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# Carbon Monitor

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Volume 15 Issue 3

April 2010

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## New Zealand Forest Fire Raises Questions on the ETS

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Following last month's story on the forest fires in the Wenita forests in the South Island we received a number of comments from readers.

Reagan Thompson of Interpine said *'I was at the Future Forestry Finance conference last week and caught your presentation, which was great. Thankfully it left me more educated on the whole ETS situation but unfortunately less optimistic!'*

*Nonetheless this email relates to comments made during the conference and in the Carbon Monitor newsletter relating to the Wenita Forests fire.*

*From my relatively lean understanding of the situation, I believe that Wenita would have a carbon liability if the forests were registered as post 1989 under the ETS system.*

*However, it is my understanding that the overwhelming majority (if not all) of the forest resource that was burnt was indeed pre 1990 forest (most of which was cutover). As such, unless there was a "deforestation event" which would require the forest to exist in a "deforested" state after four years then there would be absolutely no carbon liability. So long as Wenita replant, then they would not be compulsory participants and thus remain under the radar of the ETS.'*

We agree with Reagan, provided the forest was indeed pre 1990 replanting would resolve any and all liability for the loss due to the fire.

Piers MacLaren responded *'I have read your stuff in the Carbon Monitor, and I have reservations about the commonly expressed statement that catastrophic fire is exactly equivalent to harvesting.'*

*With harvesting, as you know, a landowner is instantly liable only for the carbon that is actually extracted from the site (eg in the form of wood on logging trucks). The owner is liable for the rest as and when it decays - if it is not replaced by new plantings or regeneration. If it's a pre-1990 forest and is not replaced by pasture, there's no liability at all (similar to harvesting).*

*With fire, should the same philosophy apply? Even a major catastrophic fire does not instantly return all carbon to the air. The fine branches, needles and slash may be instantly oxidised, but the stemwood is usually only charred and the below-ground proportion is largely unaffected. Charring wood is somewhat*

*equivalent to chemically preserving it: it slows decay. We would expect carbon loss to be spread over a number of years and to be partly compensated by newly established trees. This approach would enormously affect the economic risk and the insurance premiums involved.*

*But more to the point, what do the NZ ETS rules say? Perhaps you have knowledge of MAF policy on this one. Perhaps you could also discover: if fire has totally covered a hectare, how does MAF intend to calculate the percentage of carbon loss that is deemed to occur instantly? How to they intend to track the decay profile of the subsequent loss?*

We then asked MAF for their view on the situation and the ETS

MAF have not yet replied.

### Chaos as Deadline to Register Looms

Charles Warren of Carbon Guilty wrote to EITG saying *'Do you happen to know why there is a MED deadline for getting 2008 & 09 NZUs of 310310?'*

*Seems very unreasonable to me that MAF can't cope with all the registrations to hand so loads of people will have to wait another year. Why is the deadline needed at all?*

*Do you think a bit of targeted lobbying might work or is it cemented in legislation? Seems to me MAF would also be pleased if this deadline was dropped. It would take some pressure off them and encourage some new planting from those who get units and others who become aware of it. Currently most people are unaware credits are being allocated and sold. It is a good news story MAF should be promoting I believe."*

We covered this in a previous edition of Carbon Monitor and had written to the Minister Nick Smith and the Greens co-leader outlining why we thought allocation should occur on the anniversary of the registration of the particular forest for the ETS.

We said then and still argue now the allocation process could very well distort the market and create pressure points for the market and MAF processing.

It seems odd that the date the emitters have to make returns and account for emissions is the very same day forest owners receive



credits, credits that they may well have sold to emitters to meet their obligations.

A small glitch in processing could create chaos as emitters fail to meet targets and suffer from the consequences of default.

The system reminds me of seasonal fruit, cherries are expensive most of the year and almost free as they rot on the trees during picking season.

So why is there not a steady flow of credits onto the market throughout the year?

## Australia Embarks on REDD Forestry Deal with Indonesia

If developed countries like Australia want to continue their economic growth while they tackle climate change, it is not unreasonable for developing countries to want the same.

To ensure emissions reductions are compatible with economic growth in many developing countries, Australians need ways to provide economic incentives to reduce emissions from deforestation. Instead of an economic imperative to remove forests in developing countries, there is a need for an incentive to preserve them.

Australia is working with its close neighbours, in particular Indonesia, to find a practical way to reduce emissions from deforestation and forest degradation in developing countries, better known by its acronym, REDD.

A post 2012 outcome that puts them on a path to 450ppm is only achievable with comprehensive coverage of REDD. Australian modelling shows that the inclusion of forest-related activities in a future global agreement has the potential to reduce global mitigation costs by around 20-25 per cent. And the inclusion of REDD also potentially provides a significant economic and environmental opportunity for developing countries.

This is why Australia is actively advocating for the inclusion of REDD in a post-2012 outcome. Australia has released a formal proposal on how emissions reductions from the forest sector in developing countries can be included in a future international climate change agreement.

The proposed forest carbon market mechanism will include reductions in emissions from deforestation and forest degradation as well as enhancing the removal of emissions from afforestation and reforestation. Importantly, the proposal has been developed with a

long term vision of enabling broader land sector coverage in the future.

Australia's proposal is a market based approach that puts an economic value on activities that reduce emissions from the forest sector in developing countries. National governments would be issued with forest carbon credits for emissions reductions below an internationally agreed national forest emissions level, which takes existing emissions reduction activities into account.

An important element of REDD will be ensuring there is capacity for local communities to share in the benefits of protecting forest carbon. Reductions in emissions must be monitored, reported and independently verified to generate credits, which can then be traded on an international carbon market. As with any international market, minimum performance and institutional standards will be demanded from suppliers of credits to provide investors with certainty and confidence.

