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Global Carbon Markets – Business Opportunities and Risk Management

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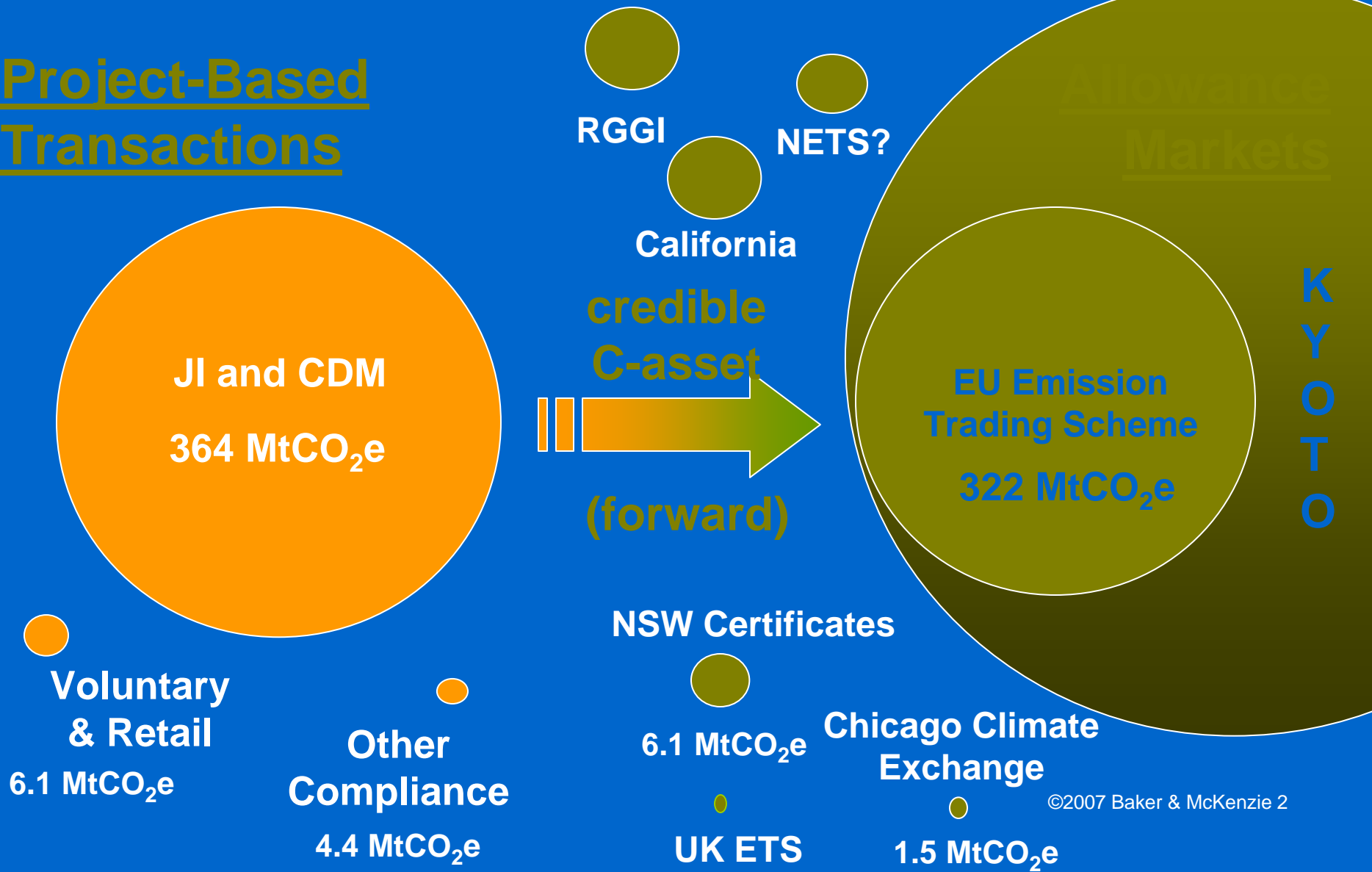
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Taken from *State of the Carbon Market 2006 Report*

Structure of the Global Carbon Market

Project-Based Transactions



Size of the carbon market (1)

- **684 million tonnes (Mt)** of CO₂-e transacted in the first 6 months of 2006:
 - 5 x the amount traded in the same period last year
 - 85% of total transacted in 2005
- Worth an estimated **€12 billion** (US\$15 billion)
- Financial value of trades in 1st half 2006 exceeded entire value traded in 2005
- **EU ETS** remains the dominant market segment –65% of total worldwide trades:
 - But financial value was lower than expected: **€9.9 billion**

Size of the Carbon Market (2)

