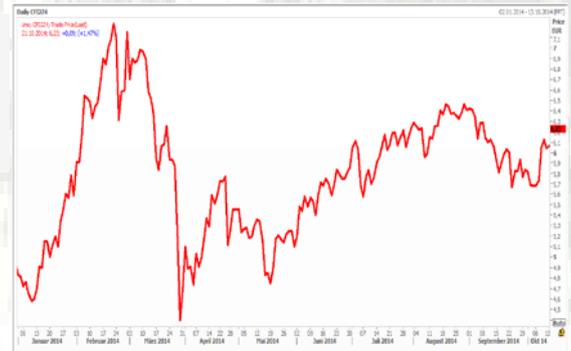


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Emission News 11-2014

Practical Information for Emission Trading
Edition 21.10.2014

CO2 tax fraud is followed by black money laundering and lending transactions with certificates

Starting in 2008 VAT fraud with CO2 certificates have cost EU member states since 2011 at least 5 billion euros. After those "business models" of criminal gangs have been put to use also in electricity and gas trading industry of the EU, nowadays not only the financing of terrorism but also the normal CO2 black money laundering moves into the field of view of market participants.

The lending of EUA certificates of plant operators to domestic and foreign traders as well as the cheap purchase of EUA for the purpose of building up some momentum may be typical signs of illegal activities of operators that can be considered with a little good as criminal transactions.

Emissionshändler.com® like to draw attention with the present here **Emission News 11-2014** to possible dangers to which operators are obviously exposed for some time with regards to all involved legal as well as in financial aspects.

Looking back at the CO-tax fraud in 2008-2011

The tax fraud, i.e. the fraudulent evasion of VAT had begun in emissions trading around the middle of 2008, by criminal gangs that created a VAT carousel and where CO2 allowances were moved across the borders of the EU Member States. Such a carousel always requires several gang band members that operated in at least two, but usually three or four of the EU countries, holding a trading

company, from where the certificates were sold to each other across borders and where the domestic input tax would be collected. The last link or trading company in the chain did not pay off the sales tax dues as required by law but disappeared in each case together with his money, at the latest when the tax payment date was overdue. "Lost Trader", the lost merchant was the term that was founded at that time for this gang member, which usually left only an empty Ltd. or Ltd.

The resulting damage estimated by Interpol at the end of 2011 totalled up to at least 5 billion euros until most carousels in emissions trading were stopped or busted. The introduction of the reverse charge mechanism, i.e. the shift of tax liability from the service provider to the service recipient, who now has the tax liability, has withdrawn the carousel scheme in the emissions trading its business foundation.

Where are the criminal gangs? - Where's the money?

Basically it can be said that the participating gang members and masterminds are at certain proportion

- a) in prison or are on remand
- b) probably already dealing since 2010 until the end of 2013 with tax evasion in the electricity and gas trading
- c) lucky to have come free in a number of cases against paying high fines to the public prosecutors for lack of evidence



- d) submerged and probably controlled from abroad their activities
- e) engaged in new businesses in the electricity and emissions trading and dealing with money laundering and speculative trading activities

In the foregoing points b) - e) a greater capital requirement is necessary, which however could be left over from the previous activities.

Exemplary criminal activities in the emissions trading

In order to assess the dimensions of the recent criminal activities in emissions trading, we give an extract from known cases below:

- According to a recent report by the Italian newspaper Corriere della Sera British and American agents have already in 2010 found documents near the Pakistani-Afghan border, indicating that some of the ill-gotten CO2 emissions trading tax money could have served to finance by Islamic terrorists. Not far from this hiding place Osama bin Laden killed was on 2.May 2011 by an attack of American soldiers. The papers found in 2010 led to a British citizen of Pakistani origin, owner of the Italian CO2-trading company SF Energy Trading SPA, based in Milan, which moved through carousel trades with companies in Germany, France, England and the Netherlands high amounts of certificates and created liabilities to the Italian tax authorities of around 1 billion euros. The money trail went over to Cyprus via Hong Kong into the United Arab Emirates and Dubai. Overall only 80 million euros were seized. Of the 38 gang members 27 are in custody according to Italian reports, 11 are still at large, including gang leader Yakub Ahmed.
- Already in February 2014, the Hamburg Regional Court has sentenced a criminal to nearly 7 years in prison and a participating CO2 dealer for more than three years. The resulting loss of about 10 million euros was also made possible because two unintentionally involved tax consultant of the company watched the carousel spinning more or less passively and did not find anything unusual about the transactions of more than 5 million tons of CO2. The judge also sentenced the tax consultant for aiding and abetting tax evasion and criticized in this context that this kind disreputable mandates had not been rejected by them. However, the mastermind of the whole scheme remained in the dark, as the accused - who had received his instructions exclusively from this

person from abroad - could this give any information.

