Carbon Market North America

Point Carbon
NEWS

Vol 3 • Issue 26 • 5 December 2008

US to clash with EU over mid-term targets in Poznan

The EU and the US look set to clash over mid-term emission cuts at UN climate negotiations.

Both the 27 member-state bloc and the world's biggest emitter agree global greenhouse gas (GHG) emissions need to be at least halved by 2050 in order to avert the worst affects of climate change.

But while the EU has set a target to cut emissions by 2020 and is keen to get some form of global agreement on the issue at next year's talks in Copenhagen, the current US administration will not consider mid-term targets.

And the incoming administration, which will take over negotiations in January has set a less ambitious target to cut emissions to 1990 levels by 2020, compared with an EU call for a 25-40 per cent cut of emissions in all rich countries over the same time period.

Harlan Watson, ambassador and special envoy to the UN Framework Convention on Climate Change, told journalists at the negotiations in Poznan, Poland the US would not discuss mid-term targets and also said long-term targets were unlikely to make it into a "shared vision."

"It remains to be seen whether we can get an agreement on a long-term goal. I doubt there will be a consensus on that point. A number of parties are not willing to agree to a long term goal until other parties commit to a near term or 2020 goal," Watson said.

Watson is part of the official US delegation representing the outgoing Bush administration at the climate change negotiations.

But a Senate delegation, led by Senator John Kerry, will also attend the summit, reporting its findings back to President-elect Barack Obama.

Kerry said that the US is ready to engage in discussions on reaching a future climate change agreement by the end of next year in Copenhagen, Denmark.

"It's a moment we've been waiting for, many of us, for some period of time," Kerry told reporters on a conference call last week. "And we intend to pick up the baton and really run with it here."

The EU said it was necessary to at least discuss targets for 2020 to map out a route to cut emissions long term.

"What is going to be the discussion is how we are going to achieve an 80 per cent goal if you don't have ambitious steps beforehand in the short term or in 2020," Brice Lalonde with the EU delegation told reporters.

He also told reporters that this issue would need to be discussed with the incoming US administration next year as a "crucial" part of the talks.

But Watson said the US would not sign up to international commitments to cut emissions until it had domestic targets in place.

"It doesn't work for us to agree to something internationally and then expect our Congress to approve it," Watson said.

Jim Connaughton, chairman of the White House Council on Environmental Quality and leader of the US delegation, said that technology constraints are the key obstacle to the US' ability to achieve mid-term emission reduction targets.

"It will still be a challenge for the US to get to 1990 levels in the mid term, which is why we have focussed so aggressively on a significant increase in technology and research funding, as well as this multibillions of dollars of new financing authority so we can get more deployment of these technologies," he said.

It will take at least a decade before these new technologies, such as large-scale renewables and carbon capture, can be rolled out and have a significant effect on US emissions, he said.

CONTENTS

RGGI exchange snapshot ($)

Exchange	Contract	Settle	Change
CCFE	Dec 08	4.02	-0.08
CCFE	Dec 09	4.15	-0.05
Nymex	Dec 09	4.15	-0.05

Point Carbon RGGI OTC assessment ($)

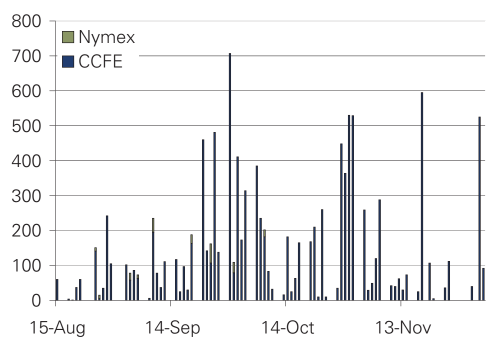
Contract	Best bid	Best offer	Close	Change
Dec 08	4.00	4.10	4.00	-0.10
Dec 09	4.10	4.15	4.15	-0.05

Source: Evolution Markets, Icap and TFS.