As a new approach, it is important that the mechanism be informed by practical experience to the extent possible. Australia recognises this in its international partnerships that build bridges across the developed-developing country divide. Take, for example, Australia's Forest Carbon Partnership with Indonesia. Under this Partnership, Australia has established the Kalimantan Forests and Climate Partnership. Through the Partnership, Indonesia and Australia are developing the first large-scale demonstration activity, targeting emissions reductions by addressing the drivers of deforestation on the carbon rich peatland of Central Kalimantan.

The challenge of any effort to reduce emissions from the forest sector is the sheer diversity of land and vegetation types and climatic conditions. Recognising the need to draw on diverse experiences, Australia and Indonesia will develop a second demonstration activity, focusing on a different aspect of REDD.

And building on our cooperation on REDD, Australia is assisting Indonesia develop the necessary policy, technical and financial pre-requisites for participation in future international forest carbon markets. Australia is helping Indonesia to build its own capacity in carbon measurement, accounting and reporting systems that will be designed by Indonesia, for Indonesia.

These accounting systems are a critical part of any national system aimed at reducing emissions. They will provide the market with the information required to ensure credibility of any emissions credits generated from the forest sector. And it shows the international community that developing countries can

develop the robust and credible systems that are required to generate tradable credits.

Not only is the Partnership with Indonesia making a practical contribution on REDD, but it is showing a new model of cooperation between developed and developing countries. Australia and Indonesia made a joint submission to the UN Climate Change Conference in Poznan in December on lessons learned from practical REDD demonstration activities in Indonesia. This was the first joint submission under the UNFCCC on REDD between an Annex I Party and a G77 country.

It is worth noting that REDD is an area where Australia and the United States have converging views. I am greatly encouraged by Secretary Clinton's comments in Indonesia in February on the need to integrate deforestation into international negotiations and on Indonesia's efforts to promote the inclusion of REDD. This is one of a number of areas where there is potential for the United States and Australia to find common ground.

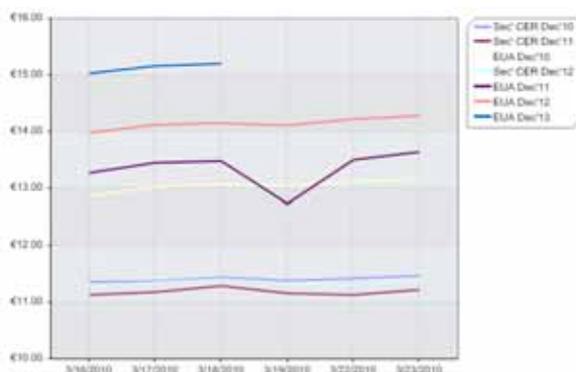
### *EU Price Update*

Allowance prices had a reasonable month with some firming of the market. Prices in Euro terms dropped over the month.

2012 CER prices suggest NZU prices of around \$19.50 at the current exchange rate of 0.52. Local market prices as per OMF financial suggest that NZU and CER are almost identical in price.

Forest owners are still struggling to meet the market requirements of large parcels. Aggregation for strip selling has come to a halt due to the legal complexities of brokers aggregating parcels. Strip sellers should be wary as they may be jointly and severally liable in the event of non delivery.

Post 2012 pricing firmed above 15 Euro or less than \$30NZ for an EUA.



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## EU Market Torpedoed As Secondary Market Shut Down

The increasing uncertainty over the legitimacy of certified emission reduction (CER) credits traded in the EU has sent the market into a massive downward spiral.

After it was revealed that the Hungarian government sold 2 million previously used CERs, the market became tepid. Then when [prices fell](#) from more than 12 euro per credit to less than one euro, trading was suspended on two exchanges, Bluenext and Nord Pool.

The issue has been brewing for about a week, since the "recycled" Hungarian credits were discovered being traded on Bluenext.

In response to the issue, the EU said it was "[surprised and concerned](#)" to discover that the CERs had re-entered the carbon market, reports Business Week.

The EU has its own type of certified emissions credits, called European Union allowances (EUAs), which it self-regulates. CERs are sold under the mantle of the United Nations, but are acceptable for use under the EU's Emissions Trading System, so long as they are surrendered for compliance after their first use.

The International Emissions Trading Association [warns](#) that the EU's emissions trading scheme could be decimated if governments cannot keep from selling "recycled" CERs, according to the Guardian UK.

So far, the market for EUAs has actually benefited from the lack of confidence in CERs. A UK auction of EUAs drew intense demand, resulting in 4.5 million sold. The price for EUAs is about 13 euro per credit.

Carbon trading exchanges ECX, Climex and Sendco2 [indicated they were unaware](#) of recycled CERs sold on their exchanges, but that they were investigating the possibility, according to ChemInfo.

Whether or not such a situation was foreseen, in early February the UK [suggested a plan](#) to shut down markets for EUAs in the event of a rampant fall in price.

The UK's cross-party parliamentary Environmental Audit Committee said intervention could involve a carbon tax when market prices fall below a set level, minimum prices for national carbon auctions, and cancellation of outstanding allowances under a reserve for new entrants.

## Commentary

The problem resulted from a legal loophole that allowed two companies to use the same carbon permit for compliance with targets in the EUETS.

The EU announced that in response it would change its rules from August preventing already surrendered CER's from re entering the trading system and being used for compliance.

The trades that exposed the problem were legal under a loophole in the Kyoto Protocol but would in the future be illegal in the EU ETS preventing companies from undertaking the same activity for compliance purposes.

This is the second set back in the EUETS the first being a large scale VAT fraud on the market.

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 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, Europe, USA and South Africa

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