

Environmental Finance 2014 Market Awards winners:

- Best Trading Company, Spot & Futures (EU ETS)
- Best Trading Company, secondary market, Kyoto Project credits
- Best Advisory/Consultancy (EU ETS)

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WEEKLY CARBON MARKET UPDATE – 15TH DECEMBER, 2014

Market Developments

- Prices unchanged week-on-week as market lacks direction due to conflicting influences
- Option expiry injects some volatility
- Weaker energy complex, falls in power, gas, coal and oil
- COP 20 (Lima) concluded on Sunday morning, we provide an overview
- ITRE meeting consolidate amendments on MSR proposal



Auction Overview

- Only two auctions this week, last of the auctions until 8th January.

Price Action

Carbon prices were unchanged this week with the front December ending the week flat at €6.66. Wednesday saw both the week high (€6.80) and low (€6.45), but it was the main option expiry day and 8Mt of €6.50 calls expiring. It is likely most of Wednesdays volatility was due to options players hedging their likely positions post expiry. The contract just dipped, intraday, through key support at €6.50 and rebounded ultimately ending the week flat at €6.66. It seems the

carbon market is a little undecided where to go next, on the one hand we have a weaker energy complex, continued mild weather, year-end selling and CER/EUA switching, on the other there is continued hedging interest due to firm clean dark spreads and a lack of auctions until the New Year from 17th December. *Price impact: much will depend on underlying utility demand through the holiday season. The absence of auctions is known and it is likely that any hedging programmes will have taken this into account. Heading into year-end it is unlikely speculators will want to take large positions. Weather will play a key role, mild weather is forecast for now....*

Friday's EUA Implied Funding Rate			
	Price	Annual Rate	Total Return
Spot	6.66	0.00%	0.00%
Dec-14	6.66	0.00%	0.00%
Dec-15	6.75	1.35%	1.35%
Dec-16	6.88	1.93%	3.30%
Dec-17	7.03	2.18%	5.56%
Dec-18	7.23	2.84%	8.56%

Annual Rate is calculated by dividing the relevant forward price by the relevant prompt price. The Total Return is calculated by dividing the relevant forward price by the spot price. Note: these rates do not include transaction costs.

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Weekly Price Changes (EUR)				
Product	05/12/2014	12/12/2014	Change	% Change
EUA Dec 15	6.76	6.75	-0.01	-0.15%
DE Power Cal 15	35.6	34.7	-0.90	-2.53%
API2 Cal 15	58.25	56.37	-1.88	-3.23%
TTF Gas Cal 15	23.45	22.45	-1.00	-4.26%

COP20 – Lima overview

Talks went into an extra two days due to a lack of agreement in the negotiations. The aim of COP20 was to review and agree the process for national emissions reduction

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pledges in 2015 and also develop a first draft of the negotiation text. However, little was achieved and progress minimal as some countries were not open to negotiation, much to the frustration of even the US. The talks ended with the adoption of a decision on national pledges, however, the decision does not require consistency in the pledges which will make comparison tough. Talks will keep going through 2015 to try and advance the cause. Some progress was made on the draft negotiating text. For a more comprehensive overview please see the piece from Jonathan Grant of PWC below or check his blog [here](#). *Market impact: None.*

Market Stability Reserve (MSR) update

This week saw the consolidation of the amendments to the ITRE (Industry, Research and Energy) proposal put forward. Importantly the consolidation did not rule out an early start in 2017 nor did it rule out backloaded allowances going straight into the reserve. 2021 remains the proposed start date for the MSR but it is noted that this is open to discussion. Threshold levels for injection into the MSR were changed upwards in the proposal and one of the main industry concerns was also highlighted with the addition of language for the continuation of the carbon leakage list and free allocation provisions post 2020. The consolidation is so far only in proposal stage and could still change. Each consolidated amendment will need to go through a vote to formally become part of the ITRE opinion on MSR. Importantly, as the main likely objectors to the MSR, ITRE didn't seek to dilute ENVI's proposal to any significant degree which makes passing the MSR legislation look more likely than not. *Market impact: none*

Important MSR Dates

- 17th December, 2014 – EU Presidency will inform member states of progress on structural reform.
- 21st January, 2015 – ITRE vote
- 24th February, 2015 – Environment Committee vote

The week ahead

As we come into year end and auctions finish the supply demand balance will shift. The exact direction prices take will most likely depend on continued underlying demand from the utilities and any weather surprises.