Quoted prices are US$ per short ton of at close of market each Thursday as per Point Carbon's RGGI assessment methodology. Changes refer to the last issue of Carbon Market North America.

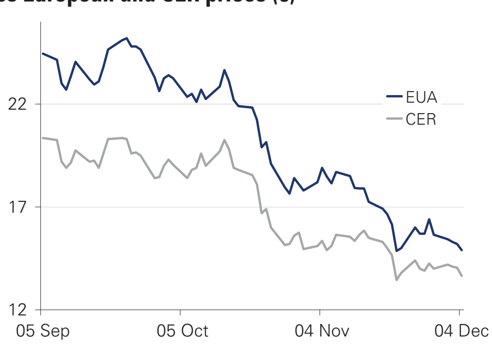
For methodology, see www.pointcarbon.com/news/methodology

Exchange volumes ('000) all RGGI contracts



Source: CCFE and Nymex

2008 European and CER prices (€)



Market comment

The benchmark RGGI contract dropped nearly 6 per cent on bets the next auction will clear at a low level.

The December 2009 contract closed at $4.15 on the Chicago Climate Futures Exchange Thursday, down from a high of $4.40 earlier in the week.

The contract's brokered closing bid and offer was $4.10 and $4.15, respectively.

Meanwhile, the closing bid and offer for the December 2008 RGGI contract, which ends 31 December, was $4 and $4.10.

Most trading took place on Wednesday when approximately 300,000 allowances changed hands in the over-the-counter market, said a broker.

A total 525,000 allowances traded on the CCFE Wednesday, compared to 40,000 on Monday. No permits traded on the exchange Tuesday and last Friday.

A broker said Wednesday's sell-off was triggered by an individual player who bought a $3 December 2008 put option contract, while selling a $4.25 December 2008 put option at the same time.

This caused many market players to sell RGGI on the assumption the $3-level indicates where the next auction price will clear.

"It is a herd mentality," commented one broker on the sell-off.

Another broker said trading has been relatively thin in the run-up to the next auction of RGGI allowances on 17 December because of uncertainty over where the price of allowances will be.

While some believe the auction may fetch a high price because it will attract many players that want to buy RGGI permits on the assumption it will be grandfathered into a federal scheme, others are anticipating a low turn out and clearing price.

A total 31.5 million allowances are up for sale at the next auction, nearly three times the amount sold at the previous auction.

"There is a huge amount of [allowances] entering the market in the next auction. The big question is how much support there is for that," said the broker.

Trading in the December 2008 contract was higher than usual with 135,000 allowances changing hands on the CCFE Wednesday.

A broker said a lot of players bought the RGGI 2008 contract so that they could deliver it before it expires at the end of this month.

US emissions rise in 2007: EIA

Total US greenhouse gas emissions grew in 2007, according to new government data.

The US emitted 7.28 billion tonnes of carbon dioxide equivalent (CO2e) in 2007, a 1.4-per cent emissions increase over the previous year, according to a report released Tuesday by the Energy Information Administration (EIA).

The increase was largely the result of a 75.9 million tonnes CO2e rise in emissions due to stepped-up energy production, the report said.

This development was primarily due to unfavourable weather conditions, which increased demand for heating and cooling in buildings, and a drop in hydropower availability, which led to greater reliance on fossil energy sources like coal and natural gas for electricity generation.

Methane and nitrous oxide emissions also increased, although their contributions to total emissions growth were relatively small.

Still, the report notes that those emissions have high global warming potential.

Methane emissions grew by 13 million tonnes CO2e in 2007, and represented nearly 10 per cent of total GHG emissions.

Nitrous oxide emissions increased by 8.2 million tonnes CO2e in 2007, and represented 5 per cent of total GHG emissions.

Intensity down slightly

Despite the overall increase in emissions, the greenhouse gas intensity of the US economy – metric tonnes of CO2e per million dollars of gross domestic product – fell by 0.6 per cent, the smallest decrease since 2002.

