

**Auctioning consultation – Response to the Consultation**  
**03 August, 2009**

**Section 1: Questions to categorize participants**

**Question A** – Name of company: UK government – the response has been drafted by the Department of Energy and Climate Change (DECC) and the UK Treasury

**Question B** – Type of respondent – Member State

**Question C** – Contact persons' details:

**Question D:**

Do you object to publication of your personal data because it would harm your legitimate interests? – **N**

Are any of your responses confidential? – **N**

**Other information:**

Please see **Annex A** of this document for detailed information on the UK's current Phase II auctions

## Section 2 – Survey questions

1	<p>As a general rule throughout the trading period, in your opinion, are early auctions necessary? If so, what should the profile of EUA auctions be?</p> <ul style="list-style-type: none"><li>• 5-10% in year n-2, 10-20% in year n-1, remainder in year n</li><li>• 10-20% in year n-2, 20-30% in year n-1, remainder in year n</li><li>• 20-30% in year n-2, 30-35% in year n-2, remainder in year n</li></ul> <p>Other? Please specify.</p> <p><b>Answer:</b></p> <p>The UK agrees that there is a need for early auctions and that they should be held during 2011, if practicable. Early auctions will provide allowances for hedging, will reduce the risk premium paid on the secondary market, and will increase market confidence in the ability of the system to deliver, especially for compliance purposes.</p> <p>There is a valid concern that the single community registry (SCR) may not be available to deliver spot allowances in 2011 and it will be extremely important that its development intersects with the development of Phase III auction design.</p> <p>With regards the profile of EUA auctions, it is very difficult to determine what the optimum level of early auctions should be. We currently do not have the knowledge to determine the split but would advise the Commission to do a thorough evaluation to ensure that the market is not flooded with allowances. The answer to Question 4 will give a clear idea as to the industry's need for allowances ahead of the phase.</p> <p>The need for early auctioning will be partially offset by banking of allowances between Phase II and Phase III. The New Carbon Finance modelling predicts 700Mt of banking into Phase III. The Commission will need to balance this surplus against the average EU hedging need to determine the number of allowances to be brought forward.</p> <p>Despite the importance of designing an appropriate auction profile we should not forget that the secondary market will play a crucial role in adjusting possible mistakes by providing/absorbing missing/excess allowances to/from EU ETS participants.</p>
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2	<p>Do you think there is a need to auction futures? If so, why so?</p> <p><b>Answer:</b>  The UK government can see that there are benefits to auctioning futures and would not preclude member states or the Commission from undertaking futures auctions. However, our current preference is to auction spot allowances for the following reasons:</p> <ol style="list-style-type: none"> <li>1. Auctioning futures adds complexity to the auction process</li> <li>2. Futures auctions are likely to be done via Exchanges, which may create barriers for smaller installations. It is likely that Governments would procure an Exchange as they have no comparative advantages in auctioning futures nor would they want to bear the counterparty risk.</li> <li>3. An effective secondary market already exists to provide futures to EU ETS participants and there is no reason why this should not continue. Secondary markets are better able to assess and bear the risks. Early spot auctions will reduce the risk premium charged on futures trades, to the benefit of both EU ETS participants and the secondary market.</li> </ol>
3	<p>What share of allowances should be auctioned spot and what share should be auctioned as futures for each year?</p> <p><b>SPOT FUTURES</b></p> <ul style="list-style-type: none"> <li>• year n : _____%   _____ %</li> <li>• year n-1 : _____%   _____ %</li> <li>• year n-2 : _____%   _____ %</li> </ul> <p>Please provide evidence to support your case.  NB: The answer to this Question will be published as part of the public consultation. Please do not submit confidential information as part of your answer to this question.</p> <p><b>Answer:</b>  The UK currently auctions spot only (i.e. sale of current EUAs with immediate settlement and immediate transfer of title). For the reasons highlighted in answer to Question 2, we are keen that the ability for a Member State to auction</p>

