



RIETI "BROWN BAG LUNCH"

May 10 2010

EMISSIONS TRADING: LATEST NEWS FROM OUTSIDE JAPAN

SIMILARITIES, DIFFERENCES, AND THE POSSIBILITIES OF LINKAGES

Henry Derwent and David Lunsford, IETA





Who are IETA?

- Only cross-sectoral, private sector international organisation promoting emissions trading to secure environmental goals
- Founded in 1999
- Membership: ~170 companies
 - 50% emitters
 - 50% project developers, intermediaries, financial institutions, brokers, verifiers, legal firms
 - 60% EU, 30% US/Canada, 10% Asia
- Swiss non profit
- Offices: Geneva, Brussels, Washington, Ottawa
- Role in Australia, Japan



Message for Japan

- Europe remains committed to cap and trade and in principle to international offsets and linking, but not yet to deeper targets
- Other large OECD countries are slowing down in the face of fierce political opposition
- The objections are in fact to doing anything significant on climate change, not to cap and trade as an instrument. They may not continue.
- Cap and trade remains a key weapon in the policy mix to achieve emissions reduction, but a uniform global scheme is a long way off
- Some larger developing countries are considering experimenting with forms of sectoral trading



Copenhagen: a sad outcome for the carbon market

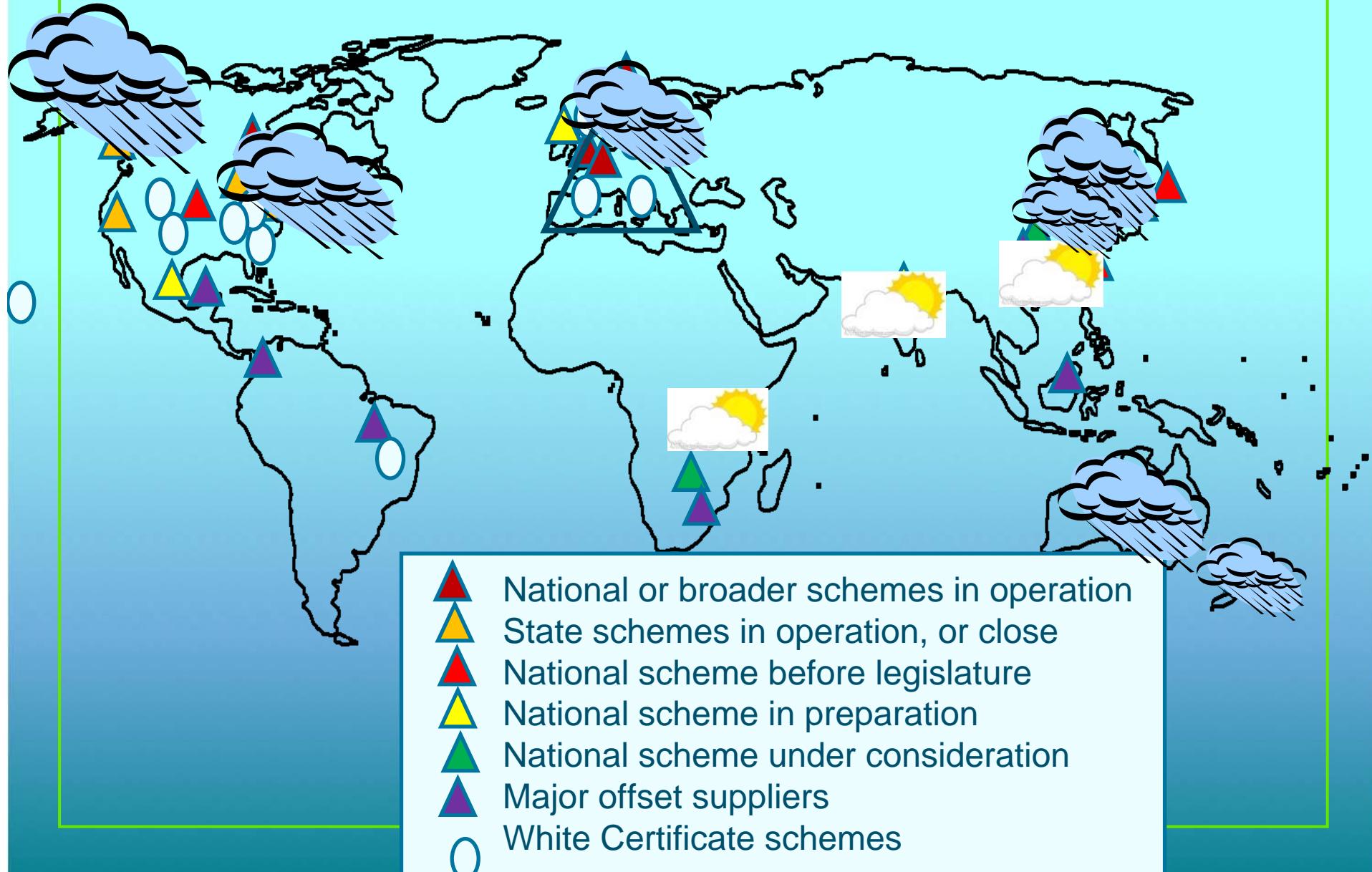


- certainty about timescales and likely price ranges (particularly for the EU-ETS) X
- reform and improved management for the CDM ?
- new scaled-up beyond-CDM private finance mechanisms X
- plans for engagement with private finance consistent with the need for it X