The Bush administration has set a goal of reducing US greenhouse gas intensity 18 per cent by 2012. Since 2002, US greenhouse gas intensity has fallen by an average of 2.1 per cent per year, resulting in a total reduction of 9.8 per cent from 2002 to 2007.

US global share could fall

US carbon emissions in 2005 represented about 21 per cent of the world total, but that number could shrink in the coming years, the EIA said.

US energy-related carbon dioxide emissions are projected to increase at an average annual rate of half a per cent from 2005 to 2030, while emissions from developing economies are projected to grow by 2.5 per cent per year, the EIA said.

"As a result, the US share of world carbon dioxide emissions is projected to fall to 16 per cent in 2030," the EIA report said.

US Congress watchdog questions CDM

Offsets may not be a "reliable" long-term approach to mitigating emissions, Congress' watchdog said.

In its newest report on the carbon market, the Government Accountability Office (GAO) examined "lessons learned" from the EU emissions trading system (ETS) and the UN's clean development mechanism (CDM).

The report offers Congress recommendations on how to avoid some of the early pitfalls of the EU ETS as it proceeds to draft legislation creating a cap-and-trade programme to reduce US greenhouse gas emissions.

Among GAO's key findings is that flexible mechanisms in a carbon market, such as the CDM's offset programme, "may be, at best, a temporary solution".

While it says the CDM has allowed industrialised countries to meet their emission reduction targets in a cost effective way, the GAO warned that some projects that went through the programme's "rigorous screening process" were not additional.

"Such projects do not represent net emission reductions and can compromise the integrity of programs--including the ETS--that allow the use of CDM credits for compliance," the report said.

The government watchdog also said that the current CDM project approval process limits the scale and cost-effectiveness of some projects.

The GAO told Congress that the US should learn from the pitfalls experienced by Europe in the first phase of its emissions trading programme, between 2005 and 2007.

"According to available information and experts, the ETS phase I established a functioning market for carbon dioxide allowances, but its effects on emissions, the European economy, and technology investment are less certain," the report said.

The GAO recommended that the US ensure it has accurate emissions data to set accurate emissions caps when Congress drafts legislation to avoid the price collapse experienced by the EU ETS in 2006, when the release of emissions data revealed that the supply of allowances exceeded demand.

In September, the GAO released a report on the voluntary carbon market, and urged Congress to consider including provisions to create "standardised quality assurance mechanisms" when it drafts cap-and-trade legislation that allows the use of offsets for compliance.

To test the quality of offsets, the GAO bought US-based and international offsets from 33 retail providers ranging from $5-31 per tonne. It found that the information they provided about the offsets "varied considerably and offered limited assurance of credibility".

RGGI auction may lure buyers preparing for federal cap

The next RGGI auction may attract bidders buying allowances to transfer into to a federal US carbon market.

The Regional Greenhouse Gas Initiative (RGGI), a cap-and-trade programme for the electricity sector in 10 northeastern states, is holding its second auction of allowances on 17 December.

A total 31.5 million regional greenhouse gas allowances (RGAs) are available for sale, almost three times the amount sold at the first auction in September.

With fresh political momentum behind the creation of a mandatory US cap-and-trade system, some market participants predict more players will bid for RGGI allowances in hopes they will be fungible under a national scheme.

"You have a revival of federal cap and trade," said Emmanuel Fages, carbon analyst at Societe Generale. "You will have buyers of various origins, such as future compliance buyers who think RGAs will be usable in other schemes."

Fages predicted the auction will be more oversubscribed than the last. The September auction was four times oversubscribed with 59 participants submitting bids for nearly 52 million allowances.

Utilities constituted the majority of buyers. But Fages predicted fewer power companies will participate in the December auction because the programme remains overallocated.

He predicted the next auction's clearing price could be as high as $5 – much higher than the September auction clearing price of $3.07.