- BKA (Germany criminal intelligence unit) and the Frankfurt prosecutor's office are still interested in two Pakistanis with international arrest warrants, because of their unpaid debt to the German tax authorities 136 million euros from CO2 trades. Their presumptive accomplice or more likely gang leader is sitting since May of this year in Las Vegas in custody for extradition to Germany. From his Frankfurt headquarters he had rotated through three more companies in Berlin, Munich and Dubai his CO2 allowances back and forth.
- Previously, other members of that branched organization had already been sentenced to long prison terms in Frankfurt, because they were convicted of CO2 carousel trades, creating a tax loss of at least 850 million euros. The predominant part of these CO2 trades ran through the Commercial Section of the Deutsche Bank, where now dealers have to face the same charges. The trade in CO2 certificates was stopped completely for this reason by the Deutsche Bank.
- Also the BKA and Attorney General in Frankfurt are still looking international arrest warrant Englishman Faisal Zahoor Ahmad, who has withheld from German tax authorities until February 2010, at least 58 million euros by CO2 carousel trades. Ahmad was Managing Director of the company "Red Star GmbH" based in Munich and bought from there certificates across EU countries.

Notice

All exemplary activities listed in this newsletter have been taken from the media and are not based on our own research.

The sources for this include the Süddeutsche Zeitung, Bild-Zeitung, Dow Jones Trade News emission, Information service Thomsen Reuters, the portal www.finanzen.ch, Focus Money Online, etc.

Exemplified criminal activities in electricity trading

We already know since 2010 that the electricity and gas trading is also used by criminal gangs as attractive source of income, at least since December 2013 it is publicly known as the Süddeutsche Zeitung carried a report about it.



Also in this sector trading carousel were built, very similar to the emissions trading scheme. In this scheme electricity supplies were sold in tax exempt status to a buyer abroad and purchased including tax from abroad as well. However, it is estimated that the volume of evaded sales tax is higher; almost by a factor of 10 than in emissions trading. This is why because on the one hand the financial volumes of current quantities in electricity trades are significantly higher and on the other hand the EU had introduced the so-called reverse charge method for discouraging tax evasion in Germany until September 2013 (emissions trading, this was already the case since 01.07.2010).

- Tax investigators are currently tracking after a big case in the field of EnBW. According to research by the *Süddeutsche Zeitung* sales tax worth several billion Euro is supposed to be evaded by electricity and gas distributors in North Rhine-Westphalia, Saxony and Baden-Württemberg. The European police agency Europol in The Hague speaks in this context of a case of "historical dimension".

The energy giant EnBW inquiry also has come under investigation. When researching dubious Russian business trades of EnBW with the Moscow lobbyists Andrei Bykov, in relation to the suspicion of slush funds and opaque transactions in emissions trading, investigators discovered inconsistencies in the book keepings for electricity trading which might indicate a never-before-seen magnitude of tax evasion.

- Confidential papers from the *Süddeutsche Zeitung* estimate the volume of tax-free sales of electricity and gas supplies from 2010 to 2011 has risen tenfold from one billion to 10 billion euros. This is one indication, which indicates almost uniquely on carousel trading. The question is only whether this is to be considered as knowingly or unknowingly assisting in tax evasion, if exorbitant amounts of megawatt hours are traded throughout Europe, while the energy remains physically in Germany. According to the authorities investigations are under way against several electricity and gas distributors in Germany, which could have been active in the carousel. According to the BKA traces clearly lead into the milieu of organized crime with a high level of specialist knowledge managed by shadow trade companies at home and abroad.
- Another known case deals with the insolvent company Power + Energy investigated by the prosecutor out of the city of Mannheim.

