

UK bows to pressure to remove VAT from carbon trade

The UK has removed value-added tax from carbon trade from today in a bid to deter fraud.

The measure will be an interim step while the UK works with other EU member states on changing European law, the country's finance ministry said in a statement on Thursday.

But the move may be at odds with the European commission, which favours a different approach to tackling the problem.

"The new law... follows evidence that commodity trading in emissions allowances is being used by fraudsters to steal VAT revenues from the UK, and that the UK may become a major target for this activity in the coming months," the statement said.

The government was under mounting pressure from a London-based trading community anxious to get clearer guidelines on what steps to take to avoid getting caught up in the sales scams.

Several traders told Point Carbon they had been inundated with enquiries from potential customers they felt were suspicious.

France first

The move follows a similar decision taken last month by France, where authorities became suspicious about a spike in trading volumes on the Paris-based Bluenext exchange.

According to Point Carbon News estimates, France would be owed almost €2 billion in VAT revenue from all carbon trade handled through Bluenext over the first six months of 2009.

Earlier this month, the Dutch government changed the way it applies VAT to carbon trade within its borders.

The UK, which hosts the majority of EU carbon trade, treats any exchange-based trade of carbon credits at a zero rate of VAT. The concession, known as a terminal markets order, is unique among EU member states and dates back to the introduction of VAT to the country in 1973.

The new ruling extends the zero rating of VAT to all over-the-counter carbon trades.

EU scrutiny

The European commission is keeping a close eye on national efforts to combat VAT fraud to ensure VAT is applied in a similar way across the 27-nation bloc.

"The commission is in the process of examining measures taken nationally to counter this potential fraud, said a spokeswoman, adding it was too early to say if the commission will take the French to court over the country's changes.

The bloc's executive wants to propose a pilot scheme
(continued on page 3)

EUA closing prices - historical

EUA prices for December 2009 delivery, as assessed by Point Carbon. Prices are published daily at www.pointcarbon.com



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EUA closing prices, OTC

Contract	Bid	Offer	Close	Change
EUA spot	13.70	13.80	13.75	-0.58
EUA 2009	13.78	13.88	13.83	-0.62
EUA 2010	14.21	14.31	14.26	-0.63
EUA 2011	14.99	15.09	15.04	-0.65
EUA 2012	16.05	16.15	16.10	-0.69

Secondary CER assessment

Contract	Low	High
Dec-09	12.34	12.44
Dec-09-12	12.27	12.37

Quoted prices are euros per EUA/CER, at close of market 30 July, as assessed through Point Carbon's bid-offer-close methodology for the over-the-counter (OTC) market. Changes refer to the last issue of CME.

For methodology, see www.pointcarbon.com.

Market comment

EU carbon fell 4.3 per cent this week as more traders began to feel prices had risen too far when compared to fundamental signals.

By Thursday's close, the 2009 EUA contract was valued at €13.83, compared to the previous Thursday finish of €14.45.

The benchmark carbon contract ended a run of 11 consecutive trading days closing above €14 on Tuesday despite few bearish signs among other energy commodities.

When the front year EUA fell as far as €13.50 earlier on Thursday, the contract's lowest price since 9 July, it attracted strong buying from utilities and financial institutions, according to traders.

"The market has been on the downside for the past couple of days, and it's bouncing back on pretty low volume," warned one carbon trader.

Weekly volume was still relatively thin, reflecting a holiday period for many traders. Around 92 million allowances changed hands on all platforms, compared to 86 million EUAs the previous week.

Volatility was also relatively lacking. The difference between the highest and lowest intra-day values of the 2009 EUA averaged just €0.34 across the week, compared to €0.46 a week earlier.

European delivered coal prices for next year delivery fell \$0.75 to close at \$84.50 per tonne, a bearish signal for carbon when coupled with flatter gas prices.

There was little movement in the other key energy markets of German power and Brent crude oil across the week.

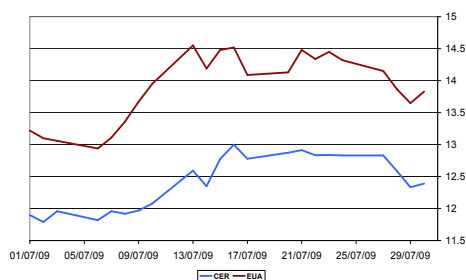
In the secondary market for UN-backed carbon contracts, CERs moved down broadly in line with EUAs.

The 2009 EUA ended at €12.39 on Thursday, 3.5 per cent lower than a week earlier.