The new Chicago Climate Futures Exchange federal carbon contract could also boost interest in RGAs and participation in the December auction, say observers.

The so-called CFI-US contracts, which expire in 2013 and beyond, can be used for compliance under a US mandatory federal scheme.

Gil Avidar, who works on the emissions desk at brokerage firm Newedge Financial, said pre-compliance buyers may be attracted to RGGI credits because they are the cheapest to deliver on the new CFI-US contract.

WCI lines may be redrawn: officials

Not all states in the Western Climate Initiative will be ready to join when trading begins in 2012.

The WCI is a North American cap-and-trade programme comprised of seven western US states and four Canadian provinces seeking to collectively reduce their greenhouse gas emissions by 15 per cent below 2005 levels by 2020.

Although the member states and provinces have signed on formally as members of the WCI with the support of their governors or premiers, each jurisdiction's own legislature needs to pass legislation before they can fully proceed.

US states need to pass legislation before 2011, when members are required to submit inventories of their greenhouse gas emissions.

Some state legislatures, especially those in coal-producing states, do not appear to share their governors' enthusiasm for WCI and could put their state's participation in regional carbon trading on hold.

Meanwhile, California, Oregon, Washington and the four Canadian provinces all appear on track to participate when the programme starts, one advisor to the WCI told Point Carbon recently.

The three US states derive a relatively large portion of their electricity from hydroelectric sources, have aggressive renewable energy targets, and have Democratic- controlled state legislatures.

But for Arizona, Montana, New Mexico and Utah, states that are more dependent on coal for their electricity production and as an export, participating in WCI is a tougher sell.

While not a strictly partisan issue, opposition to caps on carbon emissions is more likely to come from the Republican party, which control legislative bodies in some WCI states.

Cap and trade would raise the price of traditional fossil fuels, like coal, a move some experts say could be a hard sell as many states are facing budget deficits.

Meanwhile, energy producers and industrial manufacturers across the country argue that the creation of a "patchwork" of regulation would be bad for their businesses, and say they would prefer to wait for a national programme.

Arizona is one state where WCI participation may be immediately at risk. The state's governor, Democrat Janet Napolitano, originally signed the state on to the WCI, despite objections by her state legislature.

The state's house and senate are controlled by Republicans, who have complained about being left out of the WCI process and stressed their opposition to anything that will make Arizona's manufacturers less competitive.

Napolitano will now leave her post for a cabinet position in the incoming Obama administration. She will be replaced by Republican Jan Brewer, Arizona's secretary of state.

A spokesman for Brewer declined to discuss policy positions, but one source said she is opposed to the state's participation in the programme.

Canadian opposition coalition sticks to cap and trade

A Canadian opposition bloc trying to oust the ruling party has included cap and trade in its platform.

On 8 December, Prime Minister Stephen Harper will fight to stave off a vote of no confidence, after opposition parties joined forces to topple the Conservative government for what they call its failure to address the economic crisis.

On Monday, Stephane Dion, leader of Canada's main opposition Liberal party, announced a plan to form the coalition with opposition parties, the New Democratic Party and Bloc Quebecois.

"Since the recent federal election, it has become clear that the government headed by Mr. Harper has no plan, no competence and, no will to effectively address this crisis," the three leaders of the opposition parties wrote in an open letter to Canadians.

The new coalition government, which would be headed by Dion until May 2009, would make an economic stimulus package its priority, which would include investments in clean energy and forming a North America-wide cap-and-trade scheme.

A continental cap-and-trade programme was the centrepiece of the Conservative party's global warming plan.

The coalition has given few details on the design of the cap-and-trade programme they would support.

All leaders, however, back absolute targets to reduce greenhouse gas emissions instead of intensity-based reductions.

In contrast, the Conservative party supports intensity-based reductions of greenhouse gas emissions as part of its domestic greenhouse gas regulations.