**But maybe less bad – over time – for
climate change**



Stormy Weather : The Current Trading World

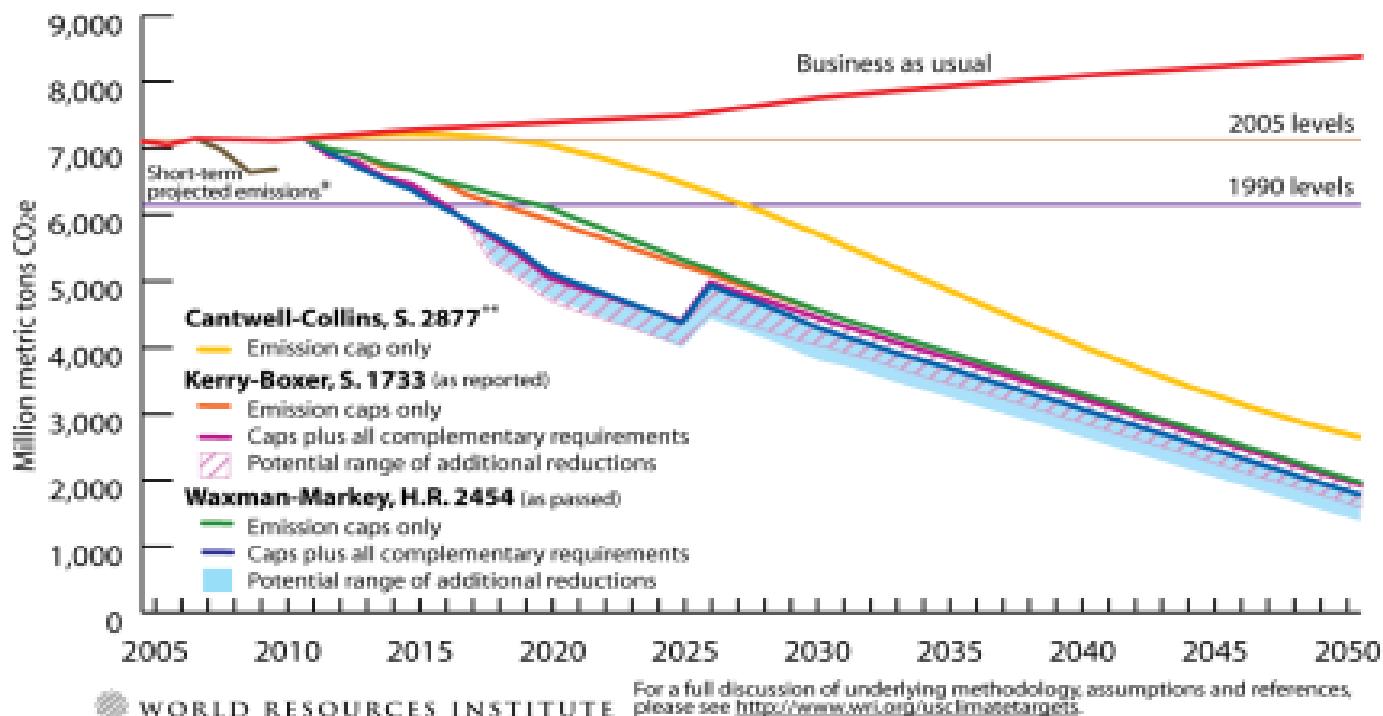




Recent US Climate Bills

Net Emission Reductions Under Cap-and-Trade Proposals in the 111th Congress, 2005-2050

December 17, 2009



For a full discussion of underlying methodology, assumptions and references, please see <http://www.wri.org/usclimatetargets>.

* "Business as usual" emission projections are from EPA's reference case for its analysis of the Waxman-Markey bill. ** Short-term projected emissions" represent EIA's most recent estimates of emissions for 2008-2010.

** Cantwell-Collins sets economy-wide reduction targets beginning with a 20 percent reduction from 2005 levels by 2020. However, additional action by Congress would be required before these targets could be met. Reduction estimates do not include emissions above the cap that could occur due to the safety-valve.



WORLD RESOURCES INSTITUTE



Latest Situation with KGL

Senate prospects for climate and energy legislation are weak without Sen. Graham and non-existent without coal-state Democrats.

- Based on various sources, below find a summary of potential design elements contained in the yet-to-be released US Senate bipartisan climate & energy bill.
 - **Economy-Wide Reduction Targets:** 17% reduction by 2020 from 2005 levels; 80% reduction by 2050.
 - **C&T Rebranded:** Legislation to re-brand “cap and trade” in favour of “pollution reduction scheme/targets”.
 - **EPA Pre-Emption:** US agency would be barred from regulating GHG emissions.
 - **Regional Pre-Emption:** State and regional GHG cap and trade schemes would be terminated, but states could still impose EE and RES measures.
 - **Phased-in Coverage:** Electric power utilities would be covered, starting in 2013, with allowances being traded on a regulated market. Allowance allocation is unknown, but likely a combination of gratis and auctioning expected. Industrials (threshold of 25ktCO₂e annually) to be incorporated in the program starting in 2016.
 - **Offsets:** Combination of international and domestic offsets allowed to help companies cost-effectively meet goals. Offset volumes, project eligibility and other details are unknown.
 - **Transport Emissions & Refineries:** No gas tax. Oil refiners likely required to purchase allowances to cover product emissions. Diesel revenues potentially channelled into US Highway Trust Fund.
 - **Price Collar:** Price floor tied to inflation, enacted through reserve mechanism. Floor: US\$10; Ceiling: US\$30.
 - **Consumer Rebates:** To cover impact of higher energy costs on consumers (potentially 2/3 of revenue)
 - **Border Adjustment Measures:** Border protections for energy-intensive industries (e.g. steel, chemical, paper).



