17.11.06 Governments criticised of wrecking the market price through auctions

Government sellers of CO2 allowances should open a futures trading account or get themselves a good broker and auction their allowances that way, a market analyst argued the day after the Irish government was partly blamed for pushing down the price by announcing its second EU allowance auction.

On Thursday this week the Irish Environmental Protection Agency (EPA) announced that it will auction 963,000 allowances for delivery in the first phase of the EU emissions trading scheme (ETS) on 4 and 5 December. Of this total amount, 252,000 will be auctioned in accordance with the Irish national allocation plan (NAP), while 711,000 are unused allowances from closures of Irish ETS installations.

During the course of the day, the December 2006 contract shed €0.30 – 3.4 per cent – off its value, to close at €8.60. Several traders quoted the offer of allowances from Ireland as one of the reasons for the downward movement, although the EU market has been bearish for the last five weeks.

“If a utility or a trading company issued a press release announcing in advance that it was about to sell 963,000 EUAs and the price went down this would be criticised as market abuse,” argued Liz Bossley of the Consilience Energy Advisory Group (CEAG).

She added: "No company in their right mind expecting to maximise its revenue would dream of doing this. Instead it would quietly and privately sell the allowances, probably in a series of smaller offers until it had achieved its objective,” she told Point Carbon.

“So why do governments feel the need to wreck the market price with an announcement before they attempt to sell using an auction mechanism?” Bossley continued.

“The point of an ‘auction’ is to sell to the highest bidder - that’s what forward and futures contracts are designed to do in an efficient market. It would be tremendously helpful to the market if government sellers would simply open a futures trading account or get themselves a good broker and auction their allowances that way,” Bossley argued.

“They would improve their own realisations and would stop imposing random shocks to the market that would be considered manipulation if done by a commercial company,” she added.

While several traders agreed that the auction announcement had been a bearish signal to the market, not many saw how the EPA could have acted differently. “It is good that they auction allowances instead of giving them away for free,” said Seb Walhain of Fortis Bank. He stressed that announcing auctions was good for transparency, a necessity for governments, but pointed out that it was “questionable wisdom” to allow left-overs from the new entrants reserve and closures to be auctioned to a market that has already been documented long.

Denmark has been rumoured to have chosen to make use of brokers and trading houses to sell a number of allowances set aside for auctioning in the first-phase national allocation plan (NAP), although final confirmation has not been given by the Danish government. Choosing this strategy was never an option for Ireland, however.

"Ireland's first national allocation plan specifies auctioning of allowances rather than sale,” clarified Kelley Kizzier, senior manager of the emissions trading unit at the Irish EPA. This could be changed in the 2008-12 period, however, as she pointed out that “the draft national allocation plan for the second phase leaves the option to sell open."

The EPA fended off Bossley’s criticism that it should not have made a public announcement ahead of the auction, and said the procedure would be repeated later on in the first phase.

"The advance announcement of the auction is not only a practical requirement in order to stimulate demand but allows all potential bidders an equitable opportunity to respond," Kizzier told Point Carbon.

"The amount of allowances available in the second auction represents the remainder identified for funding plus the initial amount available due to closure. Further auctions will be necessary in accordance with Ireland's national allocation methodology," she said.

The EPA did not think government auctions ‘wreck the market price’ and thought the carbon market should be able to absorb the supply.

"The announcement of the second auction should not be a surprise as the initial auction held in early 2006 flagged the second auction for late 2006," Kizzier said.

"It is not Ireland's intention to adversely impact the market. As there is a 20-day period between the launch of the auction process and the finalisation of the bidding, the amount offered is not considered unduly substantial," she added.

Owen Wilson at the Electricity Supply Board agreed with the EPA that the market impact of Ireland auctioning 963,000 allowances should be limited. "I would have thought that other news, such as the reduced Spanish emissions, would have a bigger impact, but the market is in an early stage of development so it is difficult to predict what has an effect,” he commented.

"Most people would express some surprise that they chose this time to auction the allowances, when the price is so low. There is a downwards trend in the market anyway, but it didn't help. This is just one quantum, but is indicative of what could happen towards the end of the trading period if people offload allowances they have been holding on to for compliance purposes, but which they no longer need,” Wilson told Point Carbon.

The ESB official was concerned that future auctions could disrupt the price more, and that a more regular flow to the market could be a beneficial solution.

"The impact on the market would be less if everyone knew when and how much would be auctioned, and this would happen at regular intervals. My view is that more frequent auctions would be the obvious way. This has to be coordinated by the EU in the future. As soon as greater quantities will be auctioned, the potential for greater market effects will arise," he said.

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