The opposition parties have criticised these intensity-based targets, claiming they will increase emissions instead of reducing them.

The coalition did not say how much they would seek to reduce emissions by, but proposed using 1990 levels as a base line.

The Conservatives use 2006 as a base line year of reducing greenhouse gases.

The Liberal party made no mention of a carbon tax, which was the central plank of its climate change policy during the general election campaign earlier this year.

Harper's Conservatives won the general elections held on 14 October, picking up 16 seats to strengthen their minority government.

The Liberals lost nearly 20 seats during those elections, with many attributing their defeat to their focus on a carbon tax.

RECENT GLOBAL CARBON POLITICS

The UN has barred **DNV** from auditing carbon reduction projects after claiming it had broken rules. The clean development mechanism (CDM) executive board said it has temporarily suspended the world's biggest auditor of CDM projects after conducting a spot check on its auditing activities. The UN claims that the company broke several rules on auditing, including a failure to provide evidence that work had been carried out by qualified experts.

The **European parliament** and member states agreed Monday to cut new car emissions from 2012. Under the agreement, greenhouse gas emissions from new vehicles must be cut 18 per cent within the next six years. Starting 2012, 65 per cent of cars must meet the goal of releasing 120 grammes or less of CO2 per kilometer. This will gradually increase to all new cars in 2015. By 2020, all new cars must not emit more than 95 grammes per kilometre.

But the parliament will refuse current proposals from the French EU presidency which would allow up to around 70 per cent of reduction targets to be met with **offset credits**, according to a key negotiator. One MEP said the "red line in parliament is drawn at a 50 per cent limit."

Brazil's new climate plan, released this week, could prevent 4.8 billion tonnes of CO2 from being emitted by 2018. **Brazil's National Climate Change Plan**, as widely expected, featured a set of quantified targets to bring down the rate of forest clearances. Under the phased programme detailed in the plan, targets are based on percentage reductions in the area deforested during four-year periods starting in 2006 and ending in 2017. The final goal would be to reach an **annual deforestation rate** of approximately 5,500 square kilometers by the end of 2017, a cut of more than 70 per cent below the 10-year baseline.

Chile's president unveiled a climate change plan, which calls for an expansion of renewable energy and calls for the mandatory reporting of emissions in the country's vital copper mining sector. President Michelle Bachelet unveiled the 2008-2012 climate plan, days before the environment minister travels to Poznan for UN climate talks.

Australia's government is under fire for delaying details of future climate targets. The Labor government had been expected to announce 2020 emissions cuts ahead of the Poznan conference. But Climate Change Minister Penny Wong delayed an announcement until a few days after.

New Zealand will "negotiate aggressively" to achieve special status in a follow-up treaty to the Kyoto protocol. Half of New Zealand's greenhouse gas emissions are from agriculture, which makes the country different from most other developed nations.

GUEST COMMENTARY
Welcome to Carbon 2.0

By Phil Adams, World Energy

With the world's climate-change stewards gathered now in Poznan and an eventful 2008 in carbon markets almost behind us, it is hard not to look ahead to 2009 as a watershed year in carbon policy and practice.

Between the upcoming US presidential inauguration in January 2009 and the UN Framework Convention on Climate Change in Copenhagen in December 2009, where it is hoped a new treaty to succeed Kyoto will be presented, expect a 2009 world carbon market marked by self-awareness rather than self-doubt, clarity vs. convolution, and linear thinking and execution.

Welcome, in short, to the dawning of Carbon 2.0.

The carbon market is no longer a grand experiment. We have tested and observed it, watched it grow. It is out of the Petri dish, developing into something disciplined, market driven and commercial.

And it is bifurcating. The new world order of Carbon 2.0 has rationalised into primary markets and secondary markets, compliance markets and voluntary markets, and government-based allowances and project-based credits. Attending this market rationalisation is a new-found, best-practices based clarity about the trading models best suited for these markets.