US Carbon Market Oversight

•Genesis of Concerns

- The Legacy of Enron
- The Wall Street Meltdown
- Skepticism about Global Carbon Markets.

•Proposals in Congress

- The U.S. House of Representatives*
- The U.S. Senate*

•Survey of Key Issues and Proposals

Most of the proposals for carbon market oversight seek to address a few primary issues:

- Who should be allowed to participate in carbon markets?*
- What market restrictions could best guard against fraud, market manipulation and excessive speculation?*
- What information is needed for effective regulation on the market, and how should the information be collected?*
- Which agency should oversee the market?*
- Can the carbon market properly utilize over the counter trading, or should elements of the market be limited to exchanges or central clearing on an approved clearinghouse?*

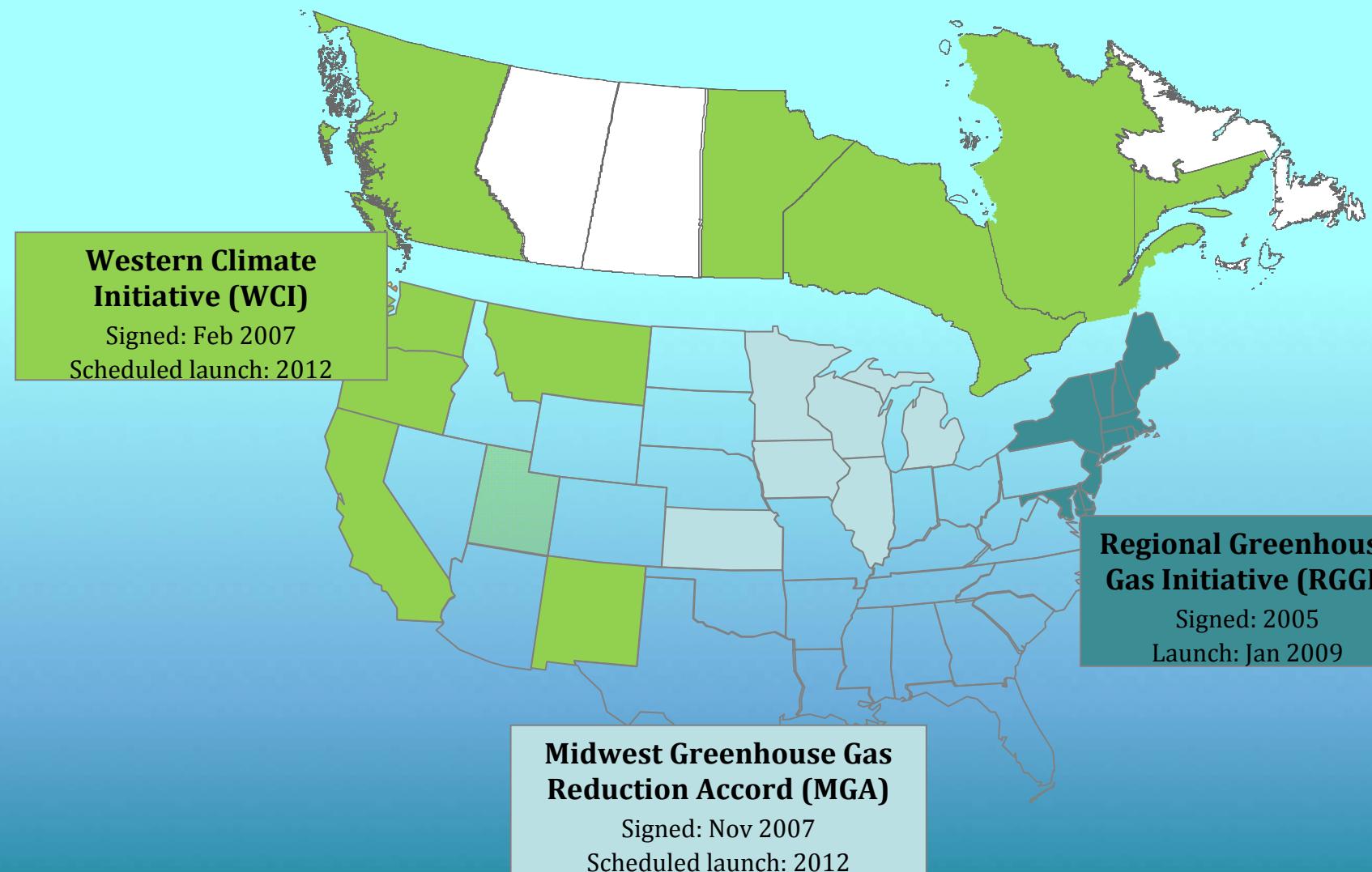


US Financial Reform

- US financial reform legislation is under debate on the Senate Floor now, and is likely to pass.
- Without climate legislation that imposes carbon-specific market oversight rules, this financial legislation will govern emissions markets
- The bill includes derivative market reform provisions that would impact emissions trading
- Most swaps will be subject to mandatory clearing and/or exchange-trading
- A carve out for OTC transactions is likely, but the breadth of the "end-user" clearing exemption is in play
- The legislation will continue to evolve during the next week, as amendments are proposed
- We should have a better sense of market implications for carbon by end of May, when House and Senate bills are reconciled



