

# Global Environmental Markets

## Announcements

February 2009



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**TFS Green, in conjunction with industry leaders, is proud to alert you to the development of the following innovative products:**

**Kyoto Multi Risk Insurance Policy:** protects investors in the carbon markets, whether they are compliance buyers, project developers, financiers or traders, by providing CDM project insurance.

**REPO (Sale and Repurchase Agreement) product:** efficiently utilizes CERs which are lying in accounts whilst the market remains at these low levels.

**Bespoke Guaranteed CER Product for Japanese Market:** enables Japanese Buyers to participate in the primary market with less risk while offering more flexibility than the guaranteed CER market.

**Forthcoming: CER Aggregation Platform:** allows Sellers of Issued CERs to sell at Market Price regardless of the size of the trade, and without having to go through the lengthy process of signing an ERPA and adding a new Project Participant each time.

**Please contact your TFS Green Broker for details**

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# CDM & VER Markets

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## Primary Market

The New Year began with prices across the carbon markets tumbling dramatically. As EUAs and secondary CERs (sCER) fell there was an inevitable impact on prices for credits from primary projects.

Prices for PIN stage projects in China at the start of the month were in the range of EUR 9.00 to EUR 9.50, with Buyers bearing the costs of CDM development. With the Dec09 sCER price trading above EUR 12.50, PIN stage prices in the low EUR 9.00 represented a reasonable discount for the level of risk being borne by the Buyer, according to the market.

However, by the end of the month, the Dec09 sCER had fallen by almost EUR 2.00 and as a result, prices for PIN stage projects which were being agreed just a short time earlier no longer represented good value for Buyers.

This led to inevitable renegotiations on pricing reported across the market, where Buyers felt they were not being adequately rewarded for the risks being borne yet Sellers were not satisfied in the value they were receiving. Moreover, the fact that the NDRC in China maintained its "official" floor price of EUR 9.00 (EUR 8.00 for WHR and Small Hydro) throughout the month meant that there was a rapid compression of prices for primary projects.

However, many parties believe the NDRC will be more sympathetic in coming months and are still considering deals in China on alternative pricing structures. Such structures allow for the Seller to realize additional value should CER prices rally in the latter years of long term off-take contracts.

Outside of China, where there are no floor prices, primary CERs are currently around EUR 8.00 for early stage projects.

## Secondary Market

Prices of sCERs mirrored EUAs with falls through January in excess of 25%. The softness of the market has also taken away most of the rationale for the widening of the CER/EUA spread as further downside weighs heavily on the minds' of traders.

The Dec09 sCER market opened at €13.20 and weakened to a closing level of €10.40 as of 30 January. The high for the month of €13.50 was on 6<sup>th</sup> January with the low of €10.00 falling on 23<sup>rd</sup> January.

The Dec09/12 sCER strip also weakened from €13.60 to €10.40. In addition, the Dec09 CER/EUA spread ranged from €2.40 to €1.40 and the Dec09/12 CER/EUA spread ranged from €3.15 to €1.95.

## Voluntary Markets

The momentum seen at the end of 2008 has continued into 2009 with buyers and sellers of VERs keeping market activity alive.

Often, the start of the year is the time when buyers assess demand requirements for the coming year and draw up a "shopping list" of VERs. Hence, there have been a number of requests for proposals and tenders already in 2009. Moreover, many buyers have had a chance to assess the impacts that the slowdown in the global economy will have on the quantity of their emissions and their budgets to offset these emissions. As a result, the demand side of the market has picked up from the end of Q3 and start of Q4 2008, specifically with respect to VCUs.

On the other side of the market, supply remains strong in most varieties of VERs, across standards, methodologies, vintages and increasingly host countries. Therefore, buyers have been able to identify suitable projects across the market and, at these relatively reasonable prices, are happy to complete deals.

The main exception remains issued Gold Standard VERs (GS-VER). Limited issuance from new projects has kept the market relatively short. However, forward supply of GS-VERs remains robust, mainly from countries such as Turkey and China.