Not surprisingly, auctions have emerged as the mechanism of choice for trading in the primary market, eclipsing bid-ask exchanges. Why? Primary carbon markets, where original government allocations or commercial-project credits are created, require a heavy information component to ensure successful transactions.

Buyers of primary allocations or credits cannot pick up their daily newspaper for a price quote on reforestation, N2O abatement or methane capture projects, nor can they monitor a given primary project credit's transaction history – there is none. Instead, buyers need a structured event that provides transparency into project details and their incumbent risks (political, delivery, credit, etc.) so that they can purchase them with confidence.

Conversely, sellers of primary green commodities need the efficiencies and scale of a marketplace to ensure global reach, liquidity and price discovery. Carbon auctions effectively encompass these needs.

> "Auctions provide the structured event necessary to birth a carbon commodity.

Think of issuing primary carbon commodities, whether government or project based, as initial public offerings. Taking a company public is information intensive and regulation bound. It requires a highly structured, tightly orchestrated event led by experts in that process. You can't bring a million shares of a new unknown company to the New York Stock Exchange or London Stock Exchange. Nor would you want to. Auctions provide the structured event necessary to birth a carbon commodity.

Which brings us back to Carbon 2.0. Many will look back at 25 September, 2008 as the seminal moment in its dawning: the first RGGI auction. That bellwether auction, administered by World Energy, embodied the laws of 10 US states, provided an array of information and transaction services to bidders, and ultimately enabled a market-driven allowance price that generated over $38 million for the participating states. The world noticed.

Auctions have since caught fire in intellectual, governmental and private-sector circles globally. President-elect Obama has pledged a 100-percent auction-driven cap-and-trade programme for the US. The UK has successfully run the first carbon auction under the European Union Emissions Trading Scheme, and a wider re-figuring of how allowances are priced and awarded under the EU framework is expected.

This Carbon 2.0 thinking was on display just last month at the second annual International Carbon Action Partnership event in Washington, DC, which brought together top climate-change thinkers and practitioners from around the world. The topic? Auctioning carbon allowances.

Like the PC industry before it, which worked through an initial array of competing operating systems on its way to becoming a mainstream mega-industry, the global carbon market has seen its share of patchwork attempts to optimise performance. The establishment of clear cut markets, certification standards and trading mechanisms is a major step forward in the evolution and growth of the global carbon market and a hallmark of Carbon 2.0.

Point Carbon is happy to consider your proposals for commentaries in Carbon Market North America Please submit ideas to news@pointcarbon.com

Editorial enquiries

Valerie Volcovici
vv@pointcarbon.com
Tel + 1 202 289 6553
Fax +1 202 289 3967

Sales enquiries

Stefanie Rhodes
str@pointcarbon.com
Tel +1 202 289 3930 ext. 251
Mob +1 202 413 5788
Fax +1 202 289 3967

Other enquiries

Point Carbon
Main office
contact@pointcarbon.com
P.O. Box 7120 St.Olav
N-0130 Oslo
Norway
Tel +47 22 40 53 40
Fax +47 22 40 53 41

Website

www.pointcarbon.com

Offices

Washington D.C.
Point Carbon North America
900 2nd Street NE, Suite 309
Washington D.C., DC 20002

washington@pointcarbon.com
Phone: +1 202 289 3930
Fax: +1 202 289 3967

Boston
Point Carbon LLC
8 Faneuil Hall Marketplace, 3rd Floor
Boston, MA 02109

boston@pointcarbon.com
Phone: +1 617 386 9299
Fax: +1 617 973 6406

Oslo (Headquarters)
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

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

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
Tel/Fax: +38 044 499 0309

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

Tokyo
Point Carbon representative
2-3 Kandanishiki-cho
Chiyoda-ku Tokyo
101-8443 Japan

tokyo@pointcarbon.com
Tel: +81 80 3170 0094
Fax: +81 3 3365 5586