Country	For Votes	Proposed Member State positions on the MSR			
		Undecided Country	Votes	Country	Against Votes
Belgium	12	Austria	10	Bulgaria	10
Croatia	7	Cyprus	4	Czech Republic	12
Denmark*	7	Estonia	4	Hungary	12
Finland	7	Ireland	7	Poland	27
France*	29	Lithuania	7		
Germany*	29	Luxembourg	4		
Greece	12	Portugal	12		
Italy	29	Romania	14		
Latvia	4	Slovenia	4		
Malta*	3	Spain	27		
Netherlands*	13				
Slovakia	7				
Sweden*	10				
UK*	29				
TOTALS	198			93	
TARGET	260				<small>* support early start</small>

Auction Results & Timetable 1st December - 12th December 2014						
Date	Volume('000 tonnes)	Auction Platform	Allowance Type	Clearing Price (EUR)	Cover Ratio	Total Bid Quantity
08-Dec-14	1,873	EEX	EUA	6.58	3.64	6,811,000
09-Dec-14	1,873	EEX	EUA	6.60	4.56	8,547,000
11-Dec-14	1,873	EEX	EUA	6.65	5.36	10,048,000
12-Dec-14	2,336	EEX	EUA	6.64	1.95	4,565,000
15-Dec-14	1,873	EEX	EUA			
16-Dec-14	1,728	EEX	EUA			

Upcoming Conferences

- Europe: E-World Feb 10th-12th 2015 (Essen)
- Platts Central and Eastern European Power Feb 17th-18th 2015 (Prague) – **REDSHAW ADVISORS SPEAKING**
- Europe: Argus Emissions Mar 4th-5th 2015 (Amsterdam)
- Europe: Carbon Expo May 27th-29th 2015 (Barcelona)

PwC briefing: COP20 Report

14 DECEMBER 2014

Jonathan Grant summarises the outcome of the climate summit which concluded in the early hours of Sunday morning.

A long campaign in Lima

The climate talks almost ground to a halt here in Lima. Progress outside the process, such as the US-China climate deal and the \$10bn pledged to the Green Climate Fund, did not translate into much progress inside the negotiating hall. Countries fired their opening salvos of the Paris negotiations here, and as a result, they agreed little of substance at the army headquarters where the climate summit was hosted. This was despite the best efforts of the host to create a positive atmosphere.

There were two main objectives at COP20: to agree the information and review process for the national pledges (or INDCs*) in 2015, and to develop a first draft of the negotiating text. Many countries dug into long held positions and were accused of not negotiating at all. The talks ran on into the early hours of Sunday morning when countries finally adopted the bare bones of a decision on the pledges and agreed to keep talking in 2015. The decision does not require consistency in the national pledges, which will make comparison tougher, and the review process is minimal. But it did acknowledge the progress made on the draft negotiating text.

Few had anticipated that this summit would be a dress rehearsal for the next one. It was always going to be an interim COP rather than a major breakthrough. Frustration is normal at this technical phase of the negotiations process as there is little reason for countries to give ground. The lack of progress here will have little bearing on success or otherwise in Paris. But, it does give a preview of what's to come next year, when negotiations move into the political phase. Success there depends on countries breaking out of the trench warfare mentality seen in Lima.

Going over the top in the ADP

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Three issues dominated discussion in the Durban Platform working group (ADP) which was established at COP17 to draft the Paris deal. The first was whether the scope of the national pledges proposed in the run up to Paris should be limited to mitigation, or also include adaptation, finance and other aspects. The second, was on how these first 'bids' by countries are aggregated and assessed. And the third was what differentiation there should be between countries, or how can the process overcome the current developed vs developing country divide.

Developed countries wanted the national pledges to focus on mitigation. Many developing countries also wanted them to cover adaptation, finance, technology building and capacity building. The intent of the INDC process was for countries to put forward their first 'bid' six months or so in advance of COP21. Detail about assumptions, baseline years, sector coverage etc, would allow others to assess and compare how ambitious each country was being. But there was further disagreement about whether to have a review process and how formal to make it.

It is generally accepted here that developed countries have to take on emissions targets. It is also generally accepted here that Least Developed Countries do not have to take on targets, though some might still do this. So the spotlight is on the emerging economies. In a coalition called the Like-Minded Group, countries including China, Malaysia and Saudi Arabia resisted pressure to move on from the binary divide between rich and poor countries enshrined in the 1992 climate convention.

Negotiators went over the top in one of the sessions towards the end of the second week. Then the US negotiator commented that the whole INDC process "had got out of hand". He had a point. Those concerned about the 'failure' in Lima to bring rigor to the INDCs are forgetting a couple of things. First, the level of ambition that a country has to tackle climate change will not be influenced by the information requested in the INDC 'template'. And secondly, the national pledges made in 2015 will be scrutinised by other countries, think tanks, the media, and NGOs. If a country has a weak plan it will be criticised; if it has a bold plan it will be celebrated. A UN review process of the INDCs is unlikely to add much.