However, on the bid side, buyers have become more price sensitive, demand has continued to fall off driving the spread between VCUs and GS-VERs down.

## EU Emissions Trading Scheme

Carbon fell below all time lows for Dec09 contracts on general bearish sentiment, weaker energy prices and heavy spot selling.

The month was marked by a lack of strong resistance levels and the realisation that the slowdown in the global economy has further slammed production requirements amongst industrials. The market has invariably been at the mercy of widespread selling which has been driven by a strong desire among the industrial sellers, namely the steel, cement and paper sectors to monetise allowances immediately.

Another factor which weighed heavily on the market in January was the forthcoming Polish EUA issuance due in mid February. The expectation in the market was that this event would likely drive down the spot market. Volumes for January broke all records totaling in excess of 340 million allowances.

The benchmark Dec09 contract opened at €15.60 on 2<sup>nd</sup> January and weakened considerably thereafter. The intra-month high was on 6<sup>th</sup> January at €15.70 while the low mark for the month was registered on the 23<sup>rd</sup> January at €11.60. The EUA Strip mirrored widespread falls opening at €16.45 to close at €12.35. The high/lows for the EUA strip were €16.48 on 6<sup>th</sup> January and €12.15 on 21<sup>st</sup> January.

EUA Spreads Dec09/10 ranged tighter intra-month coming in from between €0.55 to €0.30. The Dec09/12 spread also tightened from €1.83 to €1.35, reflecting the cost of carry.

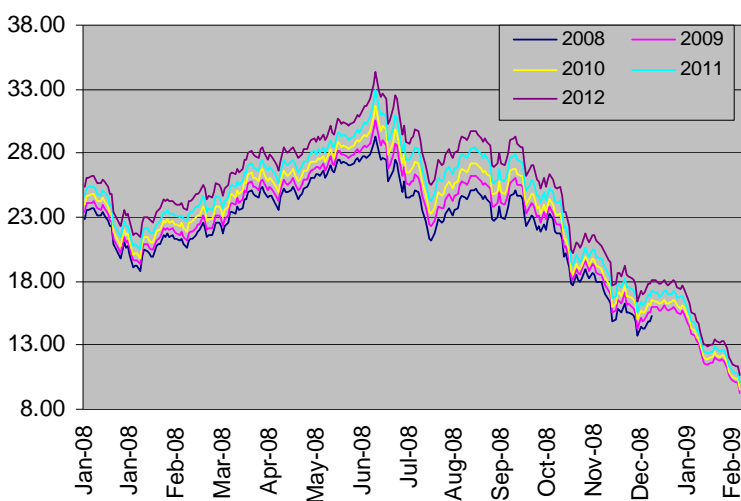


Figure 1: 2008 EUA performances

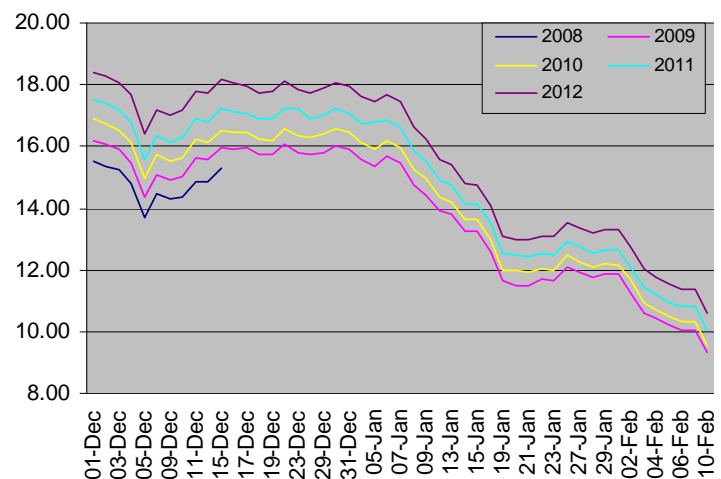


Figure 2: EUA performance since October

## Renewable Energy Certificates

RECs have resumed trading in 2009 at reasonably elevated levels and the last spot trade was done at \$50.65. The two liquid parts of the curve continue to be spot and Cal 09, (15 Jan 2010), where trades are occurring daily. In December, the Australian Government announced details of its expanded Mandatory Renewable Energy Target, which has resulted in a robust REC prices, as liable entities ensure they meet their future requirements.