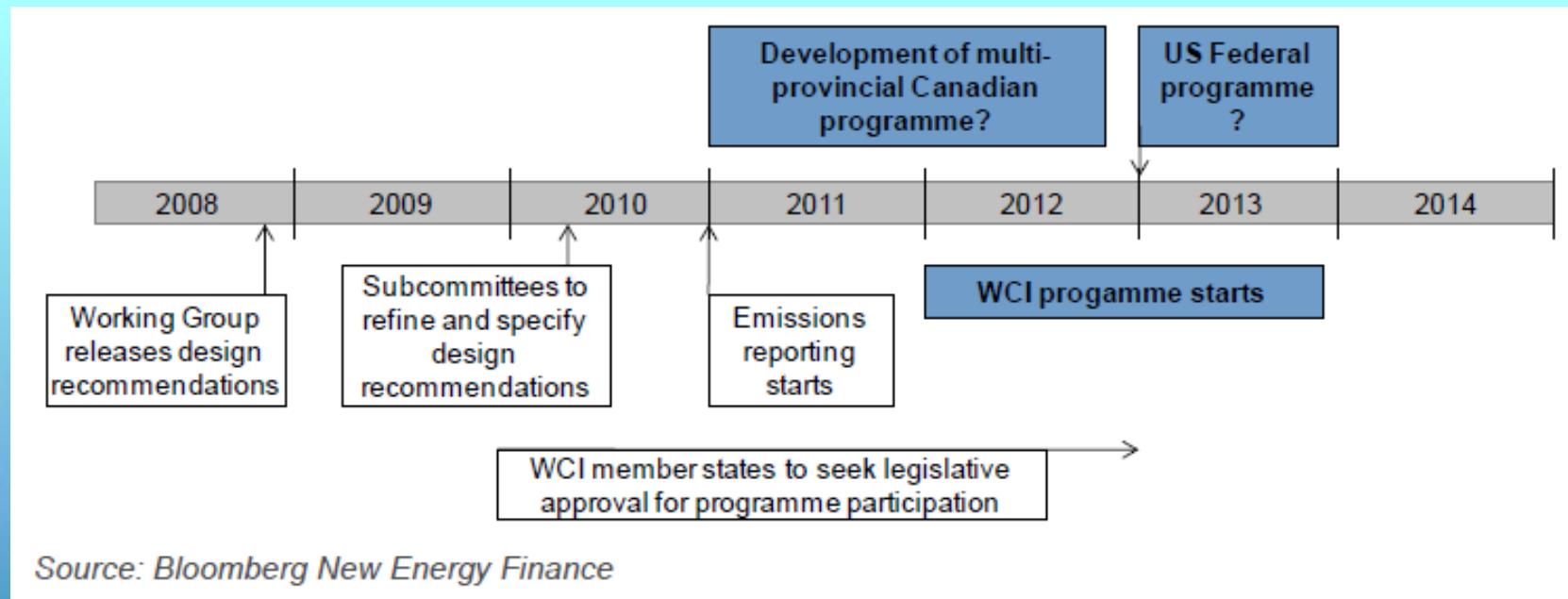
North America Regional Initiatives





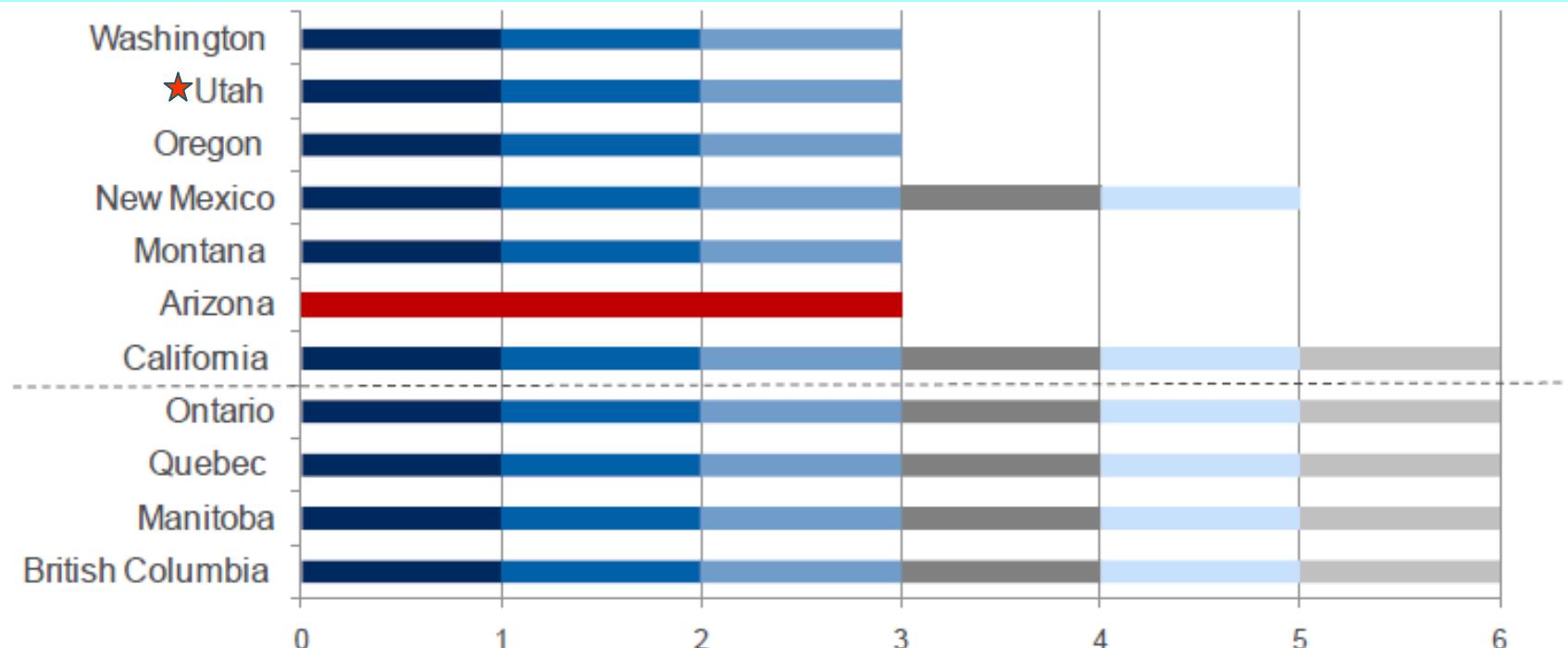
WCI Implementation Timeline

“The WCI is a collaboration of independent jurisdictions who commit to work together to identify, evaluate, and implement policies to tackle climate change at a regional level.” – WCI website





WCI Progress by Member Party



- (1) Recommended Emission Reduction Targets
- (2) Climate Action Team Formed
- (3) Final Report produced by Climate Action Team
- (4) Development of Report into Legislation / Not Applicable*
- (5) Legislation on Session Agenda / Not Applicable
- (6) Legislation Approved / Not Applicable

Source: Bloomberg New Energy Finance

Note: New Mexico has moved one step further whereas Arizona has been removed from our central view

* Note: On 23 April, Utah pulled out of a 2012 start to its cap and trade program. The state will remain a WCI member.



California

- Emissions Reduction Target: 1990 levels by 2020
- Promulgated Draft Regulation – passed November 2009. Precursor to 2nd Draft Regulation set to be released for public comment in spring 2010.
- PDR under the auspices of California Air Resources Board (CARB)
 - Primary design issue unresolved
 - Offset provisions stringent (4% of compliance obligation)
 - Unsure about of out-of-state, out-of-country acceptability of offsets
- Anticipate undue reliance on auctions versus free allocations (appropriation mechanism?)
- CARB in the process of officially certifying offsets for compliance
 - Substantial legal challenges being mounted regarding forestry protocols
- November 2010 election will have a ballot to indefinitely suspend AB32, until unemployment fallen substantially for a sustained period



Canada Federal and State Policy Update

- **Ottawa in Limbo:** Ottawa still intends to regulate greenhouse gas emissions in lock-step with Washington DC, and therefore continues to wait until the US introduces its federal climate plan before acting in Canada.