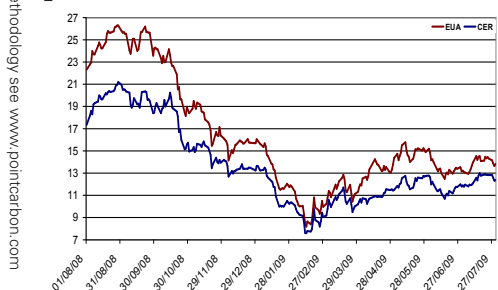
The spread between the front year EUA and CER contracts narrowed to €1.44, compared to €1.61 at the previous Thursday's close.

EUA and secondary CER prices [€/t]

Last month



Last 12 months



For methodology, see www.pointcarbon.com

UK bows to pressure to remove VAT from carbon trade (continued)

to go further in deterring such dodgy dealing later this year.

It appears to favour the same approach applied by the Netherlands, rather than the steps taken by France and the UK.

The Dutch shifted the obligation to pay VAT on spot carbon credits from the seller to the buyer, a measure known as a 'reversed-charge mechanism'.

The attention of all the national authorities has focused on the trade in spot credits. Unlike carbon futures contracts, which are financial instruments, spot carbon deals are classified as physical commodities, and so have been subject to VAT.

France leads way on carbon levies

France this week took a major step towards introducing a carbon tax on all its homes and businesses within six months as political momentum for such measures spreads further across Europe.

A government-appointed panel wants to put a duty of €32 for every tonne of CO₂ emitted from next year though the levy will exclude businesses facing carbon dioxide (CO₂) limits under the EU emissions trading scheme (ETS).

"This report will form a solid basis which usefully inform government decisions," said a statement from the French energy and treasury ministries, which were presented with the report this week.

The tax on the use of fossil fuels should be applied to everyone equally, with compensation handed back to poorer households or those in rural areas, the report said.

It said a tax of €32 a tonne of CO₂ would be equivalent to 7 or 8 euro cents a litre of petrol, and that this should be scaled up to €100 a tonne by 2030.

The government is planning to use the panel's recommendations to form the basis of a law it wants to pass by the end of the year and to come into force in 2010.

Sweden's citizens have faced taxes based on emissions of CO₂ for 20 years and their government is keen to use its 6-month stint as holder of the EU presidency to extent the policy across the 27-nation bloc to help meet wider emission targets.

Irish call

This week, a think-tank funded by the Irish government called on the country to introduce a carbon tax to cover the 70 per cent of its economy not covered by EU ETS.

The Economic and Social Research Institute (Esri) said such drastic action would be necessary for Ireland to meet its 2020 emissions goals.

The recession-battered Irish government is due to make a decision on the introduction of a carbon tax when it delivers its budget at the end of this year, although many groups have already voiced strong opposition.

Latvia edges Hungary in race to launch GIS

Latvia launched its programme to reduce emissions using cash raised from AAU sales this week, pipping Hungary which later revealed similar plans.

The Baltic country will announce a tender for local governments that seek funding for energy efficient projects in public buildings, a senior government official told Point Carbon on Monday.

The budget of €25 million (\$35.6 million) comes from revenue raised through the sale of 5 million Kyoto emission units, known as assigned amount units (AAUs), which were bought by Austria and the Netherlands earlier this year.

With the launch, Latvia will become the second country after the Czech Republic to put a so-called green investment scheme (GIS) in place.

The schemes aim to guarantee AAU buyer countries that revenue raised will be spent on climate-friendly projects.

The launch of the GIS enables Latvia to shrug off criticism from AAU buyers and green pressure groups that have criticised sellers for using the funds to plug holes in their national budgets instead of funding green projects.

Hungarian delay

Hungary said its GIS will force it to delay spending its AAU cash after months of failed promises.

Last year the east European country earned HUF28.2 billion (\$146 million) by selling a total of 8.6 million assigned amount units (AAUs) to Belgium and Spain.

But deadlines set by the GIS announced this week will force the government to keep AAU revenues for at least another five months in its cash-strapped budget.

This has led some critics to question whether Hungary plans to use the AAU revenue towards its floundering national economy afloat.

The GIS programme has kicked off with a public tender which allows people that apply for public funding to make their houses more energy efficient.

Green groups have repeatedly criticised the government for delaying the spending of this money, which they fear has discredited the country ahead of further AAU deals.

