



MEYERS NORRIS PENNY LLP

Carbon Offset System

Larry Ruud
Meyers, Norris, Penny

Fred Siemens
Weber Commodities Inc.

Chartered Accountants and Business Advisors

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right answer
starts here.



About Us



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Fred Siemens B.Comm.: Background specific to this topic.

- Current: Partner Weber Commodities: market analysis/advisory firm
- Former head of Commodity Risk Management with Meyers, Norris, Penny
- Partner in Commodity Brokerage firm
- Former President/CEO of Winnipeg Commodity Exchange
- International consulting work on structuring commodity markets and trading rules
- Supervisor, Grain Futures Act
- RCMP Commercial Crimes Section: International grain futures trading frauds



About Us



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Larry Ruud M.Sc., P.Ag.: Background specific to this topic.

- Current: Meyers, Norris, Penny
 - Director, Practice/Business Development
 - Partner, Lead Ag Consulting team for Alberta/B.C.
- Since 1994, Management consultant for clients in areas of commodity market strategies, strategic / business / operational planning
- Contracted by agencies, government departments, and associations to advise on market and other industry related issues
- Alberta Agriculture: Planning Secretariat and Market Analysis Branch





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Overview of Discussion Paper Methodology

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Methodology

- No new market achieves its' desired end state right out of the gate
 - Achieving desired end state takes:
 - time,
 - open-minded thinking,
 - broader interest thinking and
 - commitment to improvement



Methodology



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- Researched key market elements critical for a properly functioning market in the context of a carbon trading market
 - Examined both public exchange and OTC markets outside carbon
 - Examined 11 other carbon trading markets
- Factored in Alberta government's key design principles for Alberta's Offset System
- Initial gap analysis
- Initial online survey of market participants and stakeholders: further follow up surveys may be completed
- Put forward some 'Food for Thought' to initiate discussion of ideas for improvement to the market
- Stakeholders workshop today to obtain feedback on the Alberta Offset Market
- Finalize gap analysis
- Summarize options for improvement to submit to Alberta Government





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Key Elements to provide Market Integrity

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Market Integrity



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- General definition
 - Having a reputation as a good place to do business
- Unquestionable integrity
 - Required for a successful trading environment
- Individual elements important
 - Collectively form a subset of market integrity



Market Liquidity

- Liquidity
 - Timeframe for response to bids and offers
 - Contracts readily available
 - Volume of trade

- Prices = supply / demand of actual credits



Efficient Market Offset Systems

- Function of
 - Contracts having unique identifiers
 - Market liquidity
- Contracts can be
 - Readily referenced in trading registry
 - Promptly reversed
 - With minimal price movement within trading window



Administrative efficiency

- Measured in terms of
 - Least cost transaction fees
 - Ease of trading/doing business
 - Minimal levels of “red tape”



Pricing transparency

- Ability to peel back the layers
 - Supplies
 - Demand
 - Alternative products
 - Interest costs
 - Transaction/trading costs
 - Trading volumes
 - Pricing information
 - Impact of substitutable alternatives



Clearly defined, long-term protocols for generating carbon credits

- Protocols:
 - Cannot have variable interpretations
 - Need to cover multiple contracting periods
 - Cannot prejudice market if future revisions made



Markets that mirror commercial trading practices

- #1 – Define existing commercial market
- #2 – Formalize trading rules and protocols



Effective contract design

- Contracts need to be
 - Comprehensive
 - Understandable
 - Standardized
 - Enforceable
 - Subject to pre-agreed remedies



Registration of trades

- Unique identifier for each contract
 - Date of trade
 - Price
 - Term/duration
 - Description
 - Location
 - Obligations of the seller
 - Obligations of the buyer
 - Place of transfer of title
 - Current ownership



Clearing system



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- Financial performance guarantees
 - Financially remedy the aggrieved party
- A reconciliation of updated values
 - Transfer difference between buyers and sellers
 - Pertains to futures-type markets
 - Would not pertain to cash contracts such as the Alberta OTC market



Arbitration of trading disputes

- Faster, less-expensive resolution
- Non-court procedure
 - Less formal rules of evidence and procedures
- Using neutral third parties to resolve disputes
 - Industry or gov't / industry peers having technical capacity
 - Resolution is reasonable; timely; agreeable



Effective market regulation

- Impartial authoritative body
 - knowledge of rules and codes of conduct
- Applied equitably
- Applied consistently
- Sanctions that are enforceable
- Modify erroneous behaviour



Stable and reliable trading environment

- A good place to do business
- Captures all of the previous market elements
- All commitments will be honoured
- Publishes reliable results of trading activities
- Available for life span of all existing credit purchases (e.g. banking of credits)





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Gap Analysis

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Gap Analysis



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Market Liquidity

- Lacks liquidity
- Significant transaction time and cost
- Lack of clarity of long term participation
- Number of first time traders

Efficient Offset Systems

- Without central trading registry, means of offset is to resell in Over the Counter market again. Can take weeks or months to re-sell.



Gap Analysis



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Administrative Efficiency

- Less 'red tape' than a number of the 11 other carbon trading markets reviewed
- Government approved protocols a positive
- However, still lacking some clarity on process and paperwork

Pricing Transparency

- Non-existent
- Absence limits liquidity



Gap Analysis



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Clearly defined protocols

- Not all market participants understand calculation methodology, and longevity of various offset credit types

Market mirrors commercial practices

- Lacking a standardized or recommended contract design, however contracts are improving
- No dispute resolution mechanism
- No market information
- No registry of trades



Gap Analysis



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Effective contract design

- Lacking standardized terms
- Lacking recommended components to the contract

Absence of price caps

- Fixed price of tech fund creates a ceiling
- Challenge: without linking to other markets, need a 'safety valve' for buyers



Gap Analysis



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Stable and reliable trading environment

- Uncertainties over future federal system
 - Eg: Impacts ‘banking’ of credits
- Uncertainty over federal treatment of biosink credits

Registration of trades

- Not in place



Gap Analysis



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Clearing System

- Not in place

Arbitration of disputes

- Not in place
- Absence risks court process → lengthy and expensive



Gap Analysis



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Effective market regulation

- Previous discussion of gaps indicates need for improvement
- No new market achieves its' desired end state right out of the gate
 - Achieving desired end state takes:
 - time,
 - open-minded thinking,
 - broader interest thinking and
 - commitment to improvement





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Questions?

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Food for Thought

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Some Ideas



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- Standardized contract elements
 - Common terms
 - Common components eg: source of protocols, fees, expiry date, termination clauses, recourse, timing for payment, etc.
- Reporting of market information:
 - Eg: price, volume



Some Ideas



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- Public trading exchange:
 - Eg: regularly scheduled internet auctions (conservation auctions -water in AU)
- Central trading registry
 - Records trades
 - Ensures offset credits are unique
- Clearing system
 - Example of activities
 - Ensures financial performance
 - Licensing of aggregators



Some Ideas



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- Dispute resolution body
 - Eg: industry peers with gov't representation
- Certifying offset credits prior to sale
 - Recognized public authority or;
 - Private sector
- Validation of projects: increase assurance, however concern over time and efficient resource allocation



Some Ideas



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- Enhanced guidelines and templates. Eg:
 - Standardization of reports: eg: Information to be submitted within the verification document
 - Templates for project documentation throughout process
- Floating price cap:
 - Eg: X% of weighted moving average value over Y previous months of trades





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Discussion Groups

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