Green subsidiarity from a carbon economy perspective

The price of policy risk

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Presentation Outline

The corporate carbon liability to 2012

The public carbon liability to 2012

Balancing green objectives and carbon liabilities

Green burden sharing?

Conclusions
The EU Directive and the Kyoto Protocol

**KYOTO**
- Biggest compliance agreement ever
- 38 Caps
- Global Warming, Global Measures
- 6 gases*
  - Flexible Mechanisms for effective and efficient solutions
  - EU Burden Sharing, EU Driver

**EU DIRECTIVE**
- European Directive, National Law
- 29 Caps
- Global Warming, Global Measures
- Just CO₂ to start
- Redefined Joint Implementation, narrowed Clean Development Mechanism
- Setting Global Standard
- Linking opportunity (Japan, Australia)

* Carbon dioxide, Methane, Nitrous oxide, Hydrofluorocarbons, Perfluorocarbons, Sulphur hexafluoride
Emissions Trading: Cap and Trade concept

Caps are Emission Limits in tCO$_2$e, per country under Kyoto, '97, per installation under Brussels, '03.

By Definition Short Market

Credit eligibility known with Linking Directive

Accession countries likely to have less stringent caps and hence potential sellers.

Implied triple balancing act with two stage corporate road to Kyoto targets and single stage public road to Kyoto.

Current division corporate road: 50 Mtonnes first period to 200 Mtonnes in second period, depending on public reduction achievements. Too little to invest now, too much to ask later?

Opportunities for existing and future activities within the EU ETS.
Registries and trading charges

Each covered installation requires a Holding Account, a Compliance Account and a Trading Account.

No pan European standard has been set for registry charges.

Pool Allowances and strategy, optimising charges by operating from most attractive re: charges and fiscal treatment (VAT).

Entity transfers allowed. Not formally legislated but simple transfer contracts probably sufficient.

Brokerage currently around 1% per deal but varies. May reduce with larger volume trading.
Accounting example of Asset to Liability 2005

Estimate CO$_2$ asset (IAS 38 Intangible Asset measured at fair value with all changes recognised in profit and loss. RECOMMENDED)
Monitor CO$_2$ liability (IAS 20)

Emissions per year = 1MtCO$_2$
Total allocation per year = 0.9MtCO$_2$
Value asset on allocation ~ Euro 7 million
Value final short position ~ Euro -3 Million
Flexible Mechanisms: Importing Credits

Clean Development Mechanism and Joint Implementation

The baseline describes emissions without project (CDM Executive Board approval)

Reductions from the baseline = tradable compliance tools

CERs bankable into the Second Trading Period

Prices track EUAs at slight discount

Competition for ‘Green Capital Investment’ by corporations for Eurocarbon targets, EU 25 governments for Kyoto targets AND EU 25 governments for national green targets.

Compare Norwegian, Polish and Indian parks with vastly different displacement values as well as power delivery potential.

Expected emissions

Credits to sell

Project emissions

Emissions

1990 2000 2010

Opportunities for existing and future activities in Developing Countries
Timetable and political variables

Kyoto Ratification in Buenos Aires 2004, or lack thereof.

An investment driving corporate carbon short in 2005, or lack thereof.

An overriding European interest in economic efficiency and effectiveness with European green review 2006, or lack thereof.

A pan European liberalised and interconnected physical power market 2007, or lack thereof.

Political commitment to broader than carbon environmental benefits of green power and broader than domestic measures 2008, or lack thereof.

2012 targets firm, time to action remains uncertain, will it be from 2005 or 2008 onwards?
The Fortis Merchant Bank Role
Environmental Products Banking at Fortis

A core environmental products team horizontally integrated across organisational boundaries and professional disciplines

MeesPierson InterTrust
Providing CER and EUA Portfolio Holding Services and pan-European carbon position netting and administrative services
Using superior administration and interfacing for a user friendly interaction with registries

Corporate & Investment Banking
Financial services including carbon value, corporate active carbon exposure management

CIB Project Finance
Incorporating carbon price in due diligence and Discounted Cash Flow Models, financing green power (second largest world financier of wind) and carbon reduction projects.

Global Markets
Environmental Products Trading Desk with CER and EUA lines and knock on impact advice to other desks, particularly energy desks.
Conclusions

The EU ETS will be a success when corporations start delivering effective and efficient carbon reductions across the EU 25, getting the EU on track towards its Kyoto targets.

As such it can be the ‘proof of concept’ for establishing a harmonised green system, including not only green power but also e.g. environmental zoning, other emissions to soil, water and air, as well as other externalities in for example European agriculture with its 50bn annual budget.

However, the broader than carbon benefits of green power depend not only on location of generation but also, and perhaps particularly, on final destination and therefore a European green ‘certificate’ system will always have to remain linked to the electricity itself.
Contacts

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