“Despite the much anticipated launch of the GIS, we cannot be happy because it will not help (Hungary) regain credibility,” Peter Kardos of Hungarian NGO Energy Klub said.

Hungary’s reputation took a hit in February when its environment minister announced the country would delay spending of AAU proceeds this year.

The minister insisted that Hungary would only hold on to revenues from AAU sales this year, not money pocketed from AAU deals last year.

Kardos said another major problem with the Hungarian GIS is the uncertainty around the additionally of its projects.

He pointed out that the GIS targets projects are identical to those in another government programme, which have been financed for years by the national budget.

If it turns out that the government is plugging budget holes with AAU cash, Hungary can give up on its hopes of selling its remaining AAU surplus, Kardos said.

Hungary had not returned calls made by Point Carbon News at the time of press.

Mystery buyer

New Zealand company Ernslaw One Ltd has sold 500,000 AAUs to an unnamed European buyer.

The deal is the first large-scale sale of credits generated under the New Zealand emissions trading scheme to a foreign buyer.

Forestry firm Ernslaw One said the deal was done

at a price slightly discounted to the price of certified emission reductions (CERs), the UN-backed credits generated from carbon-cutting projects in poorer countries.

Unlike CERs, EU companies can’t use AAUs for compliance in the EU cap-and-trade scheme.

This means the bulk of AAU demand is expected to ultimately come from national governments such as Spain and Italy which are struggling to meet their emissions reduction targets set under the Kyoto protocol, which apply from 2008 to 2012.

EU outsiders eye closer climate ties

EU neighbours Switzerland and Iceland are trying to forge closer ties with the 27-nation bloc and its wide-ranging climate policies.

Switzerland aims to begin formal talks to link its emissions trading system with the EU’s scheme early in 2010 with the aim of merging at the start of 2013, a spokesman for the environment ministry told Point Carbon.

But work to draw up the required international treaty between the 27-nation bloc and Switzerland, which is not an EU member, will not begin until after UN climate talks in Copenhagen in December.

The Swiss reckon their companies will benefit from greater flexibility being part of a much bigger trading system.

The Swiss ETS runs from 2008 to 2012 with around 350 companies given a cap of 3.3 million tonnes of carbon dioxide equivalent (CO₂e) last year.

Emissions caps in Switzerland’s cap-and-trade scheme are set through negotiations with the government, which can alter annual caps after annual emissions have been reported.

This so-called “ex-post adjustment” was reckoned to be one of the biggest obstacles facing the potential linking of the two schemes, as the EU system does not feature such measures.

But a bill to change the Swiss scheme is expected to be finalised after September, which should remove this hurdle, according to the environment ministry spokesman.

The EU ETS is the world’s biggest carbon market, covering the pollution of around 12,000 firms with an annual cap of around 2.1 billion tonnes of CO₂e last year.

Iceland push

The EU cap-and-trade system has already linked to national schemes with other non-EU members Iceland, Liechtenstein and Norway.

EU leaders this week launched a three-year process for Iceland to become an EU country, and the island nation is keen to push ahead on linking its emission goals before entering the 27-nation bloc.

"We are looking at ways that we can be part of the effort-sharing system of the EU," a spokesman for the Icelandic environment ministry told Point Carbon, referring to the bloc's emissions goals outside the EU cap-and-trade scheme.

However, no Icelandic company will face caps under the system until aviation enters the ETS in 2012. Other than airliners, Iceland's aluminium sector will be covered from 2013 when the scope of the scheme is expanded.

Still, Iceland's situation might cause particular difficulties, the ministry spokesman said. Virtually all of Iceland's electricity is produced from carbon-free hydropower and geothermal generation, so further renewables efforts must occur mainly in the transport sector, where abatement is more difficult.

"Integrating might be more of a problem because Iceland's Kyoto target allows for an increase in emissions from 1990 but the EU has committed to 2020 cuts," he added.

Under the Kyoto protocol, Iceland must limit its growth of greenhouse gas emissions to 10 per cent above 1990 levels of 3.3 million tonnes of carbon dioxide equivalent between 2008-2012.

Iceland expects to meet those targets, despite reporting emissions as much as 8 per cent higher than in 1990 in recent years.

Earlier this month, the government launched a working group to examine ways Iceland can cut emissions by 2020, which is due to report in April next year.

Iceland has a non-binding goal to reduce its emissions 50-75 per cent under 1990 levels by 2050.

EC to delay verdict on aviation CO2 cap

EU regulators need more time to verify airline emissions data before deciding a cap.