The company should have created a tax carousel using two trading companies based in Bavaria and North German to cheat VAT from the Treasury within four months to an amount of nearly 3 million euros. Interesting here, that delivery documents clearly state that EnBW subsidiaries had operated with the participating merchants a flourishing trade in electricity, reaching a multi-million euro level per month.

The criminal activity of money laundering

Money laundering was early on an aspect of crime that occurred in connection with carousels in emissions trading.

To operate such a carousel, it naturally requires a correspondingly high initial capital. When the ton EUA in 2009/2010 was still trading at prices from 20 EUR, criminals had to have available at least 2 million euro *play money* at a normal trading volume of 100,000 tons. What could be more obvious than that this initial capital comes from opaque sources and is then washed to white instantly by the first transactions.

However, a chain of dubious trading company can also be used for further generation of washed money, because in many places black money can be fed into the system because the established structure of the bogus companies strongly supports this criminal act.

A big advantage is that this business model for black money laundering continues to function even if the fraudulent evasion of VAT through the introduction of the reverse charge mechanism in the electricity, gas and emissions trading was made much more difficult and not worth the risk.

- In late September 2014 it was announced that the private bank Julius Baer (Switzerland) is investigated in France on charges of money laundering. In the context of investigations by French investigators during a big fraud case of tax evasion in the emissions trading an investigation against the bank was initiated. The bank is alleged to have received on one of their customer accounts in Switzerland payments without to make the necessary investigations. The investigating attorney Guillaume Daïeff had initiated the case against Julius Baer because of a possible relation with a criminal case known in France as "Crépuscule", in which a large CO2 VAT carousel was busted in June 2010, which cost the French state roughly 1.6 billion euros.



Money laundering draws on existing structures

The business model of money laundering provides for the organizers and backers some benefits that have resulted from the history of the last 6 years in the electricity and emissions trading.

- It can be operated by existing gang organizations that have worked well together in the electricity and emissions trading in the past
- The structure of (so far) undiscovered or inconspicuous bogus and fake companies from energy trading can be used.
- The existing customer base of unsuspecting business partners (industrial customers, utilities, if necessary airlines) is used for money laundering
- Use of straw men of these "trading companies" who act as managers and their (sometimes) unsuspecting staff are well educated into the specifics of the energy industry

The largest and main argument which speaks for the business model of money laundering, however is that this model is product-independent, i.e. it does not matter whether it comes to electricity, gas and emission rights or whether taxes are to be evaded (whatever works for only a short period) but that a **permanent, almost inconspicuous outward business is conducted, which grows constantly based on new customers and thus increases the revenue.**

Since money laundering does not depend on the profit but on revenue, it is a nearly unique identifier for money laundering that companies are offering "best prices" almost always. This applies almost always for the purchase of emission rights and also for the sale of rights to plant operators too and certainly in many cases also for the innovative product "lending of emission rights".

However, it seems in the case of "lending of allowances" also a new business model has developed: Speculating with customer funds, which is made possible by EEA certificate lending and the sale of the certificates by the merchant. This model however can only be criminally prosecuted if the speculation of the trader has gone wrong and this had been expressly forbidden in the corresponding passages of the contract.

For the sake of completeness we already have to mention here that outside of the electricity and gas trading and the mandatory emissions trading

another, apparently very large area of fraud in CO2 certificates exists. Here it is the **voluntary market** (carbon offsetting) where environment individuals, professionals and small businesses are being cheated with VER and CER. To this end, more can be found at Emissionshändler.com® soon.

Infobox

Mandatory Onsite Visit for the 2014 Audit

Many aircraft operators are facing the following dilemma because of the change in ETS reporting regulations for the years 2014 – 2016.

Due to the fact that aircraft operators only have to report Intra EU flights during the above mentioned time period, the annual emissions report might total up less than 10 flights for which emissions need to be reported. Does this justify an onsite visit of a verifier that possible spends more time and money for traveling than for actually auditing the 10 individual flights?

