

COMMODITY RISK MANAGEMENT & TRADING

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RENEWED CONFIDENCE

Energy Risk's second annual
Environmental Rankings




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RENEWED CONFIDENCE

Energy Risk carried out its second annual Environmental Rankings survey this year in which respondents voted for their preferred players in emissions & renewables markets. [Katie Holliday](#) analyses the results and talks to market participants about their views

Confidence in the potential of the environmental markets continues to be strong despite the absence of an international framework for a global carbon market and it looking increasingly likely a deal won't be reached at the United Nations Climate Change Conference (COP-15) held in Copenhagen this month, say market participants.

They hope that Copenhagen will give clarity to other issues such as the shape of future carbon market mechanisms and which new countries will sign up to the new Kyoto agreement, and that this will drive the markets forward.

Against this backdrop, *Energy Risk's* second Environmental Rankings Survey provides a timely insight in to how energy industry participants view the current state of play. The Survey had 461 valid responses this year, a 90% increase on last year, reflecting the increasing interest in these growing markets.

The dominant players from last year held on to most of the top positions but a large amount of votes were cast for a vast array of smaller players, showing the current fragmentation and immaturity of some of these markets. Consolidation amongst smaller players is expected to be a trend in the coming years.

Dominant players in the survey this year include Barclays Capital, Deutsche Bank, JP Morgan,

Morgan Stanley, CF Partners and Element Markets, who all gained first places, as did Orbeo, a joint venture between Société Générale and Rhodia, and Carbon Trade & Finance, a joint venture between Gazprombank and Commerzbank.

Carbon markets

This year has been a testing one for the carbon markets due to the global economic recession and subsequent drop in the carbon price, and a lack of available project finance. In February this year, the price of carbon in the European Union Emissions Trading Scheme (EU ETS) dropped to €8 (\$11.89) per tonne of carbon dioxide (t/CO₂), from highs of around €30 in the summer of 2008, according to European Climate Exchange (ECX) data, causing critics to say the price was too low to incentivise investment in clean technology and therefore that the scheme wasn't working. Carbon is currently trading on ECX at around €13 per t/CO₂.

According to New Energy Finance data, the global carbon market shrank by 21% to \$30 billion in the third quarter of 2009, from \$38 billion in

the second quarter of 2009, with the majority of the deterioration focussed on the European side of the market. The North American markets and the international offset markets grew, but not enough to compensate for the reduction in volumes traded on the EU ETS. New Energy Finance still expects the total value of the global carbon market to grow to \$122 billion by the end of 2009, a 3% increase on the 2008 value of \$119 billion but almost double the value of 2007, which amounted to \$65 million, and quadruple the 2006 value of \$35 billion.

Energy Risk's Environmental Rankings Survey first looked at the trading of emissions allowances on the EU ETS. Barclays Capital topped the dealer category for European Union Emission Allowances (EUAs), while Orbeo also gained first place for a second year running for the trading of EUA options.



A global recession will prompt a drop in prices. The carbon market reacted exactly as it should have done

Louis Redshaw, head of environmental markets, Barclays Capital



According to Louis Redshaw, head of environmental markets at Barclays Capital, this year's drop in the price of carbon shows that the EU ETS was functioning properly. "Anyone who says the market isn't working, while the price is falling during a recession, is contradicting themselves, because a global recession will prompt a drop in prices. Therefore the carbon market reacted exactly as it should have done," says Redshaw.

Deutsche Bank gained the top position for trading Certified Emissions Reductions (CERs), the credits generated under the UN's Clean Development Mechanism (CDM) scheme, in both the primary and secondary markets, while BNP Paribas, Orbeo and CF Partners also featured highly in the dealer category for CERs. Global brokerage Tradition gained first place for CER broking.

The CDM market was valued at \$32.8 billion in 2008 by the World Bank. Primary CDM transactions in 2008 were valued at \$6.5 billion, equivalent to 289 million tonnes of carbon dioxide (CO₂) and trading in the secondary CDM market totalled \$26.3 billion, equivalent to 1,072 Mt/CO₂.

According to David Costa-D'sa, head of environmental financial products structuring at Deutsche Bank, a clearer framework for the trading of CERs should increase CDM volumes even further. "We need to know exactly what the rules are going to be," he says. "We need to know whether or not we will have the CDM in its current format or whether we will have a sectoral system post-2012, or some combination of the two. A lot will depend on what role the US decides to play," he adds.

