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Auctioning and EU-wide cap in commission proposal for ETS review

The European commission will in January propose that in the third trading period of the EU emissions trading scheme (ETS) commening in 2013, around two-thirds of all CO2 allowances must be auctioned.

It will also propose that allocation of allowances will be made according to one EU-wide emissions cap set by the commission, rather than by each of the 27 member states drawing up their own national allocation plan.

Jos Delbeke, the commission's senior climate change officer, revealed this when he outlined some of the key issues in the commission's yet unpublished proposal at a side event to the UN's climate change summit at Bali this week.

Delbeke said that the commission would propose that "a very high percentage" of the allowances to the energy sector would be auctioned. Industries - especially those subject to international competition - would receive a larger amount of their EUAs for free.

European power companies have been criticised for passing the cost of CO2 allowances on to their customers, because they have received most of the allowances they need for free. The International Federation of Industrial Energy Consumers has estimated that this has cost German energy users €0.50-0.80 per MWh so far, while the power companies have been cashing in billions in windfall profits.

The debate in Europe has centred around whether windfall profits should be taxed whether the energy sector should see a higher propostion of its allocation auctioned.

"If we are not going to go for a common solution in Europe for auctioning, the debate on windfall profits is going to spoil the atmosphere, and we will see 27 member states ... tax away windfall," Delbeke said.

The proposed increase in auctioning after 2012 comes as no surprise, officials from several member states have even predicted that 100 per cent of all EUAs would come at a cost for companies.

"Auctioning worries me a lot," said Liz Bossley of the Consilience Energy Advisory Group, a UK-based think-tank.

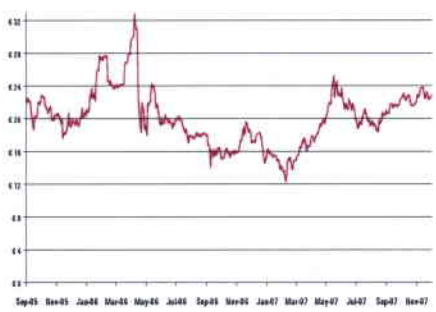
"If it is restricted to the power sector it might work, but if industry has to bid alongside the power sector in EUA auctions it could drive some of them out of business," she told Point Carbon.

Bossley argued that since power companies are in a position to pass on all CO2 related costs to their customers, they will have no concerns about the price of carbon.

While Delbeke suggested that industrials would receive more free allowances than energy companies, he did not go into further details, leaving industry sources uncertain about what exactly they will be facing in the third trading period. (continues on page 3)

EUA closing prices - historical

EUA prices for December 2008 delivery, as assessed by Point Carbon. Prices are published daily at www.pointcarbon.com



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"The revision of the ETS must provide mechanisms to protect the international competitiveness of industry.," said Gordon Moffat, director general of the European Confederation of Iron and Steel Industries.

"The steel industry is carbon and energy intensive with a high share of process emissions on the overall CO2 emissions. It is exposed to intense international competition. Any form of auctioning would result in direct and indirect relocation of production and emissions, and is therefore totally unacceptable," Moffat told Point Carbon.

"Provision must be made for sectoral agreements which can succeed in a global reduction in emissions," he added.

Open issues

For the 2008-2012 period of the ETS, 2.08 billion allowances will be allocated each year across the EU. As more sectors and greenhouse gases are likely to be brought into the trading scheme from 2013, this means that EU governments will auction a minimum of 1.4 billion allowances every year from 2013 on.

More than 100 million EUAs will be auctioned by governments on a monthly basis, almost the same amount of allowances that currently trade in the market on a monthly basis.

Delbeke did not specify whether the commission would set standards for auctioning methods or whether each government would be left to decide how often to auction how many allowances on which platform using which methodology.

Considering the impact auctioning is likely to have on the market, both in terms of price and liquidity, market participants are likely to spend the weeks up to 23 January pleading with the commission to introduce various guidelines.

Another issue bound to create some public discussion in coming months is how government's should spend the income from the sales of all the allowances.

Analysts at Deutsche Bank and Point Carbon have recently forecasted the phase-three EUA price to be around €35-36, at least early in the trading period. Should those estimates turn out to be correct, European governments will see revenues boosted by some €50 billion or more on an annual basis, if the commission proposal gets adopted.

The end of national allocation plans

Delbeke said that under the current allocation method, companies across the European Union are subject to varying conditions to a degree that needs to be addressed.

"This variety has to be removed, and the allocation process in the future will be very much harmonised," the director said.

For the first two trading periods governments have submitted individual allocation plans to the commission. The plans have varied significantly in the approach to key issues such as amount to be allocated and how to share the emission reduction burden between sectors. As a result many companies have complained that their government's NAP has put them at a competitive disadvantage to companies in other EU states.

The commission's solution is to base the allocation of allowances on the EU's bloc-wide target of reducing greenhouse gas emissions to 20 per cent below 1990 levels by 2020. The commission will design an allocation plan for the whole union after agreeing an allocation methodology with the member states.

"The member states are no longer going to be asked to compile national allocation plans, but the member states will be very closely involved in the elaboration of the allocation details," Delbeke explained.

A report submitted to the Swedish government last week by the country's Energy Authority and Environmental Protection Agency recommended a solution similar to the one outlined by Delbeke.

"By setting the cap for the whole EU ETS directly at EU level ... the scheme's climate integrity can be secured. It also creates the conditions for EU-harmonised allocation through auctioning or benchmarking in various sectors across the scheme," the report said.

Kyoto credits

If the international community reaches an agreement on a treaty to take over for the Kyoto protocol after 2012, the European commission would be likely to allow more use of imported carbon credits from Kyoto projects for compliance purposes, Delbeke said.

In phase two EU companies can use almost 280 million Kyoto credits per year, some 13.4 per cent of the total allocation.