To give a very brief summary, the Governments exposure draft proposes:

- A dual linear ramp up from 2010 to 45TWh in 2020, maintaining that level until 2025 and reducing to 23TWh in 2030, when the scheme finishes. To put this in perspective, the "old" scheme achieved 9.5TWh of renewable generation in total.
- An unclear penalty price
- There are no changes to the current banking/borrowing provisions.
- Full, unlimited banking and limited borrowing is allowed.
- There are no changes to eligible technologies or the treatment of existing eligible generators.

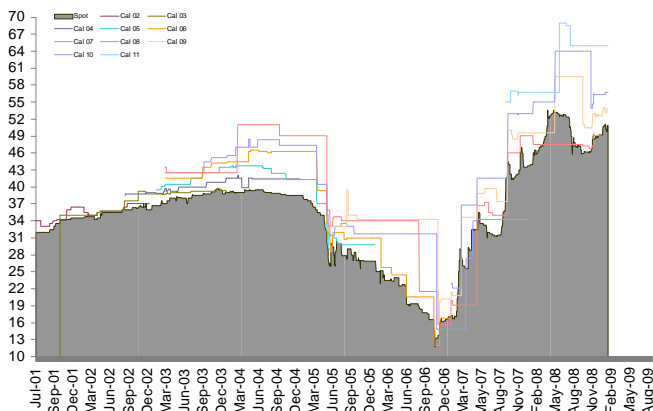


Figure 3: REC

## NSW Greenhouse Abatement Certificates (NGAC's)

NGACs continue to trade at very, very low levels and the most recent trade in the spot market was at \$2.95. Liquidity is very patchy, and sellers are limited to those who can make money at these low levels.

This tends to preclude the demand side abatement, compact fluorescent light (CFL) globe installation companies. There has still been no clarity concerning the transitioning arrangements of NGACs by the NSW Government into the Federal Government's Carbon Pollution Reduction Scheme. This has resulted in a stagnated and still over-supplied market.

## Victorian Energy Efficiency Certificates (VEEC)

The VEEC market is a new, state-based energy efficiency scheme, and applies to residential energy efficiency activities in Victoria.

There is a range of eligible activities available, including CFL installation, and a liability has been imposed on residential electricity retailers. Trading is just commencing, and the most recent VEEC trade was for Calendar 09 at \$17. This scheme is the first of several of state based schemes to be introduced.

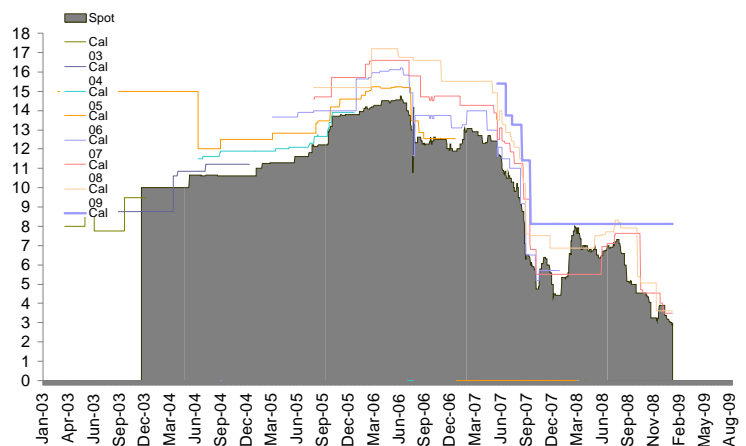


Figure 4: NGAC

## US Markets

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### SO<sub>2</sub>

SO<sub>2</sub> prices have steadily declined since their peak of \$240 after the re-instatement of the CAIR rule in late December. Prices touched a recent low of \$100 on 5<sup>th</sup> February. The price skid seems to be attributed to a lack of interest amongst financial players and diminished demand from generators who have revised their 2009 generation forecasts in light of the economic downturn.

