

● Carbon market developing in CEE and poised for changes

By: Sanja Kuprešak, 24. 11. 2008, [More by this author:](#)



Pravda Capital has become one of the leading independent corporate financial advisory firms in Central Europe. The firm says that changes for carbon trading to be agreed upon in 2009 will significantly impact the market. The new priorities of U.S. President-elect Barack Obama will also bring changes.

The company advised Orco Property Group on the acquisition of IPB Real and completed the financial restructuring of Aliatel, the largest alternate telecom operator in Czech Republic. Pravda Capital is a partner of CO2e.com, a leading broker of emission allowances and member of financial service firm Cantor Fitzgerald. In 2006 Pravda Capital entered the carbon emissions brokerage and brokered over 5 million tons for over 100 clients across Central Europe.

Jan Pravda, founder and owner of Pravda Capital, told CBW that the spread between the European Union Emission Trading Scheme (EU ETS) and the so-called Kyoto credits, the link between the EU and the world, will go to zero. His company was the first one to make the same prediction in 2006.

While serving as managing director and a member of the board of Patria Finance, Pravda led the corporate finance team and executed a number of mergers and acquisitions in various sectors, including energy and power. Pravda gained global investment banking experience with investment banking firms Merrill Lynch & Co. and Credit Suisse First Boston in London and New York.

Q: How did you start your company?

A: The company was established in 2003 as a corporate finance investment banking group. ... The first year was very successful because we led several groundbreaking transactions. In fact, we helped create Orco. In the beginning, it was a small company that owned a few houses in Vinohrady [in Prague]. We helped Orco buy the largest retail developer in Prague, IPB Real, which has a portfolio of several thousand flats. It was solved by the state in a very complicated process, and Orco made €100 million on that transaction. IPB Real was originally a subsidiary of the failed Investiční a Poštovní banka. Orco Property, a company listed on the French stock exchange, purchased 100 percent of IPB Real from [former state bail-out agency] Česká konsolidační agentura (ČKA) for Kč 602 million (€20 million), and the shareholders in 2005 valued it at €130 million.

We also ... helped restructure a company called Aliatel, the second largest telecommunications company at that time. ... In the end, Aliatel was successfully sold to GTS Novera, which is a nationwide telecommunication operator providing a full range of voice, data transfer and Internet access services of guaranteed high quality. ... We also advise [energy producer] ČEZ regarding financial strategy.

Q: Since 2005 you have been active as brokers of carbon emissions allowances, launched under the EU-ETS. How did you start this business?

A: I am what Americans call "an earth scientist" by training, and the topic of global warming is close to me. Second, I have a lot of energy banking experience from New York and London, and that comes very handy. Third, and perhaps most importantly, this is a business where you can make money and contribute to both the common good and help your clients. We have one principle in our business, and that is, 'We make money in a way that others benefit as well.'

Q: Are you still in the corporate finance business?

A: I realize that the corporate finance business in the Czech Republic is ... not very interesting. ... So, I focused on business management. Our experience from energy and power and our ability to execute cross border transactions have helped us to become a leading provider of these services in Central Europe. Thanks to our energy and power experience, this is an area of significant focus. Our expertise is applicable across Central Europe, where this sector is going through privatization and deregulation.

Q: Where do you trade with carbon emissions?

A: We trade in Poland, Slovakia, Italy, and we have some clients like SABMiller, the second largest brewer in the world, managing their carbon exposure in Central Europe. ... The advisory business is based on local relationships at best, i.e. who you know, and much less on what you know. The carbon business and equity trading business, like most of global trading, is based on what you know and less so on who you know. ... With our experience and plenty of capital, we can operate not only on the EU level but also can do business in the U.S. This is a global initiative that we are slowly approaching. That is why we are glad to have the partnership of the Irish company Carbon Warehouse, specializing in global carbon investments. Currently, only 30 percent of our carbon business is in the Czech Republic.

