Carbon Monitor

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New Zealand Emissions Trading System Comes into Force

Power bills and fuel prices will increase when the NZETS comes into force on the 1st July 2010.

Mercury Energy, part of the Government owned Might River Power, wrote to its retail customers indicating it will increase its electricity an average of 3.3% or $5 per month and 2.3% or $1.70 per month on its natural gas charges. The pending GST increase October 1st will add another 2.5% to all bills.

Given Mighty River Power is highly weighted towards hydro electricity which is exempt the emissions charge one would assume coal fired generators like Genesis and Contact energy will increase prices significantly more than the 3.3%. However Contact on their web site state that their average electricity price will increase only 3.2% for those not on their 'two winter price promise' and 2.2% for gas.

Emitters are required to surrender 1 NZU for every two tonnes of C02 emitted into the atmosphere post 1st July or otherwise pay the Government $25 NZD.

The $25 cap is 'temporary' until 2012. Meanwhile industries identified 'at risk' are being allocated 'free' NZU units to offset their emissions. Most recently the fishing industry, which is heavily fossil fuel intensive, had some 700,000 units set aside for those companies with fishing quota as at 24th September 2009. This 'free' allocation is designed to help these companies continue to compete on international markets. Companies must apply for these units.

Farmers complain giving money to forest owners won't solve the climate change issue and note that the ETS will mean a reduction of 12.5% in profitability for the average sheep farmer despite that fact that agriculture remains exempt from the ETS.

Issues with HFC Projects under the CDM has Potential to Significantly Reduce CER supply

Under the so called Clean Development Mechanism, or CDM developed countries can sponsor projects in developing countries that would otherwise not happen and receive carbon credits called Certified Emissions Reductions or CERs. Such CER's are eligible for the EU emissions trading system and the NZETS.

Prices for a secondary CER, that is one issued from a project by the UN after third party verification trades at a slight discount to the main European credit the EUA. The discount once substantial has reduced to less than 20% or 15.40 for an EUA and 12.50 for a CER. However primary CERs (those sold before they are verified and issued) trade at a significant discount. Why? In the past projects have significantly underperformed in terms of the volume of CER projected by the project versus those actually issued. This creates the risk the units purchased will not in fact be available.

Mine methane offset projects where methane that would otherwise escape into the atmosphere is captured and burned have underperformed in projected CER volumes, sometimes over 30% below that projected in the project document lodged with the UN. Whilst burning methane creates C02, methane has a GWP or global warming potential of 21 (1 tonne of methane is the same as 21 tonnes of C02) combustion effectively reduces greenhouse gases in the atmosphere significantly.

Recently HFC-22, the replacement for CFC in fridges and air conditioning (remember the ozone hole of the 1980's) has become the focus for questionable CDM projects. HFC-23 is a by product of manufacturing HFC-22. Originally the darling of CDM as each tonne of HFC-23 removed from the atmosphere is the equivalent of 11,700 tonnes of CO2 being removed yielding a huge 11,700 CER units. These projects are now coming under scrutiny with some having the amount of credits drastically reduced.

CDM watch, www.cdm-watch.org recently reported that the 19 registered CDM HFC projects would create half the 1 bn CER's issued up to 2012. China has the vast majority of these projects with 11 registered. The estimated cost per tonne of C02 equivalent is USD$0.20 with an income of over 70 times that.

Estimates vary, but using the perverse incentive of manipulating what is called the 'base line' that is the case of business as usual before a project commences, some 90% of the HFC-23 may not be eligible for CER credits.

This could have the effect of removing 45% of the projected CER supply to 2012 and significantly alter the dynamics of the Carbon Markets leading to price increases and potential volatility.

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CDM watch, an organisation set up in April 2009 was established by NGO's (non government organisations) to create an independent perspective on CDM projects with a goal of creating a reformed CDM post 2012 that has better verification and creates sustainable development in CDM host countries.

New Australian PM Walks Carbon Tightrope

The new Australian Prime Minister Julia Gillard has reactivated the carbon debate and called for limits on carbon emissions in Australia.

Reuters notes that this debate has cost at least 4 Australian leaders their jobs in recent times and quotes Gillard as saying the process 'needs to be carefully explained to the Australian people' and of course needs the support of the Greens in the Senate to pass into law.

Typical of the diversity of the debate is the fear of blue collar workers facing increased power bills whilst white collar workers want action on climate change. This has the potential split voters creating the perception of the issue undermining the current Government's support. It is widely reported that disgruntled Green voters swept Rudd to power and the reigniting of this issue will have the effect of placating their concerns as to the lack of progress and what was perceived as ex Prime Minister Rudd's backing down from an ETS.

Reality is the new Prime Minister is talking the talk and it will take some time for a cohesive plan to emerge than can be 'sold' to the Greens as a repeat of an embarrassing loss in the Senate wont help her consolidate her position.