Amit Oza, senior emissions broker at TFS Green, Tradition's environmental team, is also eager for clarity. "It's vitally important to have an idea of what role CERs will play post-2012. Though there will be continuing debates about India and China taking on reduction targets, there are many other CDM countries that will not undertake reduction targets; these countries are most likely to continue to play a role in developing emissions reductions projects in the long-term," adds Oza.

Oza attributes Tradition's success in CER broking down to its continued commitment to the origination of projects. "We have a strong supply line coming out

of Latin America and Africa as well. We're also working on new areas, such as the UN's programme for Reducing Emissions from Deforestation and Forest Degradation (REDD), where we've seen strong demand from companies in Europe, the US and Australia looking to purchase these credits," he says.

In terms of the market for Emission Reduction Units (ERUs), credits generated from the Kyoto Protocol's Joint Implementation (JI) mechanism, Carbon Trade & Finance gained first place in the dealer category, while Deutsche Bank came in second. In the broker category, CF Partners were voted first with Evolution Markets and Tradition coming second and third.

So far, the market for JI projects has not grown as much as was originally anticipated in comparison with the CDM markets. The JI market was valued at \$294 million, equivalent to 20Mt/CO₂ in 2008, according to the World Bank, a figure vastly overshadowed by the CDM's \$32.8 billion.

Experts blame the lack of development in this area of the market on political wrangling over operational procedure. Russia and

the Ukraine are viewed to be the hotspots for JI development, but while the Ukrainian market has generated a number of projects, the Russian government stalled over finalising legislative procedures and projects only very recently have begun to be approved. Many industry experts are sceptical as to whether the JI projects will continue as a carbon market mechanism once a new global carbon agreement is finalised post-2012.

Martin Lawless, head of environmental financial products at Deutsche Bank, says they have typically viewed JI as a "single market" scheme to 2012. "There are many proposals on the table at Copenhagen and it is far from certain that JI in its current form will be extended into the next phase of the Kyoto Protocol or its replacement," says Lawless.

Carbon Trade & Finance's executive director, Ingo Ramming, has a more optimistic outlook for the future of trading ERUs. "Of course, the CDM market is much bigger than the JI market, but this is because ERUs could only be generated from 2008," he says.

Ramming says he expects approximately 300 million tonnes of CO₂ reductions to be generated through JI from 2008 to 2012. "The importance of JI will grow going forward since the number of countries with emissions caps will grow. A future climate agreement therefore becomes pivotal," he says.

Ramming puts Carbon Trade & Finance's success down to its focussed approach. "We believe it is extremely difficult to develop projects across the globe and focus therefore solely on JI," he says.

Simon Glossop, company partner at CF Partners, which gained first place in the brokers of ERUs category, is more pessimistic about the future of ERU trading. "It's not looking likely that JI will continue much longer," he says.

As a diversified company, CF Partners isn't too concerned about the possible discontinuation of JI projects post-2012. "We



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Ingo Ramming, executive director, Carbon Trade & Finance

pride ourselves on being a mini-environmental investment bank looking across the carbon and renewables markets. We offer a variety of different services, from buying and selling credits, fund management, arranging structured transactions, mergers & acquisitions and advisory," says Glossop.

The US emissions markets categories were dominated this year by US-based Element Markets. It topped the categories for the US sulphur dioxide and nitrogen dioxide markets (SO₂ and NO_x), the US Regional Greenhouse Gas Initiative (RGGI), US Voluntary Emission Reductions (VERs), as well as the US Renewable Energy Credits (RECs) category.

Evolution Markets gained first place in the broker category for SO₂ and NO_x and US RECs, while Tradition gained first place for RGGI and Evolution Markets topped the broker category for US VERs.

The US voluntary markets have suffered a decline this year. Trading of Carbon Financial Instruments (CFIs) on the Chicago Climate Exchange (CCX) has decreased, for example. A total of 3.2 million contracts

were traded in October 2008, while 2.6 million were traded in the same month this year.