Here is what the regulation EU/600/2012 in article 31 says:

"By way of derogation from Article 21(1), the verifier may decide, subject to the approval by a competent authority in accordance with the second subparagraph of this Article, not to carry out site visits to installations based on the outcome of the risk analysis and after determining that all relevant data can be remotely accessed by the verifier and that the conditions for not carrying out site visits established by the Commission are met. The verifier shall inform the operator thereof without undue delay.

The operator shall submit an application to the competent authority requesting the competent authority to approve the verifier's decision not to carry out the site visit."

So the airline is responsible to apply from its regulating competent authority a statement that the submitted annual emission report which has been audited without an onsite visit will be acceptable.

Therefore it is advisable to reach out to your competent authority in advance (before scheduling a verification) to see whether a verified annual emission report for 2014 without an onsite visit is acceptable. The German DEHSt answers an informal written application for an onsite visit waiver instantly.

Incredible deals on the EEA Lending

In Germany and Poland plant operators are already receiving for over a year almost incredible offers on how they can raise interest on their EUA certificates with 5% or more.

Here is taken advantage of the fact that the duplicate allocation, obtained in April for the years 2013 and 2014 was only partially used for delivery



of the 2013 obligation. Since the operators usually get in the following years in March another free allocation which will be used to for surrendering a year later, operators always have one year of allocated certificates on their account. Of course, the height of the so constantly available account balance also depends on the level of allocation in proportion to the obligation, so that it also occurs in many cases that the operator does not have a full allocation available to lend out, only a partial one. But according to this principle of "always in stock of a year-allocation" almost all operators physically could lend out a certain amount of EUAs to others, provided that they have an advantage of it. An advantage may be, for example, that the operator after the end of the rental period will receive interest in the form of cash or additional EUA. However, it should be made clear here that not everything what is physically possible also works mathematically and also certainly not is safe for the operator.

Gains and losses on "rental shops"

Emissionshändler.com® would like to point out in this article that plant operators can expect offers which appear more or less lucrative, but usually also have a higher risk potential than if money is invested in a bank for normal interest. In addition (or instead) it can never be ruled out that the operator is accidentally involved in a money laundering carousel

In any case, there are valid mathematical laws on possible gains and / or imperative losses that also apply when trading CO₂ allowances, as Emissionshändler.com® wants to show in some examples below.

Lending of money brings in CO₂ trading profit

The process of lending money for interest is a well-known business. It is possible at any bank. In Germany currently between 0.5% and 1.8% interest will be paid, depending on how much money will be taken as a loan and for how long. If you were interested a possibly higher interest rate, then one should look at CO₂ trading.

Here you can make money with a SPOT-purchase, which is covered simultaneously by a FORWARD-sale. This is possible if the so-called forward curve makes a "steep rise", i.e. the selling price in 3 years

is significantly higher than the present SPOT purchase price.

	Name		Last	Pct.Chng	Net.Chng	Bid	Ask
CFI224	ECX EUA DEC4	↑	4.71	-2.89 %	-0.14	4.70	4.71
CFI225	ECX EUA DEC5	↑	4.87	-2.79 %	-0.14	4.86	4.88
CFI226	ECX EUA DEC6	↑	5.09	-2.3 %	-0.12	5.08	5.10
CFI227	ECX EUA DEC7	↑	5.30	-2.93 %	-0.16	5.30	5.33
CFI228	ECX EUA DEC8		5.71			5.56	5.59
CFI229	ECX EUA DEC9		5.99			5.81	5.86

FORWARD-Prices on the ICE Stock Exchange for Buy & Sell Transactions

If you look at the above FORWARD-price situation in the stock market, the following business is possible as an example, where an operator wants to invest money at the end of 2013 for 3 years.

Thus, the operator buys at the end of December 2013, the amount of 10,000 t EUA Spot for 4.66 €/t (spot price is 5 cents below DEC14 ask price of 4.71). So he invested 46,600 euros. At the same time he sold this 10,000 t as a forward to the end of 2016 as DEC16 5.08 EUR / t (bid).

After the operator has received the 10,000 EUA spot on his account, he stores them until December 2016 and then returns them to the stock market and collected the sum of 50,800 euros. In the best case scenario the two transactions would create costs of 2 cents per tonne, so that after deduction of 400 euros cost remains a net income of 3,800 euros, which corresponds to a rate of 2.72% / year. In this case, the forward curve is not steep enough so that it would yield more interest than a normal investment. Chances are that you can do better at constellations in the stock market as well as luck and skill, the right time, to achieve an income of up to 4-5%. The advantage is here that speculative losses and profits can occur due to the simultaneous purchase and sale, but of course no additional gains.

