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The cost to EU companies for the delayed allocation '08 EUA's.

In collaboration with

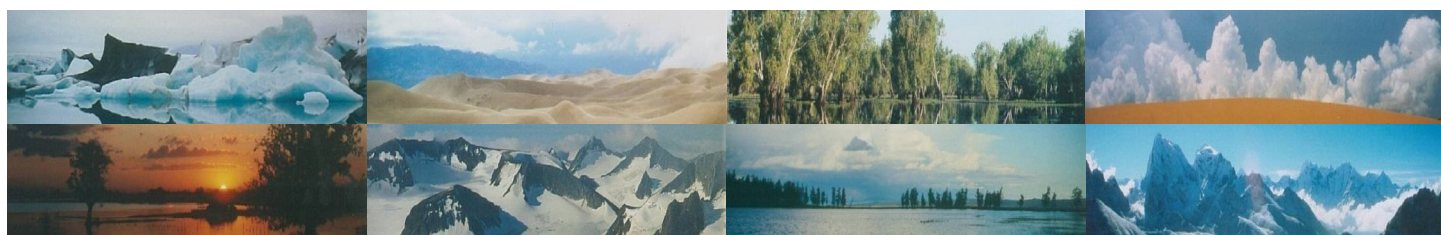


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1. Introduction

The object of this research is to evaluate the financial impact on EU companies due to the delayed issuance of 2008 EUA's. Usually, the EUA's which are due to the EU companies (pursuant to the *Emissions Trading and Linking Directives* Dir. 2003/87/CE and 2004/101/CE) in accordance with their respective National Allocation Plans (NAP's), should be issued within the 28th of February of each year. So far, the 2008 EUA's have been issued solely in Austria, Finland, Denmark, Ireland and Spain. It is likely that for countries such as the UK, France, Italy and Germany, the 2008 EUA's will be not issued until the end of the year and, possibly, until April 2009. By then the ITL and CITL connection should have been finally completed. The delay is mainly due to technical problems in connecting the ITL (International Transaction Log) with the CITL (Community International Transaction Log). Those two registry systems need to be connected to allow the reconciliation process of EUA's and AAU's, between the EU Emission Trading System (EU-ETS) and the International Emission Trading System (IETS) under the Kyoto Protocol. The UK was the first country to deny the EUA issuance to avoid a difficult and potentially risky process of reconciliation once all the EUA have been released. Hence, the prudent decision to wait until the two registry's connection is fully functional. Other countries have followed the UK's lead and denied the EUA issuance.

This situation is producing relevant financial losses to EU companies (due to the impossibility of using EUA based financial transactions which can originate profits). Accordingly, our objective was to calculate such losses by taking into account the profits that could have been made by EU companies in using the appropriate Carbon Portfolio Management tools.

2. Methodology and Calculations

This research takes into account the profits that could have been made using Carbon Portfolio Management tools such as:

- (i) The so called *Repurchase Agreement*, meaning the *Spot* sale and simultaneous *Forward* repurchase of EUA, with delivery taking place before the due date for compliance; and
- (ii) The *EUA/CER Swap* on a *spot* basis.

It is important to clarify that the financial techniques which are used in Carbon Portfolio Management to maximise the returns of the *commodity* CO₂ are the so called *Arbitrage* techniques. According to the financial theory, *Arbitrage* is defined as "*the simultaneous sale and purchase of essentially the same good made in two different markets at two different prices which allows the making of a profit. The perfect arbitrage does not imply risks, does not imply capital investment and takes place simultaneously*". The *EUA/CER Swap* is effectively a *perfect Arbitrage* transaction, while in the *Repurchase Agreement* it is only the timing which is delayed (meaning that even if the transaction is fully completed as far as price and all other contractual terms are concerned, the delivery and the related payment will take place at a later time).

As far as the calculation of the losses is concerned (more precisely the missed profit due the impossibility of carrying out the above referred EUA based financial transactions), it has been EXACTLY determined based on the following variables which are well known and defined at the time of the publication of this study:

- (i) Credit interest rate Euribor 3m - 4,967%
- (ii) Debit interest rate Euribor 3m + 2% *spread* - 6,967%
- (iii) Reference price for sale *EUA Spot (mid price)* - € 27,05 /tonn
- (iv) Reference price for *Forward* purchase *EUA dec. '08 (mid price)* - € 27,55/tonn

- (v) Payment date and delivery EUA *Spot* - 1/3/08
- (vi) Payment date and delivery EUA *Forward* - 22/12/08
- (vii) EUA date of issuance to the client - 1/3/08
- (viii) *Spread* EUA/CER spot € 7,83/tonn
- (ix) quota for compliance use of CER's: please see country specific data
- (x) EUA's allocated according to NAP: please see country specific data
- (xi) Reference date for calculation of losses - 16/6/08

Changing the above variables will change the results of the calculations.