- **Push for Cross-Country Coal Phase-Out:** During the week of April 19, Minister Prentice unveiled the Conservatives' plan to mandate the gradual retirement of coal-fired power plants across Canada and encourage investments in low/non-emitting power sources
- **British Columbia:** Cap and Trade Act: BC is committed to developing a cap and trade system under the WCI. The provincial government has enacted enabling legislation for a cap and trade program
- **Alberta:** plan includes a list of measures, but none have specific emission reduction targets or estimates
- **Quebec and Ontario:** developing a cap and trade system as part of the WCI and has signed an MOU together
- **Manitoba:** At Copenhagen, Manitoba committed to moving forward with legislation enabling the creation of a GHG cap and trade system.



CPRS Design and Australian Politics

Key dates

July 2008	Release of Government Green Paper
September 2008	Final Garnaut Report published
October 2008	Treasury modelling released
December 2008	White Paper released
March 2009	Draft legislation released
May 2009	Bill presented to Parliament
3 rd Quarter 2009	Legislation enacted
December 2009	Copenhagen Roundtable
Early 2010	First auction of permits
July 2010	Forestry sector eligible to generate credits
July 2011	Scheme commences
2011 – 2012	\$10 fixed price & unlimited permits (no cap)



Where they had gotten to





NZ ETS

Key features of the NZETS

- Broad sector coverage, with each sector phased in over time
- Upstream point of obligation
- Allocation targeted to mid-stream
- No free allocation for those who can pass on costs
- Linked to international markets - no quantitative restrictions on imports

Key changes made in November 2009

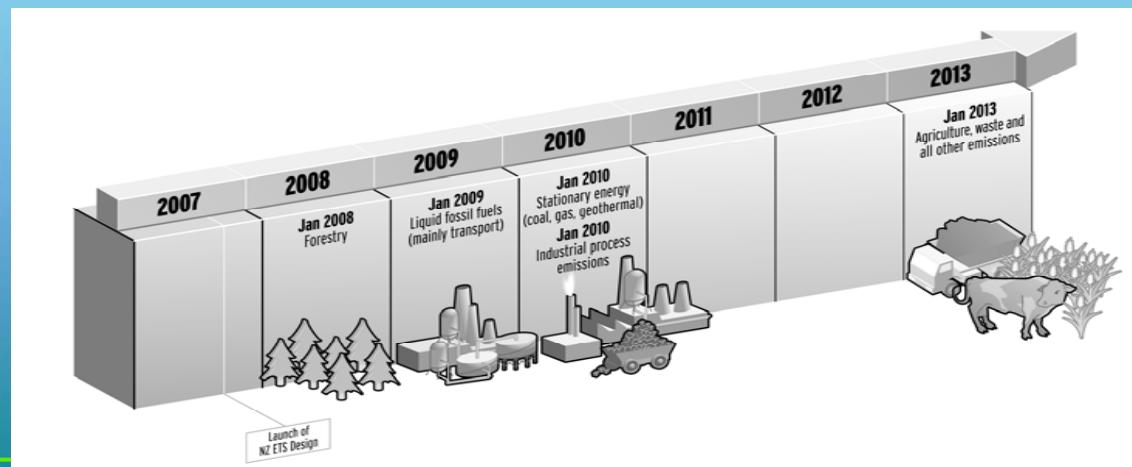
- Change to entry dates for a number of sectors:
 - Stationary energy and industrial processes enter on 1 July 2010
 - Liquid fossil fuels enter on 1 July 2010
 - Agriculture enters on 1 January 2015