Lending of EUA in CO₂ trading brings loss

The lending of money for interest via the detour of buying and selling of EAs is a working principle, as the previously mentioned example show. Even though this process does not provides more interest income, as if the money had been brought to the bank.



Now, however, we will demonstrate, how it works, to use EUA carried in the account for sale (sale and buyback) and create additional interest (EEA).

An operator lends (sells) its EUA to a dealer and allows the dealer to utilize the EUAs "in his own interest", so that in three years, the lender will be repaid plus interest, payable / available in additional EUA certificates. This is precisely the promise, which is currently made by traders to operators.

Emissionshändler.com® has investigated this "model" together with two German banks and, deducted after a few minutes that this cannot work for the simple reason that it is the opposite way of the former model "lending of money", and thus will not yield 2-3% interest, but provides at least 3% loss.

The loss in this model will be generated as follows:

The plant operator sold the end of December 2013, the amount of 10,000 t EUA spot at 4.62 €/ t (spot price is 8 cents below DEC14 bid price of 4.70) to a "dealer". He gets according to his calculation 46,200 euros, but is not paid in cash.

Instead at the same time he buys these 10,000 t as a Forward trades to the end of 2016 with 5.10 €/ t from the dealer (DEC16 Bid) and pays 51,000 euro.--. Including the 400 euro extra costs thus suffer a **loss of 5,200 euros**, representing over 3% loss per year. Clear to see that this makes no sense.

So why is EEA lending at interest up to 5% offered to the market by a dealer?

The answer to this question is relatively simple if you take a look at the model "Lending of money in CO2 trading" in more detail. Only this model can generate even though only a little - though safe - income without also risking speculative losses.

If the dealer uses the system operator on the other hand as EUA supplier and thus initially enters around 3% loss, then this may indicate that the dealer:

- a) invests the money from the sale of spot EUA in other markets and industries and collects there to much higher yields
- b) operates in the field of money laundering (consciously or unconsciously)

- c) is interested in building a client relationship and that can cost a few percent loss once

The variant c) is the one that plant operators would like to believe. This is especially true if the dealer has its registered office abroad and would like to expand into other countries and is providing corresponding arguments for the potential customer.

Moreover lending transactions provide besides the adjacent to the existing risk of being involved in money laundering always the risk of total loss. This is in the nature of things, if the dealer at the time of surrendering the allowances to the operator is no longer able to pay or does not exist anymore or was not authorized by initially unrecognized contractual clauses, to gamble away the money in high-risk projects.

Conclusion

The lending of certificates to dealers holds many dangers. Unintended and possibly criminal assistance in money laundering and total loss of the certificates used are quite realistic scenarios that need to be considered. Also the purchase and sale of certificates to dealers (not know to the operator for many years) may lead to dangers.

Note to our readers

Since 2006 Emissionshändler.com® publishes its proven CO2 newsletter.

About 4,500 industrial customers, utilities, interest groups and individuals in Germany, Poland and other Eastern European countries can currently benefit from our emission letter in German, English and Polish, to inform themselves about current practices and up to date on topics on European emissions trading.

To continue offering our newsletter in the most accurate and up to date form and quality to our interested readers, from February 2015 onwards, we will have to provide our newsletter offering for a fee (with a few exceptions).

Further information and registration information will be available in the upcoming remaining free issues of our info letters.

We look forward to your interest and to welcoming you in the future as subscription based reader.

New and financially attractive offers should be scrutinized in detail by considering the unfortunately possible scenarios of money laundering and speculation.



Only if a trusted dealer does have on all of the operator's questions good and reasonable replies and answers and also can offer collateral, then it may make sense that an operator shall consider such an offer for sale or lending of certificates and possibly even accept it.

Disclaimer

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Our offer

Please contact us without obligation at +49 (0)30-398 8721-10 or info@emissionshaendler.com as well as via mail or find out more about the Internet services under www.emissionshaendler.com.

Kind emission regards



Michael Kroehnert

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