Markets for LULUCF Credits

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LULUCF Markets?

- Voluntary Markets in the LULUCF sectors
- Compliance Markets
  - CDM Market (only 4% of the total market, Apr 05)
    - **PRICE:** No market price, differentiated pricing for tCER and ICER expected, BioCarbon Fund main buyer, $4-5tCOe
  - JI Market
    - **PRICE:** Only very few projects
  - National projects and RMUs
  - Local compliance systems (e.g. tradable Abatement Certificates under the New South Wales GHG benchmark scheme, AUS)
    - **PRICE:** Not disclosed

Voluntary Market

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- Voluntary Markets traditionally high interest in LULUCF
- Purchase of credits outside of compliance obligations
  - Various motivations: *inter alia*, internal emission targets, corporate responsibility, strategic positioning, competitive advantage, learning-by-doing, public relations, etc.
- Individuals and Firms have engaged in purchases of emission reductions to become “carbon neutral” (event, corporation, or product)
- Price: no market price, prices between $1-20/tCOe depending on the motivation for the support of a project

LULUCF in the CDM

- Only 4% of all CERs purchased in 2005 (down from 7% in 2004)
- Restrictions in the eligibility and use limit the market (temporary crediting system, projects limited to afforestation and reforestation activities, rules even more complicated than in mitigation CDM).
- But: the temporary crediting system creates carbon "to rent" which has significant economic benefits for project developers and carbon buyers
- Prices: no market price yet, price not yet differentiating between tCERs and lCERs, ca EUR5/tCOe
- Limited interest because of perceived (UNFCCC rules) or real (EU ETS rules) hurdles

LULUCF in Annex I countries

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- Only a few projects under development
- JI LULUCF projects follow the same rules as JI mitigation projects, no UNFCCC restrictions
- The EU however has extended the limitations applying to CDM to JI, effectively eliminating private demand for LULUCF ERUs
- Prices: the limited private sector demand means that prices for JI LULUCF credits remain low

- Credits for national forest projects: RMUs
- No private demand so far, not eligible under EU ETS

The Trouble with LULUCF Projects

- Implementation challenge:
  - Financing, sustainable and longterm project management, forestry sector often publicly controlled, monitoring
- Project Risks:
  - Loss of carbon, permanence
- Legal Problems:
  - Land title, title to carbon, transfer of rights, implementation and management contracts
- Methodological Troubles:
  - Baseline data often not available, definition of forest, leakage, etc

But also significant benefits

For Project Developers:

- Carbon revenue (tCERs) can help to cover the operating costs of the project
- Carbon component can help to access finance for additional sustainable development benefits
- Carbon monitoring complements general project monitoring
- Partnership with carbon buyer (can also act as investor)

But also significant benefits

For Buyers:

- Borrowing of compliance time
- Opportunity costs can be calculated against marginal abatement costs = Companies (other than Governments) can calculate those costs
- tCERs add liquidity and flexibility to the market
- tCERs support the environmental, social, political and economical benefits of the EU ETS and the Kyoto Protocol

LULUCF Credits in the EU ETS

A Study of EcoSecurities (Feb 2006) shows:

- There is demand (40% of all respondents confirm interest in forestry credits)
- There is little opposition (only 13% of all respondents are against including forestry projects in the EU ETS)
- ....to expand the scope of LULUCF projects (only 10% of the respondents oppose the expansion of LULUCF CDM Projects beyond aff/reforestation)
- Biggest hurdles (except for exclusion from the EU ETS): temporary credits, lacking methodologies