"We need more time to check the existing data.

We want to make 100 per cent sure that the data is accurate," said spokeswoman for the European commission.

The commission, which was planning to have the data ready by 2 August, reckons it could take several more weeks or longer to ensure it has responded to all questions raised by the aviation industry, she said.

Under the directive to include aviation in the EU emissions trading scheme, the total quantity of CO2 to be allocated will be based on the aviation sector's average annual emissions in the period 2004-2006.

Aviation will be covered by the cap-and-trade scheme from the beginning of 2012.

The spokeswoman stressed that the postponement will not delay the implementation of the directive.

She said historical aviation emissions data will be used for the decision on the total quantity of allowances for the aviation sector due by the end of September 2011.

Endesa's emissions fall 23% in first half

A fall in first half emissions outpaced a 17 per cent drop in power output for Endesa in Spain and Portugal as dirtier coal-fired output decreased by more than gas.

Spain's biggest power company emitted 9.4 million tonnes of carbon dioxide from January to June, compared to 12.2 million tonnes a year earlier.

The group were allocated allowances to cover 6.1 million tonnes of pollution under the EU emissions trading scheme, and met all but 100,000 of the 3.3 million shortfall in EUAs from its own investments in UN-backed carbon credits.

Despite many developers complaining of slow issuance rates for the credits, known as certified emission reductions (CERs), Endesa increased its proportion of in-house credits year-on-year.

Just 2.3 million CERs were used to meet an allowance shortfall of 3.4 million in the first half of 2008, the spokeswoman added.

Amid plunging demand for electricity in recession-ravaged Spain, the group generated 28,026 GWh from January to June, compared to 33,759 GWh in the first half of 2008, according to first half results.

Rhodia sees steady CER earnings

French chemicals producer Rhodia reported steady profits from the sale of UN-issued carbon credits.

The firm said its energy services division booked EBITDA (earnings before interest, taxes, depreciation and amortisation) of €37 million in the second quarter, scarcely changed from €38 million in the corresponding three months in 2008.

Around 75 per cent of earnings made by the energy services division come from the sale of CDM credits, also known as certified emissions reductions (CERs), which Rhodia generates through the destruction of nitrous oxide (N₂O), a highly potent greenhouse gas.

The French chemicals producer said it was sticking to its forecast that it would be issued with 13 million UN-backed carbon credits this year, which it sells onto financial and compliance buyers at a profit.

Polish power output falls 3.7% in H1

Data showed emissions from Polish power plants are likely to have fallen year-on-year.

Generators in Poland produced 74,705 GWh of electricity in the first half of the year, down 2,832 GWh, or 3.7 per cent, from the same period last year.

Plunging hard coal-based output is likely to have borne the brunt of lower demand for electricity, as the country's industrial base continued to experience the worst of the global economic crisis.

A more detailed breakdown of the data will not be available before next week, but final data for the first five months of 2009 revealed the extent of the decline in coal-fired generation.

Electricity from hard coal fell 7.5 per cent to 34,311 GWh from January to May, meaning carbon dioxide emissions are likely to be significantly lower this year compared with last. Polish power plants emitted 156.9 million tonnes of carbon dioxide in 2008, approximately 7.4 per cent of total emission under the EU emissions trading scheme.

Hungary's top emitter eyes 3.3% less CO₂ in 2009

Power company Matra expects it will emit 5.9 million tonnes of carbon dioxide (CO₂) this year.

Despite a cut of 200,000 tonnes in CO₂ emissions compared to last year, the utility expects to need 1.2 million EU allowances more than it was allocated

in 2009, the chairman of the company told Point Carbon.

"In the last months we have bought all the CO₂ permits we think the company will need this year," Jozsef Valaska said.

Matra's lignite-fuelled power station is responsible for a fifth of Hungary's emissions under the EU cap-and-trade scheme and half of the country's power sector emissions.

A fire broke out at the 950-MW power plant and damaged two 100-MW units earlier this week, which the company reckons will be out of action for about a month.

But Valaska said the outage will not have an impact on the company's overall output nor on overall emissions this year, because Matra intends to replace the missing production by delaying planned maintenance of other units.

Valaska added output may actually grow this year by 100 million KWh compared to 2008 when Matra produced 18.4 billion KWh of electricity. The RWE subsidiary has been able to cut its emissions despite increasing output because of energy efficiency measures deployed, he said.

Vattenfall power output falls 7% in H1

A drop in Vattenfall's power output is likely to reduce the utility's CO₂ emissions in the ETS.