So expect more talk, behind the scenes negotiations and the large emitters placing pressure on the politicians. Potentially with the NZETS now coming into play the Australians can see a set of fully fledged regulations including process of 'free' allocation to industries 'at risk' and this may help their building a palatable ETS for all stakeholders

Carbon Brokers and the Financial Advisors Act

The New Zealand Financial Advisers Act 2008 (FAA) and its companion legislation, the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA), are currently being finalised and will come into force from the end of this year.

Broadly, the FAA requires all financial advisers to be registered and some financial advisers to be licensed. The FAA also sets out disclosure, conduct and qualification requirements for financial advisers. Similarly, the FSPA requires all financial service providers to be registered and to join an alternative dispute resolution scheme.. The definitions for "financial adviser" and "financial service provider" are still subject to review by the government.

Recent media commentary has suggested that carbon brokers will be outside the regime set up by the FAA and FSPA. However while brokers trading physically settled emissions units may fall outside the definition of "financial advisers", they may still be financial service providers. Further, brokers trading cash settled derivatives on carbon or emissions units are likely to be both financial advisers and financial service providers. Such cash settled instruments are likely to be "futures contracts" under the Securities Markets Act 1988. The regulatory requirements of the Securities Markets Act, as well as the FAA and FSPA requirements for futures contracts will apply.

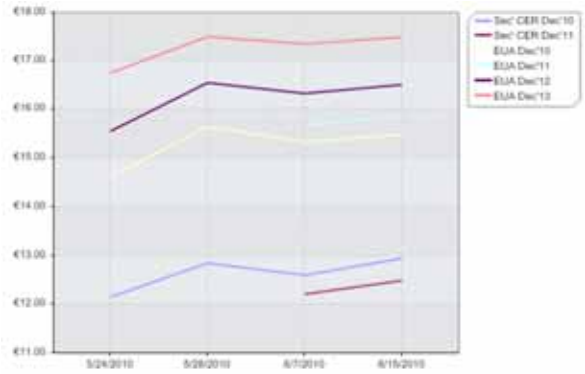
This area is complex and Buddle Findlay Alastair Cameron 04 498 7340 alastair.cameron@buddlefindlay.com may be able to assist.

EU Price Update

Allowance prices remained steady for most of the month with prices of EUA spread around 16 Euro.

2010 CER prices suggest NZU prices of around $22.80 at the current exchange rate of 0.57.

Post 2012 remained around 17.50 Euro or $30.70 NZ for an EUA.



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Carbon Forestry Workshops Excellent Source of Information

Run recently by the University of Canterbury and MAF these workshops provided forest owners with objective information on whether or not to participate in the ETS and the potential returns.

The presentations were analytic and chose to use the LEV or land expectation value as a measure of performance.

Akin to the Net Present Value, the LEV for forest owners was set at an 8% real (net of inflation)

Current log prices (which have increased in the last 6 months) provide an LEV per ha of less than $1000 and a narrow window in which to achieve this around age 25. Currently forest land can be purchased at $3000 per ha or more.

The effect of a carbon credit income at $20 per tonne with the associated surrender obligations was examined and yielded LEV of over $5000 per ha, and more importantly permitted a much wider time period in which to achieve this. Carbon income effectively widens the window for harvest to at least 5 or more years.

Its common sense with carbon income each year one can delay harvest but seeing the analysis really cements home the business benefit of the carbon income.

Some work was presented on the sensitivity of the LEV to the increase or decrease in carbon prices over time. These demonstrated that assuming a steady increase of say 5% pa for carbon prices from a base of $20 to $32.50 in 10 years time would have a minor effect on LEV. What this means is that steady increases in carbon prices present less risk to forest owners than expected. However if prices jump then the situation they cautioned is quite different. Given the Kyoto period is 5 years (2008-2012) and each 5 years a new agreement is expected, and that is likely to call for more drastic emissions reductions the modelling may not be valid.

Extensive discussion was made on the comparison of the MAF look up tables and the actual measurement regime. It would appear the tables are significantly (up to 20%) below the actual carbon stored. Analysis of the cost benefit of measurement versus tables indicated using LEV as the outcome, that measurement could be cost effective on a block larger that 10ha on the basis of $200 per sample plot.

At this stage the measurement guidelines are not in place and MAF appears to favour separate sample plots than those already in most forests and potentially will dictate their location to avoid 'gaming' using existing sample plots.

EITG says this does not make sense, given the existing sample plots have been chosen to accurately estimate timber production. Carbon content is derived directly from standing timber volume. The measurement issue will be open for submissions later in 2010 and we recommend all forest owners make submissions.

The slide presentations are expected to be released on the climate change web site shortly.

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'Carbon Monitor' is a client service of EITG.
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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This blog is designed to discuss all aspects of emissions trading and GHG as well as the Kyoto Protocol

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