dependent country must cut carbon emissions 160 million tonnes of CO2 below expected levels to reach its target to cut greenhouse gas output to 5 percent below 2000 levels by 2020.
Some 94 million tonnes of this must be met through paying for emission cuts abroad, as Australia's economy would be unable to achieve larger cuts domestically at acceptable price levels in such a short time frame, according to government estimates.
Under Australian rules, companies will be allowed use U.N.-backed CDM credits to offset 50 per cent of their emissions, far more than the 14-percent cap employed in the EU system. But analysts fear Japan's desire for a new carbon market and the introduction of EU law banning its companies from using most credits after 2012 will mean the CDM may not produce enough offsets to meet Australian demand over the next decade.
This is because big suppliers of CDM credits may see little point in maintaining the domestic bureaucracy needed to support existing and new offset projects under the U.N.
"There are numerous factors playing out right now that are effectively shaping the future of the CDM and I expect Australian policy makers will be watching this issue very closely," said Wilson.
"Unless the bilateral agreements are in place, it will, in effect, reduce the (offset) supply pool for the Australian market," said COzero's Armstrong.

Let's get this party started: Using international carbon units in Australia

By Sally Burns, Managing Director, and Claire Byers, Director, Sigma Global

As the dust settles on the passing of the Clean Energy legislation, attention amongst Australia's compliance players and traders alike is turning to the sticky question of how exactly they can capitalise on the acceptance of eligible international units from 2015 onwards.

Clearly the inclusion of international units is a great boon to compliant players looking to lower their costs, and a tantalising arbitrage opportunity for those traders looking for new and improved hedging strategies. That said, there remain a few perplexing uncertainties which may make it difficult to fully capitalise early on the generous allowance (50 percent of each installation's liability from 2015 until 2020) and current low CER prices.

Eligibility is a key concern. Several types of international units will be accepted but the details will be defined by regulation, due for release in late 2012. The government has already indicated that similar project type exclusions as under the EU ETS may apply for CERs. They haven't as yet replicated the geographical restriction to least developed countries (LDCs) which is a key difference that will result in two distinct classes of CERs. Other variables aside, those that are eligible for compliance for both schemes are likely to bear more relation to the higher priced scheme. However, before we all rush out and buy up every CER from non-LDC, post 2012, take note of a somewhat tricky design feature that regulatory changes can disallow certain units with up to one year's notice. Something of a fly in the ointment of forward purchases! If changes are implemented, liable entities will only be able to surrender disallowed units for the compliance year in which the unit was disallowed. Some small comfort can be taken from the government taking EU ETS and NZ ETS eligibility into consideration which could provide some indication on likely changes.

Should supply of CERs eligible in Australia and ineligible in Europe fall short of demand, Australian buyers will still be able to compete with European buyers for green CERs although at current prices that's hardly going to give great cause for concern. There's also the added bonus of having more than one scheme to sell into as a hedge against the government altering the eligibility criteria.

Adding further to difficulties is the fact that international units are defined as financial products meaning anyone wishing to directly deal in these units and participate in auctions, until such time as any exemptions are applied, will need to hold Australian Financial Services Licences. This is certainly no insignificant requirement given Australia's renowned stringency in financial market regulation and one that may see many companies opting to trade through intermediaries to avoid such a requirement.

Yet another consideration is the international unit surrender charge which will apply during the three collared flexible charge years from 2015. The charge for using international units will be capped at a maximum of the floor price and while the details will be set in regulations due around April 2012, it's likely it will be based on the difference between the "international price" and the floor price. How the "international price" will be defined remains a mystery. It's unlikely an EU CER index will be used if only because of the FOREX complications, meaning it may come from one of the Australian exchanges, the ASX perhaps? The charge will reduce the cost advantage of using CERs although almost any final definition of the international price based on an index will leave room for purchasing at prices lower than the floor price. The primary markets are also likely to offer significant opportunities for those companies willing to dabble and the charge is only for a few years after all.

So what do we have? Fluid eligibility criteria on highly regulated assets that have an extra charge slapped on them. Interesting times ahead.

Do you want to write a guest commentary?
Contact stian.reklev@thomsonreuters.com.

Offices

Oslo
Point Carbon
Akersgata 55, 3rd floor
P.O. Box 7120 St.Olav
N-0130 Oslo, NORWAY
contact@pointcarbon.com
Phone: +47 22 40 53 40
Fax: +47 22 40 53 41

Kiev
Point Carbon Kiev
3 Sportyvna Ploscha
Entrance IV, 4th floor
Olymp Business Center
01601 Kiev, Ukraine
kiev@pointcarbon.com
Tel: +38 044 499 0308
Fax: +38 044 499 0309

Washington D.C.
Point Carbon North America
1200 First Street, NE; Suite 310
Washington, DC 20002
washington@pointcarbon.com
Phone: +1 202 289 3930
Fax: +1 202 289 3967

Malmö
Point Carbon Malmö
Östra Förstadsgatan 34
212 12 Malmö, Sweden
contact@pointcarbon.com
Phone: +47 22 40 53 40
Fax: +47 22 40 53 41

London
Point Carbon London
Second Floor
102-108 Clerkenwell Road
London, EC1M 5SA
United Kingdom
london@pointcarbon.com
Phone: +44 (0)20 7253 7878
Fax: +44 (0)20 7253 7856

Beijing
Chemsunny Trade Center
Central Tower 2F
28 Fuxingmennei Street
Xicheng District
100031 Beijing
China
Phone: +86 10 6627 1298

Carbon Market Europe
A Point Carbon publication
Copyright © 2011
All rights reserved

Editorial enquiries
Stian Reklev - stian.reklev@thomsonreuters.com
Tel: +86 135 2167 1614

Sales enquiries
Graeme White - graeme.white@thomsonreuters.com
Tel +47 22 40 53 64
Fax +47 22 40 53 41

Disclaimer Point Carbon News

The news and data provided in this publication were prepared by Point Carbon's News division. Publications of Point Carbon's News division are provided for information purposes only. Prices are indicative and Point Carbon does not offer to buy or sell or solicit offers to buy or sell any financial instrument or offer recommendations to purchase, hold or sell any commodity or make any other investment decision. The information contained in this publication has been obtained from sources that Point Carbon believes to be reliable.

Point Carbon's News division receives compensation for its reports. Point Carbon's News division reports are published on a subscription basis and are not issued at the request of any client of Point Carbon.

Point Carbon's News division renders editorial decisions independently of the business interests of other components of the Point Carbon company.

For more news, please visit www.pointcarbon.com/news

POINT CARBON

THOMSON REUTERS