In the early hours of Sunday morning, the Lima Call for Climate Action agreed what countries "may include" in their mitigation pledges next year. It also "invites" countries to submit their plans on adaptation. There isn't a formal review process, but the UN will publish all the national plans and compile a synthesis of the aggregate effect of these plans, or in other words add them up and see how they compare with a 2 degrees pathway.

Who is giving the orders?

The host always puts on a good show during the high-level ministerial section in the second week. Ban Ki-moon and Al Gore gave a rousing talk to ministers who then gave their statements. It is often said that only the ministers can shift a national position and find a compromise. But this is rarely the case when the negotiations are in a technical phase.

In fact, some suggested that the troops were giving orders to the generals. To be fair to the ministers, few have the time to get to grips with all the arcane detail in all aspects of the climate talks. And it is understandable that

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they rely on their advisors at this technical stage of the process as they need to save their ammunition for the political phase in 2015.

Money talks at the climate talks

Climate finance was, as ever, a hot topic at the climate summit. Inside the negotiating halls, many stated that the \$10bn pledged to the Green Climate Fund is not enough. Outside the halls the discussion was more nuanced. Some talked of the ‘missing trillion’ or the amount of incremental investment needed in low carbon technology to achieve the 2 degree goal. Most appreciate that public finance will not be enough, and that much more could be achieved if it levers private finance.

At two IETA side events over the weekend, the GCF Secretariat said that they are now “open for business” and are “keen to engage” the private sector. Many made the point that the GCF could help manage the risks that private banks are not good at managing i.e. policy and sovereign risks. It’s likely that the GCF will work with developing country governments build capacity to help projects become more investable. It may help governments implement programmes such as renewables feed-in tariffs and even provide payment guarantees that can attract private sector investment. If the GCF is able to take on some of the risk of these projects, it could help to ‘crowd in’ the private sector.

The ‘Elements Text’

The Lima decision acknowledges the work done to prepare the “Elements for a draft negotiating text”. This is the first draft of the document that could eventually become the Paris Accord (or whatever it is called). Much of the technical debate on the text was deferred to next year. It includes a range of options for mitigation, adaptation, finance as well as the mechanisms to achieve them.

Much of the talk for business was about the role of market mechanisms and carbon pricing to stimulate investment. It is unlikely that the COP will have any impact on the price of EU carbon credits, which is more influenced by decisions in Brussels. However, an ambitious deal in Paris could stimulate carbon markets in the EU, China, the US and elsewhere. Nothing is ruled in or ruled out at this point, so there is still the potential for market mechanisms to feature in the final deal.

Zero emissions by 2050 and the carbon bubble

A controversial issue in Lima was the link between a particular mitigation target in the draft negotiating text, the potential for stranded assets and the role of CCS. One of the mitigation options in the Elements Text refers to full decarbonisation by 2050.

Many high profile observers commented on what this target would mean for the energy sector and the potential for stranded assets. This was emphasised by Al Gore who said he preferred to describe fossil fuel stocks as ‘sub-prime’. But many in industry as well as the head of the Saudi Arabian delegation commented on the

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implausibility of the target. They also noted the potential for carbon capture and storage to lower the overall cost of achieving emissions reductions and to increase the amount of burnable carbon.

Preparing for the battles in 2015

The three main implications of the hard fought negotiations in Lima are:

1. It is unlikely that there will be much progress in the UN before Paris, though advances may be made outside the process in national announcements or bi-lateral deals;
2. It is unlikely that the deal will align with a 2 degrees pathway, as neither developed nor major emerging countries' targets look ambitious enough; and
3. It is most unlikely that the emissions targets in the Paris Accord will be legally binding. And it is unlikely that even the monitoring, reporting and review process will be legally binding, as this is strongly resisted by the major emerging economies.

The challenge in 2015 will be to change the negotiating dynamic and build on the progress made outside the UN process. Putting climate change on the agenda of the G20 and G7 next year is unlikely to achieve much, if some simply revert to their bad habits of frustrating the UN meetings. It will be a long campaign for negotiators in 2015, who will have to be careful to avoid a Copenhagen-style collapse in Paris. But a weak agreement like the Treaty of Versailles or Kyoto Protocol may simply store up trouble for the future. To win the war on climate change, the deal will need to be global, with ambitious INDCs and the public and private finance to achieve them.

*Intended Nationally Determined Contributions or INDCs

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