Post-2010 Vintages are seeing sporadic interest with the majority of business concentrated in Vintage 2010 in particular. It is currently trading at slightly higher than the implied post 2010 2:1 CAIR compliance ratio. Option interest has been light, but several June and December calls have traded in the 85% to 100% implied volatility range.

### NO<sub>x</sub>

CAIR Annual NO<sub>x</sub> allowances have also seen a sharp decline in price since the re-instatement of CAIR. Prices peaked at \$6,250 for Vintage 2009 allowances in late December and touched \$2,900 during the first week of February. The allowances seem to be the victim of the same decreased demand that has pushed the Spot SO<sub>2</sub> market lower.

Vintage 2010 and 2011 have held up better on a relative basis, only declining 20% from their late December highs. Vintage 2010 last traded \$1,900 and Vintage 2011 \$1,750. Call options have been very active. The December 8000 Call and June 5000 Call have both traded for large volumes during the first week of February.

### CAIR

CAIR Ozone allowances have been extremely dormant. The EPA is still in the midst of their 2008 true-up period for this product. Until this process is completed most of the allowances will be locked and unavailable for trading. Additionally, since the market is a summer compliance program it tends to not attract utility and trader interest until later in the year. Vintage 2009 Ozone allowances were last quoted \$575 bid and \$675 offered.

### Legislative Developments

News this month has been dominated by President Barack Obama's economic stimulus bill making its way through Congress, with drafts allocating anywhere from \$70-80 billion in renewable energy development estimated to cut 61 million tons of CO<sub>2</sub>/yr. More quietly, in the background, Senator Barbara Boxer (D., Cal.), chair of the Senate Environment and Public Works committee has set a goal of producing a greenhouse gas bill, which would champion both investment in clean technology and include a robust carbon market, before December's international climate change negotiations in Copenhagen. A similar movement has formed in the House, where chairman of the House Energy Committee Henry Waxman (D., Cal.) has set an ambitious goal of May 22 for a U.S. climate bill to come out of committee, adding that "We cannot afford another year of delay."

Texas State Democrat Representatives Eddie Rodrigues and Ana Hernandez, on January 14, introduced House Bill 634 which would direct the Texas Commission on Environmental Quality (TCEQ) to establish a greenhouse gas cap-and-trade system to line up with either RGGI or another cap-and-trade system it deems fit.

However, as the bill must first make it out of committee for a vote in the house, then through the Senate and eventually to the Governor's desk, the development is still at its earliest stage, with a steep hill to climb.

## US Markets (continued)

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### The Regional Greenhouse Gas Initiative (RGGI)

RGGI volumes have seen steady growth over the early part of the year. The price range has been between \$3.50 and \$4.15. However, we have seen a significant increase in liquidity, with 100,000 to 250,000-allowance transactions becoming commonplace.

The option market has seen the greatest growth with calls and puts for March through December 2009 actively quoted. Implied volatilities have been trading in the 60% range for calls and 55% range for puts for all expiries. Option transactions of 500,000 to 1,000,000 allowances have become regular events. The next RGGI auction is slated for March 18th.

### Voluntary Offset Developments

The Climate Action Reserve (CAR) (formerly the California Climate Action Reserve) has announced a series of workshops in New York (10 Feb.), Sacramento (13 Feb.), Houston (17 Feb.), Washington D.C. (19 Feb.), and Chicago (25 Feb.) (with a Seattle date to come) to provide an overview of projects and protocols, the North American market and the reserve itself. TFS Energy's Adam Raphaely has been invited to, and will speak at the seminars in New York and Sacramento.