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Contents

- ▶ **CO2 Market Development**
- ▶ **COP 17: The Durban Package**
- ▶ **Spot Carbon Market To Be Included in MiFID**
- ▶ **Aviation To Be Included Into EU ETS, Despite International Opposition**
- ▶ **Glossary**

CO2 Market Development

Within the last couple of months, CO2 prices more and more decoupled from fundamentals and are now mainly determined by the macroeconomic outlook and by political options.

The fears about the European economy in the light of the Southern European and the US debt crises caused prices to crash. On 14 December 2011, EUAs reached a new all-time low of 6.30 €/EUA. On the same day, CERs reached their all-time low of 3.80 €/CER (both prices with delivery on 19 December 2011).

Especially in November, this development was enforced by several analysts putting down their price prognoses and thereby causing uncertainty in the carbon market. Many analysts now think that even the third trading period would be long.

In addition to that, a very mild winter with a relative low energy demand made prices for power, coal and gas fall. The additional supply from the NER300 was another bearish factor.

A bullish factor would be if the EU decides to strengthen its emissions reduction goal of 20% up to 25% or even 30% (by 2020 compared to 1990). Also a breakthrough in the Euro crisis could cause prices to rise again.

Sources: Point Carbon, FutureCamp

COP 17: The Durban Package

COP 17 was the longest climate conference ever. Early on Sunday morning, delegates had brought the Durban Package on its way. The four decisions are a landmark deal in the multilateral approach to tackling climate change.

The Durban Package contains:

- (1) A second commitment period for the Kyoto Protocol without a gap. Thus it has finally become clear that the flexibility mechanisms CDM and JI can continue.
- (2) The framework that was built in Cancun has been strengthened and operationalized. Institutions for Adaptation, Finance, and Technology can launch their work in 2012. A new market mechanism has been defined.
- (3) An agreement on the Green Climate Fund was reached. The fund shall become the most important climate financing instrument and will support mitigation and adaptation.

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(4) A process to establish a legal framework that includes all countries has been launched. The new instrument shall be finished no later than 2015 and be put in place in 2020.

The Durban Package sends clear signals to project developers and investors. With regard to the EU's 2020 target, an increase in ambition has become more likely.

Source: FutureCamp

Spot Carbon Market To Be Included in MiFID

On 20 October, the European Commission proposed classifying carbon certificates for spot delivery as financial instruments, thus extending the Markets in Financial Instruments Directive (MiFID), currently covering e.g. carbon options, forwards and futures, to the spot market. The move has come about in response to theft and fraud issues which have repeatedly shaken confidence in the EU ETS. Reactions, however, have been mixed.

Some market participants fear the extra bureaucracy involved with the compliance requirements and question the effectiveness of MiFID as an instrument against the specific problems of the carbon market. Others expect extra certainty to be provided to the market by its inclusion into financial market protection, ultimately strengthening it. Exemptions from MiFID requirements for emitters trading on their own account, for small volume activities and others have been announced, but are yet to be determined.

IETA and BDI both criticised the proposal. They see additional burdens especially for small and medium-sized companies and call for solutions tailored to the special needs of the carbon market. IETA also mentioned that the securities of the past are already closed and fears that the functioning of the carbon market will be influenced.

The proposal still has to be approved by national governments and the European Parliament.

Sources: EU Commission, IETA, BDI

Aviation To Be Included Into EU ETS, Despite International Opposition

From 1 January 2012, aircraft taking off or landing in the EU will be covered by the EU ETS. The fact that entire flights fall under the scheme, regardless of whether emissions actually occur inside EU airspace or not, has been contested as a violation of sovereignty rights and international agreements such as the 1944 Chicago Convention governing civil aviation. However, a lawsuit filed by the Air Transport Association of America (ATA) and several US carriers that has been referred to the European Court of Justice, is expected to be turned down after on 6 October the Court's adviser, Advocate General Juliane Ko-kott, gave her (non-binding) opinion that the EU plans are fully compatible with international law. On 21 December, the Court's final verdict is expected.

Moreover, in the US, the fact that the EU ETS will equally cover non-EU airlines is widely seen as an illegal taxation of US airlines. On 24 October, the House of Representatives passed a bill outrightly banning US carriers from participating in the scheme, which would put them in a catch-22 of either violating EU or US legislation. The bill still has to be passed by the Senate where it was proposed on 7 December.

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Other states such as China, India and Russia, backed by the International Civil Aviation Organization (ICAO), have also opposed inclusion of their airlines into the EU ETS. They might actually be exempted eventually if the respective states come up with "equivalent measures", a formulation in the EU directive that might leave leeway for a compromise. Meanwhile, the EU Commission pushes ahead as planned. On 26 September, it published the benchmark figures which determine free allocation of allowances to each airline up till 2020. Actual allocation is effected by EU member states and is about to begin in December. Free permits will cover roughly two thirds of the sector's expected emissions in 2012, dropping to around 50% in 2020 due to growth in air travel. Amid volatile EUA prices, cost estimates for covering the remaining shortage currently seem difficult. Additionally, an economic dip in the wake of the Eurozone debt crisis might slow the increase in air travel and dampen airlines' demand for EUAs.

Sources: Point Carbon, European Court of Justice, EU Commission, IATA, ICAO, US House of Representatives Transport Committee, FutureCamp

Glossary

ATA	Air Transport Association of America
BDI	Bundesverband der Deutschen Industrie (German Industry Lobby Group)
CDM	Clean Development Mechanism
CER	Certified Emission Reduction
CO ₂	Carbon dioxide
COP	Conference of the Parties
ETS	Emissions Trading Scheme
EU	European Union
EUA	European Union Allowance
ICAO	International Civil Aviation Organization
IETA	International Emissions Trading Association
JI	Joint Implementation
MiFID	Markets in Financial Instruments Directive
NER300	New Entrants Reserve of 300m EUAs
US	United States

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Entered in Commercial Register at Munich District Court
(Amtsgericht München), No. HRB 131384
VAT ID: DE208207923