Europe's fifth biggest electricity producer generated 79.6 TWh power in the first half of 2009, down 7.1 per cent compared to the same period last year, according to the company's financial statement.

And for the three months between April and June, Vattenfall's electricity output fell 12 per cent versus the same period in 2008.

The company did not disclose figures for carbon dioxide (CO₂) emissions, but the breakdown of output data indicates emissions are likely to fall in the European emissions trading area.

Although the bulk of the declining output was reported in CO₂-free hydropower and nuclear power production, fossil-fuel based generation fell by 1.9 per cent in first-half 2009.

Fossil fuels account for 46 per cent of Vattenfall's total electricity production in the EU, including Norway.

Guest commentary***Patience: the carbon market will deliver***

By Alexandra Galin, policy and working groups manager, Carbon Markets and Investors Association (CMIA)

When policymakers created the EU emissions trading scheme (ETS), foremost in their minds was to construct a mechanism – to supplement other measures – to allow for an economically viable transition to a low-carbon economy. In creating a carbon market, they ensured progress toward specified emissions reduction targets is measurable at every juncture.

The 2020 targets were not designed to be easy, yet no policymaker could have foreseen the events of 2007-2008. The economic downturn proved deeper and longer than many predicted. CMIA does not take issue with those calling for tighter caps. We believe that an ambitious target resulting in a strong price signal is needed to spur investment and encourage behavioral change. However, we strongly disagree with claims that the integrity and purpose of the carbon market has been compromised.

We stress the transition to a low-carbon economy was designed to be gradual: an annual trajectory was mapped in advance to provide investment certainty. Whether or not the emissions caps are overly lax ignores the basic premise of the ETS design – the EU is on target to achieve the emissions reductions it has set. The downturn has, in fact, brought to the fore one of the key benefits of a market-based mechanism: price sensitivity. Yes – liable entities under the EU ETS discovered that as industrial output halved, they were in possession of surplus allowances. Yes – industry sold these surplus allowances, and this injection of supply without corresponding demand led to market depreciation. No – the events of the last six months do not indicate the EU ETS is not performing its function as a key mechanism to achieving emissions reductions.

Firms that used the capital from selling surplus EUAs did so in critical circumstances. A capital injection into a firm struggling to retain its workforce and maintain operations is vital, but became close to impossible as banks tightened lending in the credit crunch. These industries that have profited from monetising surplus EUAs may not have behaved rationally if one considers the long term. Caps will continue to narrow, and if fuel-substitution and carbon supply-chain management is not managed, firms will be required to put the capital forward at a later date, when prices are likely to be much higher. While it may appear contradictory that the EU ETS likely saved from effective bankruptcy the

very industries it seeks to reform, it is dangerously short-sighted to judge the market on the events of the last six months.

The type of retroactive intervention proposed, most recently by environmental group Sandbag, would cripple market integrity. Narrowing and expanding caps in response to economic circumstances rather than letting the markets respond organically would create a kind of ‘carbon casino’, in which participants merely bet capital on the next unpredictable regulation. Arbitrary and capricious rule-changes are an anathema to an efficient and effective market. If regulators had retroactively decreased caps and forced large-scale EUA purchases, installations could have collapsed under the added financial liability. This outcome is in no citizen’s interest. As analysts noted, even in the midst of the current recession, the EU ETS was still short of allowances in 2008. Since caps will continue to narrow, EUA prices are poised to rise substantially. Firms are well aware of this fact, and are, no doubt preparing.

The EU ETS sets a limit of 50 per cent of the required reduction effort in phases 2 and 3 to be met by credits generated from Kyoto offset mechanisms. While we agree that difficulties do exist in the clean development mechanism (CDM), we would point to its multiple benefits in developing countries, as well as reform proposals under consideration. Those who argue that by “exporting emissions” developed countries make no progress ignore that emissions reductions are a global issue: where and how carbon is emitted is irrelevant to the atmospheric concentration of CO₂. The EU’s supplementarity limits are set to allow developed countries to reduce global emissions at a lower cost, without precluding, once carbon prices rise to a certain level, to reduce them at home. It is important not to view markets through a short-term lens, but rather look toward how it achieves a long-term goal.

Patience, however, is a difficult concept to sell. We would not argue against more ambitious targets. We would only clarify that even with targets that the EU has set, the market is poised to bring Europe emissions reductions in a measurable and cost-effective manner. The recession may have made it easier, but only until the inevitable recovery.

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