- A transition phase will operate until December 2012:
 - one emission unit for every two tonnes of emissions
 - fixed price of \$25 per emission unit

Change to an intensity basis for allocation of emission units to emissions-intensive, trade-exposed industry

Change to 1.3 per cent per year phase out rate for freely allocated emission units

Previous phase-in timing:





EU-ETS current issues

	2008	2009E	% change
Electricity	1,510	1,400	-7.3
Other sectors	610	500	-18.0
o/w Iron & Steel	135	95	-29.7
o/w Cement	190	155	-18.4
o/w Refineries	155	140	-9.6
o/w Other*	130	110	-15.4
TOTAL	2,120	1,900	-10.4

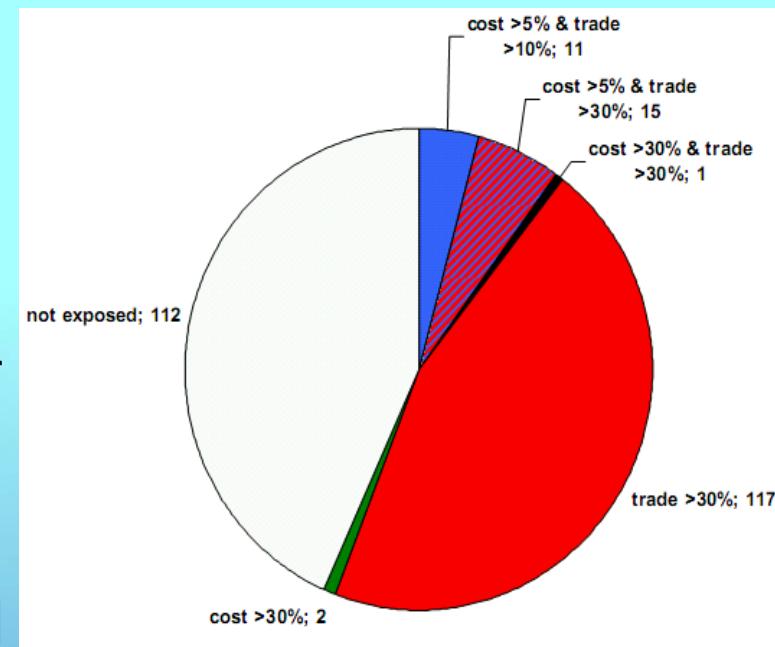
Sources: CITE, Deutsche Bank. *The other sectors covered by the ETS are Coke, Metallic Ores, Glass, Ceramics, and Pulp & Paper.

- Over-supply
- Auctioning
- Benchmarking
- Market oversight and fraud
- Tougher targets
- Use of international offsets
- Leakage, border adjustments and competitiveness
- Need for other instruments – the “trading taliban”



Auctioning

- Major exceptions to 100% auctioning ambition – power sector, trade-exposed sectors
- Amount auctioned (100-300t in advance?), and when: degree of hedging needed
- Single or multiple platforms
- Types of instruments auctioned
- Maximum bidding limits; eligibility; tied bids; frequency
- Auctioning rules may be delayed till after summer





Market Oversight

- OTC and exchanges
- Registries and recycling
- Commodities or financial instruments
- Transparency and commercial confidentiality
- Special problems of carbon
- Comparison with US issues
- Fraud issues