3. Financial Analysis.

3.1 Europe. The analysis takes into account the impossibility of carrying out *Repurchase Agreement* and *EUA/CER Swap* transactions, both within the whole EU and for each country. The losses regarding the *EUA/CER Swap* transactions have been calculated on the basis of the average country data regarding the percentage of CER's that can be used for compliance purposes under each country's specific NAP.

We have considered the countries which have the higher % of EUA's allocated under their NAP's in respect of the aggregate of the whole European Union. Such countries are Germany 22%, UK 11%, Italy 10%, France 6% and the rest of the EU with an aggregate 44%.

The EU aggregate losses amount to almost € 1 billion on 16/6/08 with a daily loss in excess of € 9 million. By the year end the loss for all industrial sectors in the EU could have reached a ballooning € 2,7 billion.

Table 1: EU aggregate losses and for each country.

EUROPE	All the EU	Italy	UK	Germany
Country Quota as % of total EU	100%	10%	11%	22%
Daily loss/cost	€ 9.230.876	€ 1.140.878	€ 904.031	€ 3.119.144
Loss at 16/6/08	€ 996.934.564	€ 123.214.794	€ 97.635.318	€ 336.867.546
Prospective loss at 31/12/08	€ 2.732.339.176	€ 337.699.807	€ 267.593.094	€ 923.266.607
quota of CER/ERU for compliance	10,00%	14,989%	8,00%	20,00%
Total allowance under NAP	2.080.000.000	201.630.000	228.943.678	453.100.000
Average <i>Spread Swap</i> EUA/CER	€ 7,83			
interest rate - credit	4,97%			
interest rate - debt	6,97%			
<i>Spread</i> EUA - <i>Spot/Forward</i>	€ 0,50			

* Please note that Spain has issued its EUA's and should not be considered for the purpose of this work

France	Spain	Rest of EU	EUROPE
6%	7%	44%	Country Quota as % of total EU
€ 703.050	€ 1.048.434	€ 6.272.914	Daily loss/cost
€ 75.929.402	€ 113.230.914	€ 677.474.760	Loss at 16/6/08
€ 208.102.806	€ 310.336.580	€ 1.856.782.676	Prospective loss at 31/12/08
13,50%	20,00%	20,00%	quota of CER/ERU for compliance
132.800.000	152.300.000	911.230.000	Total allowance under NAP
			Average <i>Spread Swap</i> EUA/CER
			interest rate - credit
			interest rate - debt
			<i>Spread</i> EUA - <i>Spot/Forward</i>

3.1.1 United Kingdom. UK's daily loss is just below € 1 million (€ 904.000), and losses up to 16/6/08 exceed € 97 million. The losses forecasted until year end could reach € 267 million. Compared to other EU countries with similar quantities of EUA's allocated under the NAP, UK's losses are lower because of the lower amount of CER's which can be used for compliance purposes. In fact, UK's share of CER's allowed for compliance purposes is the lower in the EU (8%).

3.1.2 Italy. Italy's daily loss is just above € 1,1 million, and losses up to 16/6/08 exceed € 123 million. The losses forecasted until year end could reach € 337 million.

3.1.3 Germany. Germany, in addition to the highest share of EUA allocation in Europe (22%), has also the highest share of CER's allowed for compliance purposes (20%). Germany's daily loss is above € 3 million and losses up to 16/6/08 already exceed € 330 million. The losses forecasted until year end could reach € 900 million.

3.1.4 France. France's daily loss is around € 700.000, and losses up to 16/6/08 exceed € 75 million. The losses forecasted until year end could reach € 208 million.

4. About Us



BIANCONICONSULTING is a carbon consultancy firm founded in 2006 by Andrea Bianconi, an independent consultant for climate change who is working in both London and Milan. It was the first consultancy firm to offer its services in Italy in connection with CDM projects, VCM projects, JI and Emissions Trading. The company has a strong background in waste management projects (particularly composting). The company operates through a network of independent consultants of proven capabilities in their countries of origin and is currently working on projects in Turkey, Indonesia and South America.

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EDELWEISS ENERGIA S.P.A is an international trader of electricity, natural gas, and environmental products (REC's, CER's, EUA's, VER's). Environmental products are mainly traded OTC and the electricity trade takes place in the Italian, French, Swiss, Austrian and Slovenian regulated markets.

Edelweiss Energia provides efficient and innovative Portfolio Management services to small and medium resellers of electricity and gas as well as Green Marketing projects using REC's, Green Certificates and other Environmental Products.

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SENDECO₂ The Mediterranean CO₂ Exchange

The Mediterranean CO₂ exchange, was founded in September 2004 to provide to large, medium and small industrial plants, Spot trading of Emission Allowances in an efficient, safe, transparent and fair manner. SENDECO₂ is a private equity owned company with offices in n Barcelona, Lisbon and Milan, that benefits from the institutional support of the Catalanian regional Government, the Valencian regional Government and the environmental foundation, Fundacion Forum Ambiental. SENDECO₂ is also part of the Pan-European **Climex Alliance**. SENDECO₂ is currently rolling out its experience and expertise in other European countries.

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