Barcap's Redshaw says it is likely that the voluntary markets, both in the US and Europe, will be eclipsed by mandatory schemes. "Trading of voluntary credits will continue for corporate social responsibility (CSR) obligations, so we'll continue to see companies offsetting in that, but by and large the voluntary sector will be superseded," he says. "The question is, what emissions credits will count under the US scheme? And will the

voluntary credits count within a US cap-and-trade scheme?" he adds.

Angela Schwarz, president and chief operating officer of Element Markets says the shape of the US's mandatory cap-and-trade scheme is now viewed as an eventuality rather than a possibility, but reiterates this does not mean that the current US compliance markets should be ignored. "While the SO₂ and NO_x markets are not viewed as high growth markets in comparison to carbon, we do not expect regulatory changes to occur over the next two years to buoy the markets," she says.

The US REC market is still fragmented, with approximately 30 US states now having introduced renewable portfolio standards (RPSs), but a lack of uniformity in RPS design makes it difficult to trade across state lines. But this year, the Waxman-Markey Bill, which was approved by the US House of Representatives in June but is yet to be voted on in the Senate, brought the US closer to establishing a federal mandate for renewable energy generation.

Schwarz says REC trading in the US is set to explode. "US REC trading is extremely complex and



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Amit Oza, senior emissions broker, TFS Green

rules-based. We have extensive research capability that tracks and analyses developments across the new and existing REC markets as we move closer to a national RPS,” Schwarz says.

Over in the UK, Morgan Stanley gained first place for UK Renewables Obligation Certificates (ROCs) in the dealer category, while CF Partners surpassed Tradition and Evolution Markets for the best broker of ROCs. This year, the UK government boosted trading of ROCs through a change to the allocation of ROCs in May. Offshore wind developers now receive 1.5 ROCs per megawatt hour (MWh) of wind power rather than 1 ROC. Onshore wind projects receive 1 ROC per MWh.

Clean and efficient

The survey also looked at supply and investment in the renewables, clean technology and energy efficiency sectors. This year the results for best supplier were varied, with no one supplier dominating the renewables space. Spanish utility Iberdrola topped the wind power category, while global solar developer SunPower Corporation gained first place for solar power. Spanish multinational corporation Abengoa was ranked the best supplier of biofuels.

In terms of investment, Spanish investment bank Banco Santander gained first place for the wind, solar and biofuels categories. UK-based electric power station Drax gained first place for best utility in terms of biofuels production.

US energy services company Ameresco gained first place for preferred firm in the energy efficiency category. US-based research firm

Sustainability International gained the top position for best advisor in the energy efficiency.

The trading of energy efficiency credits, or white certificates as they are often termed, has been described as a potential new growth market by some experts. Element Markets’ Schwarz says the US market for energy efficiency credits is one to watch. “We have recently participated with transactions taking place in Connecticut, and we continue to monitor other states as we foresee this as a potential high growth market,” she says.

In terms of green energy project finance, CF Partners was voted best advisor in this category, while JP Morgan was the most highly ranked investment bank for both project finance and green energy funds and indexes.

CF Partners performed well this year across the renewables advisory categories, gaining first place for wind and biofuels. Global accountancy firm



Roman Webber,
head of the
renewable energy
team at Deloitte

Deloitte gained second place in both these categories but surpassed CF Partners in the solar power category and gained first place.

Roman Webber, head of the renewable energy team at Deloitte, says that despite the unlikelihood of a deal being reached in Copenhagen, the environmental community remains upbeat about an international agreement being reached in the future. “What is likely to emerge is some sort of ‘agreement to agree’.” While we are more likely to have a political rather than legally binding agreement, the latter is not that far off,” he says. “I expect to see China and the US agreeing to be part of a future global pact at Copenhagen,” he adds.

Webber says having a carbon price is an indirect driver for the renewables sector incentivising investment. “A global agreement on carbon, and a rise in the price of carbon, will be positive for the renewables industry long-term,” he says. ■

ENERGY RISKS ENVIRONMENTAL RISK RANKINGS 2009 – CARBON TRADING

ERUs – primary (JI)						
2009	2008	Dealer	%	2009	2008	Broker
1	1	CarbonTrade & Finance	25	1	–	CF Partners
2	3	Deutsche Bank	18	2	3	Evolution Markets
3	–	CF Partners	15	3	1	Tradition
4	–	Citigroup	10			