*Three Britons charged over €3m carbon-trading
'carousel fraud'*

Europe's Carbon Mafia

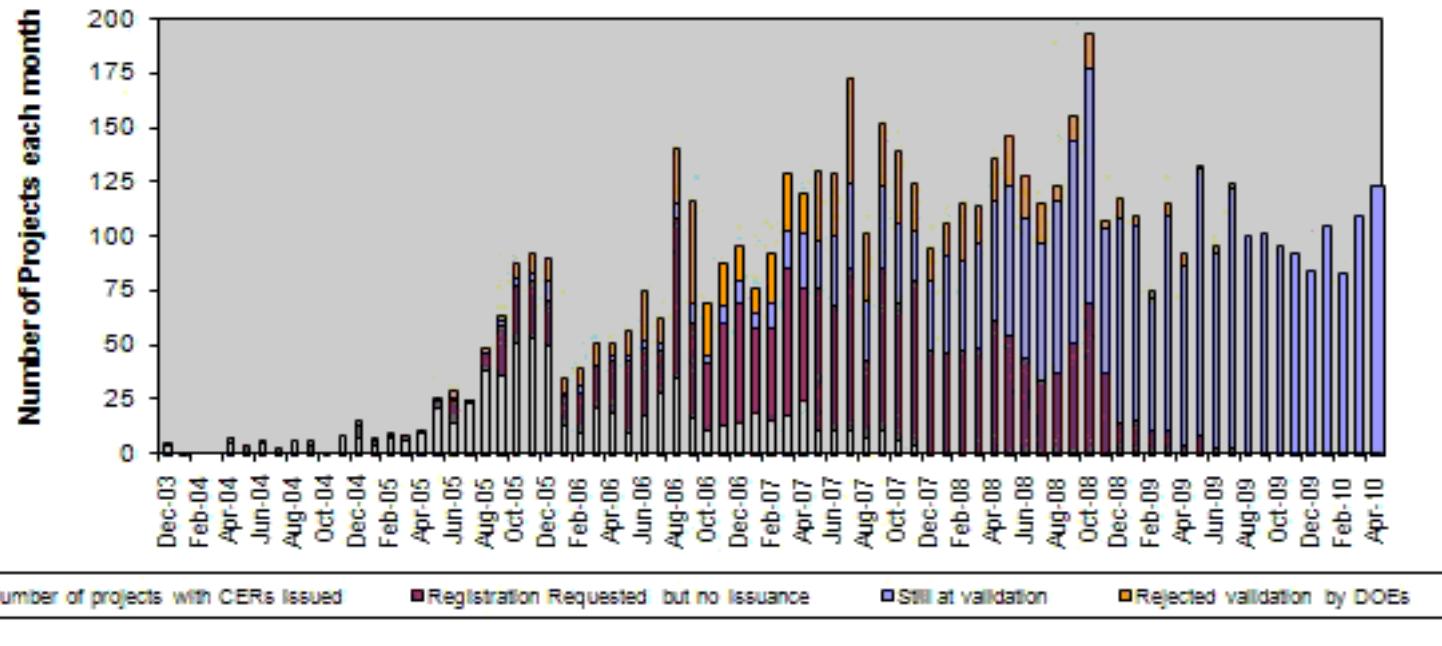


-30% and draft communiqué

- Economic analysis
- Non-EUETS sectors carbon tax
- Further restrictions on CDM
- No serious proposals to pull back
- EU looking for linking but prepared to go it alone
- Impact of renewables and energy efficiency obligations
- Imports and border tax adjustments very difficult in practice
- Risk of losing out in green jobs race



CDM – state of the market



- Pipeline seems to continue
- EU abandonment
- Dependence on the US
- Competition from AAUs
- Balancing portfolios
- Fragmentation of international offsets



CDM reform



Good news from Copenhagen:

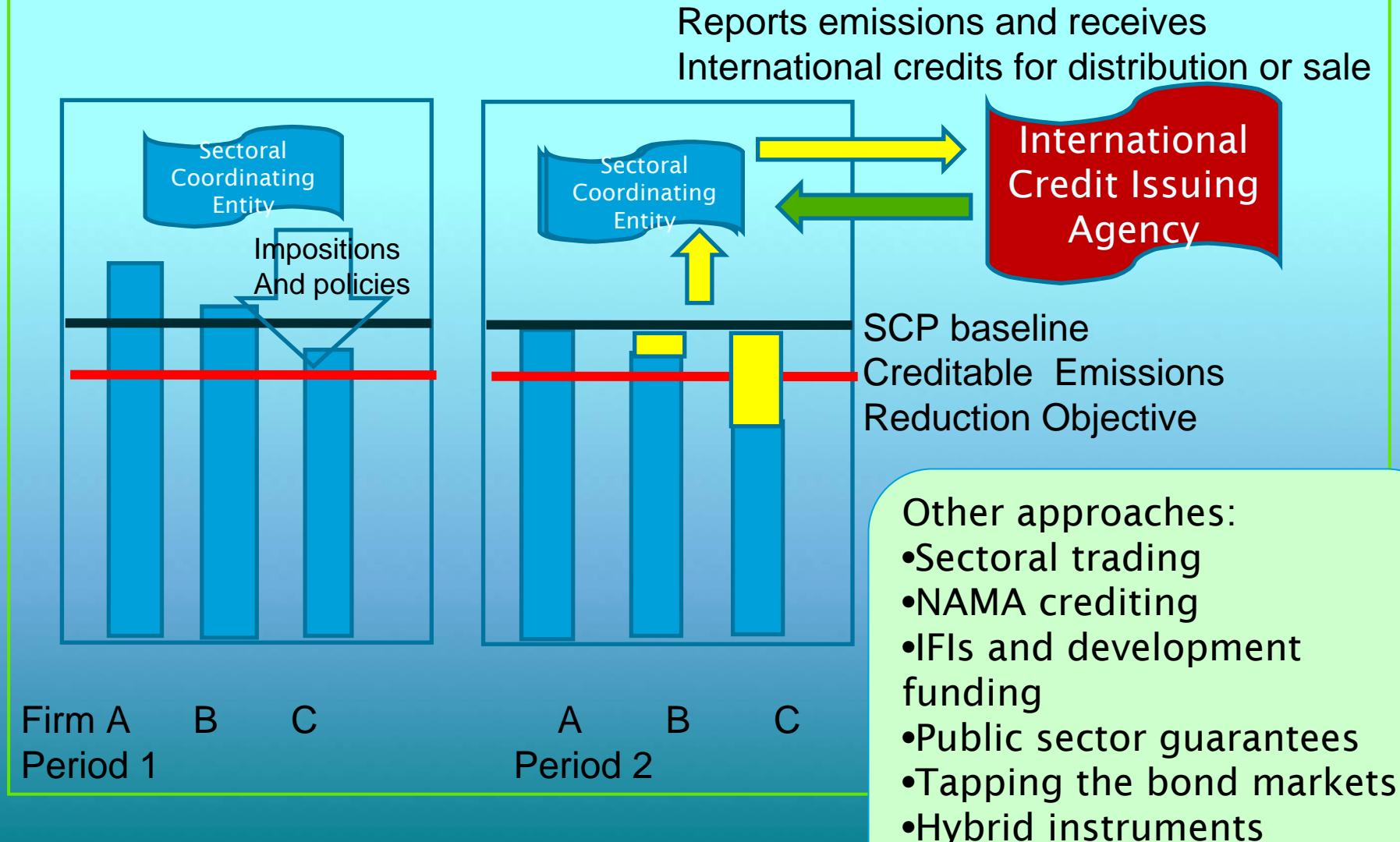
- Explanation, communication, host country prerogative, appeals, LDCs, staffing
- VVM materiality and level of assurance