- Kyoto's flexible mechanisms also saw considerable growth in volume:
 - Carbon credits from CDM and JI projects equivalent to 226Mt CO₂-e, worth €1,976 million, were traded in the 1st half of 2006
 - Secondary CDM trades increased tenfold compared to 2005
- CCX and NSW GGAS showed four times higher volumes and values than in 2005
- 2006 forecast:
 - Total volume of 1,382Mt CO₂-e will be traded
 - Total worth of approximately €22 billion

Emissions Trading Context in Australia

- Move in public perception from uncertainty to certainty
- Further carbon constraint inevitable = no longer “crystal ball gazing”
- Considerable experience in environmental markets and carbon-related regulation in Australia
- First mandatory jurisdiction-wide Greenhouse Gas Emissions Trading Scheme is in Australia: the NSW Greenhouse Gas Abatement Scheme
- Already number of mandatory environmental markets in Australia that have as an aim a reduction in greenhouse gas emissions (GGAS, MRET, Qld 13% Gas)
- NETS and PM Task Group on Emissions Trading

PM Task Group on Emissions Trading

- Issues Paper 7 February 2007
- Terms of Reference to advise on the nature and design of a “workable global emissions trading system” in which Australia could participate
- Task Group instructed to assume that Australia must preserve its competitive advantage associated with fossil fuel reserves and uranium
- Terms of Reference and Issues Paper would suggest any outcome:
 - must include all major economies and emitters; and
 - would enable continued exploitation of fossil fuel reserves (relying on technology to ameliorate impacts)
- Final Report by 31 May 2007

Importance of Global Markets (1)

- PM Task Group TOR recognises most critical aspect to climate change – global solution with all major emitters
- Emissions trading as part of response also needs to be global –
 - Access to cheaper abatement
 - Allow Australia to export abatement opportunities (perhaps packaged with fossil fuel exports?)
 - Facilitate active participation of developing countries and technology transfer
- But BIG question remains – should Australia wait for the (i.e. US, key developing countries) before introducing emissions trading?

Hedging Opportunities for Australian companies (1)

- Many existing opportunities to link to Kyoto and non-Kyoto schemes in absence of a fully integrated, global emissions trading scheme
- Key hedging benefits for Australian companies in a pre-market environment –
 - Access to abatement now at a price lower than in the future under a mandatory scheme
 - Experience at the company level in identifying and managing emissions
 - Experience in developing emissions reduction projects (understanding additionality, project risks etc.)

Hedging Opportunities (2) – Linking into the EU ETS

- Linking Directive – 1 CER/ERU = 1 EUA
- Ability to ‘bank’ between trading phases
- But some qualitative restrictions:
 - No LULUCF or nuclear
 - limits on large Hydro
- Proposed quantitative restrictions – “supplementarity”:
 - phase 2 quantitative limits on numbers of CERs (e.g. Netherlands 8%, Germany 20%)
- But important differences between primary and secondary CER/ERU markets
- Kyoto/non-Kyoto Linking – proposed that Kyoto units be recognised in NETS, RGGI, California Scheme

Hedging Opportunities (2) – CDM and Voluntary Markets

- Australian companies can participate in CDM notwithstanding that Australia has not ratified Kyoto
 - As Buyer: Obtain authorisation from Annex I country to participate and hold an account in national registry
 - As Seller: Enter into JV arrangements with developing country entity to develop a CDM project
 - No restrictions on entities from non-Kyoto countries participating as buyer or seller
- Growing international market for voluntary emissions reductions or “emissions reductions”
 - Contractual right typically not recognised under any mandatory or statutory scheme, but typically independently verified
 - generally less valuable, but still marketable
 - Linking – no regulatory restrictions on eligibility from one scheme to another

Managing risk and capturing opportunities (1)

- Important to manage who takes benefit or detriment of carbon constraints for environmental products in everyday agreements
 - One party could be left with responsibility for works or costs while other might be able to take benefit
- Often failure to take account of carbon liabilities or benefits in contract price
 - One party subject to mandatory emissions trading scheme and cannot pass on or share the cost
 - worse if other party can take benefits under the emissions trading scheme and leaves former entity with all liability
- Consider carbon constraints in change of law or force majeure clauses
- Importance of clear and accurate description of environmental products – often technical

Managing risk and capturing opportunities (2)

1. Take a long term view of risks
2. Take a global view of opportunities
3. Take advantage of opportunities to reduce carbon related costs when they arise
4. Know and understand your greenhouse gas emissions
5. Know the contribution to greenhouse gas emissions, and any carbon policies, of entities both upstream and downstream in your supply chain
6. Protect your interest in/entitlement to carbon credits or other environmental benefits in business arrangements, as well as your ability to recover carbon-related costs
7. Understand the timing issues associated with the carbon market and trading schemes

Further questions?

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