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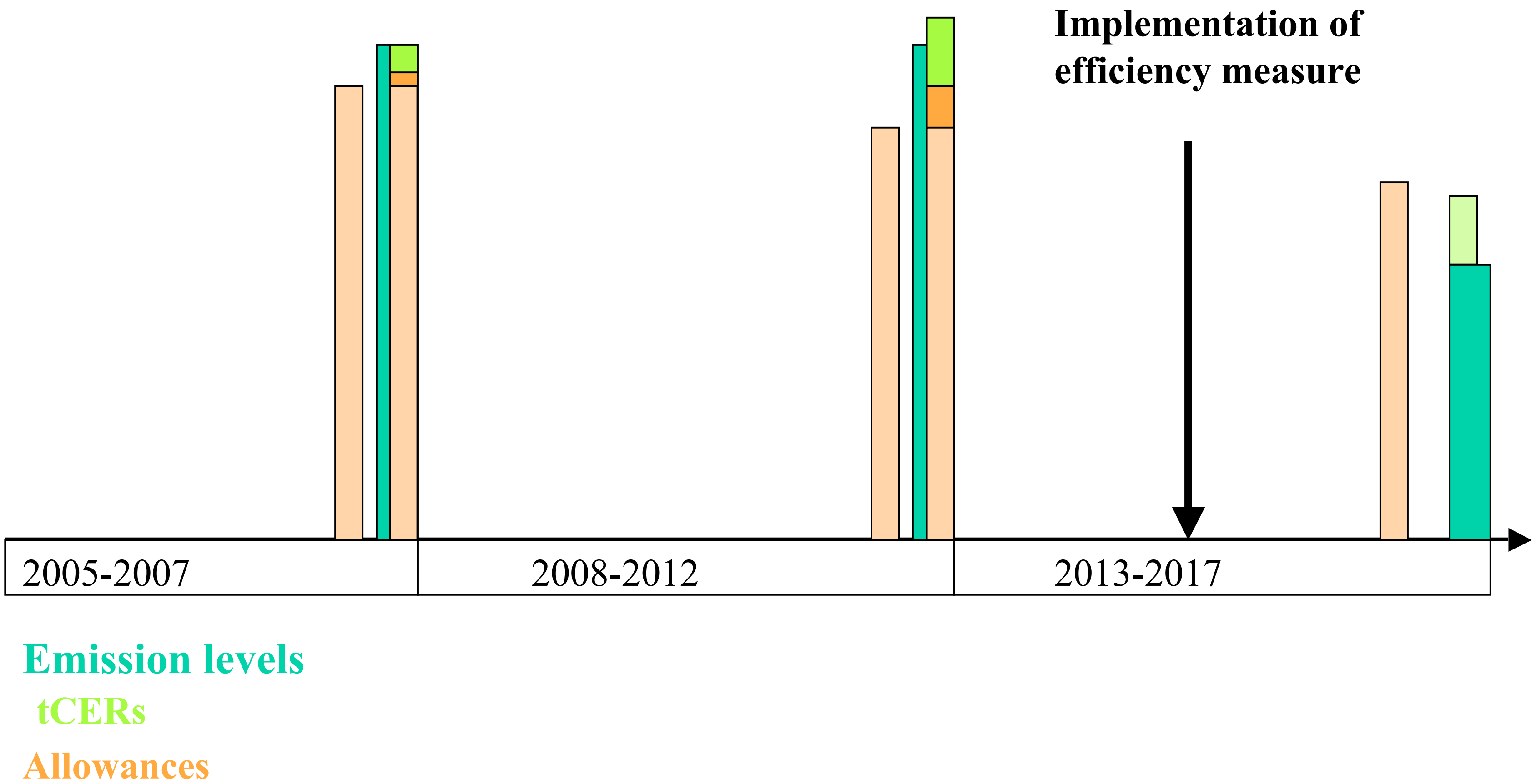
Economic Benefits



Amending the EU ETS

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- Can help to achieve the objectives of the EU ETS by adding additional flexibility to the system
- Allows to partly overcome the problem of the short allocation periods (5 years)
- Replacement burden should be with the operator using temporary credits. Operator is in the best position to assess and mitigate the permanence risk and assume the replacement obligation.

How it could work:

- Operator uses tCER to meet EU ETS obligation
- Member State uses tCER to meet Kyoto commitments
- EB notifies Member State a tCER needs to be replaced
  - Member State has 1 month to replace the credit
- Member State notifies operator
  - Operator has 15 days to replace the credit [alternatively: when it surrenders its credits for compliance]
- Failure to replace the credit results in emission excess penalty

Possible Amendment

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Amendment: Add new Article 11(a)(4):

An operator that has used a tCER shall surrender a CER, [tCER] ERU, or allowance at least 30 days before the tCER expires to cover the emissions which had been covered by the expired tCER. If the operator has not replaced any tCERs it has used to cover its emissions by the time they expire, the operator shall be held liable for the payment of the excess emissions penalty in accordance with Article 16.

Questions?

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