Less good news:

- standardised baselines
- CCS,
- McKinsey Report



New Instruments – Sectoral Crediting Model 1





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www.carbonexpo.com



Global Carbon Market
Fair & Conference

Cologne, May 26–28, 2010

CARBON EXPO 2010 – The world's leading international Trade Fair and Conference
for emissions trading, carbon abatement solutions and new technologies.

Jointly organized by:





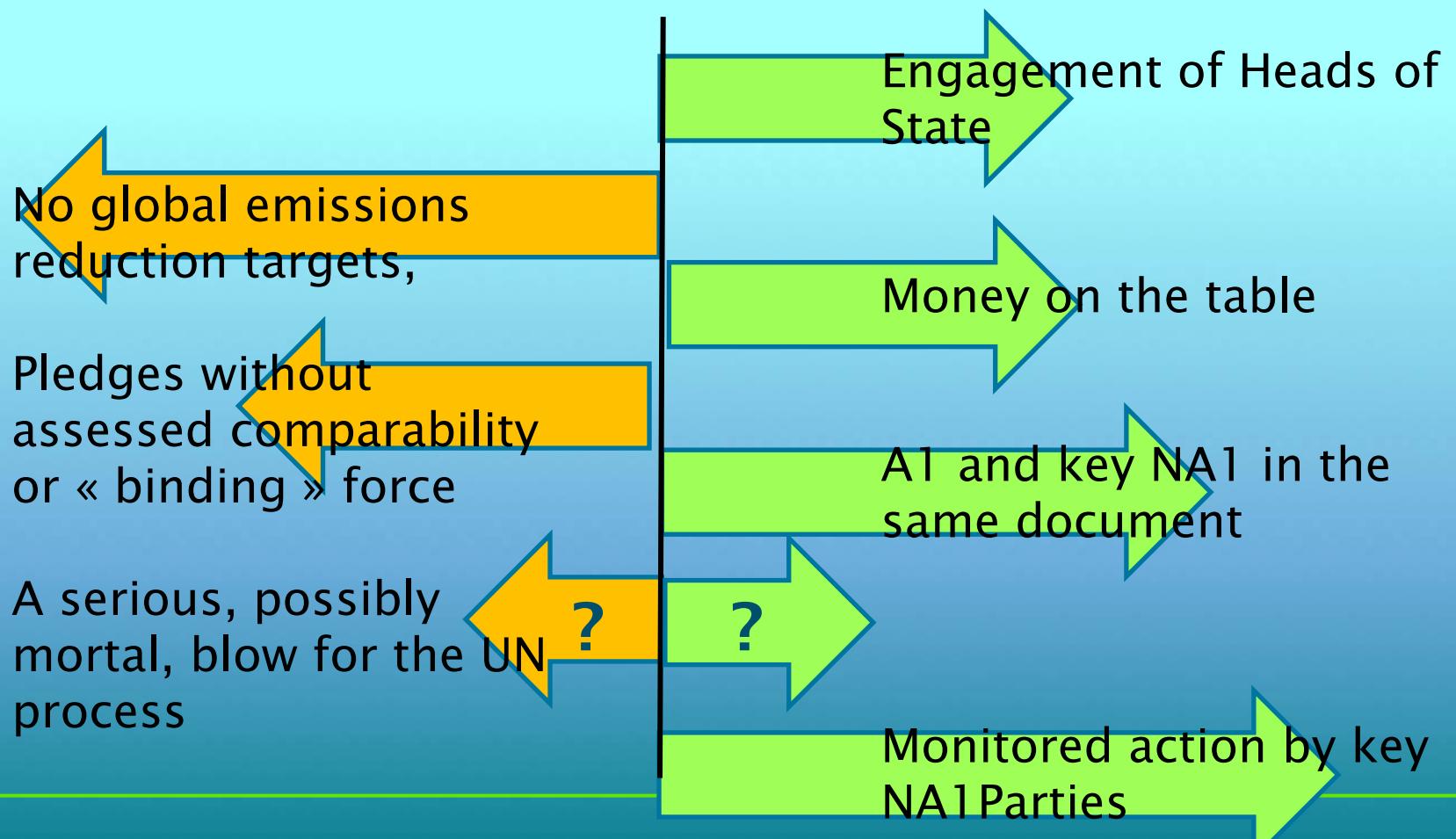
IETA
INTERNATIONAL EMISSIONS
TRADING ASSOCIATION

www.ieto.org

MAKING MARKETS WORK FOR THE ENVIRONMENT



Four Steps Forward, Two Steps Backward And one either way...





On the Road to Cancun



- better organisation?
- Ministerial preparations
 - Petersberg and beyond
- Heads of State again?
- belief in an outcome
- MEF, G8, G20, AGF

Don't worry, there's always Rio....