Q: Can you describe how you manage carbon trading?

A: Someone calls us and tells us to sell their exposure, and if we agree on conditions, we sign a contract. After that, they send the allowances, for example, €500,000 to €5 million worth to us, we do the exchange and

collect our fee. Ninety percent of companies in the carbon trade business are private companies.

Q: How is the carbon trading business regulated in the Czech Republic?

A: The state decides how much allowances companies can get, and that is all. The carbon business is not regulated at all. We are the first company in Central Europe to be the members, since January 2006, of the [environmental exchange] Bluenext. ... When we formed our business plan in 2005, we analyzed all exchanges that claimed to be in the carbon business. We saw that the spot market would be the key to the beginning of the business in Central Europe and that Bluenext would become the leader. The evaluation was quite right—Bluenext is the biggest carbon spot exchange in the world. The futures and derivative markets are yet to develop here.

Q: In one of your publications, you mentioned that ČEZ is getting free allowances until 2012. How will the situation for ČEZ change after 2012?

A: ČEZ has undeserved profit, and European Commission knows it. Until 2012, ČEZ is getting the allowances for free, hence generating some €1 billion of windfall profit by including this cost into the marginal price of power and thus forcing customers to pay for it. After 2012, a new version of Kyoto Protocol is expected to be agreed upon in Copenhagen in December 2009, and the EU plans to force big utilities that have natural local monopolies to pay for such allowances in an auction. This will eliminate the windfall profit. Now you have other risks involved, such as China, India and Brazil, and also the position of the U.S.

Q: What kind of risks?

A: These are the negotiating positions of the big polluters vis-à-vis the Copenhagen process. The U.S., the second largest emitter of greenhouse gases, is in the middle of the financial crisis and will put this on the back burner with President-elect Barack Obama, stating that his priority is investment into renewable energy, while the cap-and-trade system, such as the one in the EU—the EU ETS—will probably be a second priority. China, the largest emitter, and India, on the other hand, are saying that the developed world must pay for 80 percent to 90 percent of the carbon reduction in the near future. You can see that these positions are miles apart from the position of the EU; therefore, reaching a concise agreement will not be easy for Copenhagen. If the agreement is not concise, the whole trading scheme will be in danger of collapsing as it did in May 2006.

Q: What happened in 2006?

A: Allowances in 2006 and 2007 went from €30 to €0. We were the first in Central Europe to publish an article—in May 2006—predicting that allowances in 12 months will have no value. The problem is that the Kyoto credits are linked to European ones. You have a big pool of European allowances, and when you make a little hole, it starts draining. That can happen. The bigger disagreement in Copenhagen, the bigger the hole will be.

Q: In September 2008 the Czech Republic and Japan signed a memorandum of understanding to start carbon emission trading. Do you know how far this agreement went?

A: As far as I know, based on public information, the Czech Republic and Japan entered into a memorandum of understanding that they intend to trade Kyoto credits called AAUs (assigned amount units). To complete such a trade, however, one needs to engage in more intense bilateral negotiations with multiple parties so one achieves the best price. This needs to be done on a global scale. That way one can almost replicate the conditions of transparency provided by the electronic auction of EU ETS. Another way of completing this is to organize, in parallel with the bilateral talks, an electronic auction of the AAUs. When asked, we and our partners are prepared to help.

Q: What are your future predictions for carbon market trade?

A: A few months ago we stated on [business news agency] Bloomberg that the spread between the EU ETS and the so-called Kyoto credits, the link between the EU and the world, will go to €0. At that time it was €5 per ton. This week it went as low as €1.7 per ton, indicating that the risk for the world—the contagious flu—is truly spreading to EU and that the systems are connected more than ever. We predict that this spread will go to €0, i.e. less than €1 per ton. EU companies were making a lot of money by buying cheap Kyoto credits and using them in lieu of the EU credits. That opportunity, an arbitrage between the EU and the world, is now diminishing and will be gone in a few weeks.