	<p>solely spot is provided for in the EU calendar.</p> <p>It is also important to ensure that there is an adequate supply of spot in the market in order to give equal access to installations that are unable to buy futures because of their credit score. Furthermore, an adequate supply of spot will increase liquidity and will be essential for the secondary markets to deliver the derivatives.</p>
4	<p>Should the common maturity date used in futures auctions be in December (so the maturity date would be December in year n, both when auctioning in year n-2 as when auctioning in year n-1)? If not, please suggest alternative maturity dates and provide evidence to support your view.</p> <p><b>Answer:</b>  The maturity date should be in December. We see no reason why Governments should try to establish different maturity dates. The December delivery contracts for futures have been established by the market as the industry standard and are very liquid. The December date gives buyers the allowances when they want to take delivery. If sufficient demand for futures with another maturity date were there, we would see some futures being written with that date. There is a risk that Government will receive diminished revenues if it sells futures with different maturity dates, which the market finds difficult to price, and therefore discounts.</p> <p>Unlike physical commodities, EUAs are an artificial product which is only needed at one time of the year (the compliance period). This is consistent with a single delivery date.</p> <p><b>CONFIDENTIAL QUESTIONS</b>  <b>Request for potentially confidential information 1</b>  Please send the answer to this question in paper and electronic format, marked on the envelope "Strictly Private and Confidential – Auctioning consultation", directly to the European Commission, DG ENV, Directorate C, Unit C2, to the attention of the Head of Unit, Office BU-5 2/1, 1049 Brussels, Belgium. It will be treated confidentially and will not be disclosed publicly.  For ETS operators: what share of your expected emissions covered by the EU ETS in a given year n do you hedge and how much in advance?</p>

	<ul style="list-style-type: none"> <li>• year n : _____%</li> <li>• year n-1 : _____%</li> <li>• year n-2 : _____%</li> <li>• earlier years (please specify) : _____%</li> </ul> <p><b>Request for potentially confidential information 2</b></p> <p>Please send the answer to this question in paper and electronic format, marked on the envelope "Strictly Private and Confidential – Auctioning consultation", directly to the European Commission, DG ENV, Directorate C, Unit C2, to the attention of the Head of Unit, Office BU-5 2/1, 1049 Brussels, Belgium. It will be treated confidentially and will not be disclosed publicly. What share of the annual quantity of allowances you intend to purchase via auctions would you wish to buy spot or futures respectively?</p> <p><b>SPOT FUTURES</b></p> <ul style="list-style-type: none"> <li>• year n : _____%   _____ %</li> <li>• year n-1 : _____%   _____ %</li> <li>• year n-2 : _____%   _____ %</li> </ul> <p>Please specify whether you are an:</p> <ul style="list-style-type: none"> <li>• ETS operator; or</li> <li>• other participant.</li> </ul>
<p><b>5</b></p>	<p>For spot auctions: What should be the <b>optimum</b> frequency of auctions? <b>Twice a week</b></p> <p>What should be the <b>minimum</b> frequency of auctions? <b>Weekly</b></p> <p>What should be the <b>maximum</b> frequency of auctions? <b>Daily</b></p> <p><b>Answer:</b></p> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>• The answer to this question considers frequency across the EU. For example, a system with 2 Member States holding fortnightly auctions would be indicated as ‘weekly frequency’.</li> <li>• In answering this question we are considering the whole auction pot (~1bn EUAs per year), without distinguishing</li> </ul>

	<p>between spot and futures.</p> <p>Approximately 25m EUAs were traded daily in 2008. Given the volumes of allowances to be auctioned across the EU (~1 billion year from 2013), frequent auctions will be necessary. Auctioning twice a week (~100 auctions/year) would results in volumes of approximately 10m EUAs, which would be quite easy for the market to absorb. Weekly auctions (~50/year) would have a volume of 20m and could possibly be absorbed without significant difficulties. Anything less frequent than weekly is probably sub-optimal. For example monthly auctions would have volumes of around 100m EUA –4 times the daily volumes. This would be hard for the market to absorb and could result in price depressions.</p> <p>Small, frequent auctions would a) lessen the impact on liquidity with gradual supply and b) smooth the price movements in the secondary market. Larger auctions risk causing volatility – more information is revealed in one go rather than over repeated weekly auctions. Feedback from the market confirms this point. Administration/bidding costs could create a constraint on more frequent auctions and this would need to be considered.</p> <p>Different auction processes will probably require different frequencies. For this reason the above preferences are indicative only and do not preclude alternative solutions to suit the model that will finally be chosen.</p>
<p><b>6</b></p>	<p>For spot auctions, what should be the:</p> <ul style="list-style-type: none"> <li>• Optimum auction size?</li> <li>• Minimum auction size?</li> <li>• Maximum auction size?</li> </ul> <p>If deemed appropriate, please indicate a range and/or distribution over different sizes. Please provide arguments to support your case.</p> <p><b>Answer:</b> Please see Question 5. We see no problem with all allowances being auctioned as spot, as the market will deliver futures for companies that want them.</p>

7	<p><b>Question 7</b> For futures auctions: What should be the <b>optimum</b> frequency of auctions?</p> <ul style="list-style-type: none"><li>• Weekly?</li><li>• Fortnightly?</li><li>• Monthly?</li><li>• Quarterly?</li><li>• Other?</li></ul> <p>What should be the <b>minimum</b> frequency of auctions?</p> <ul style="list-style-type: none"><li>• Weekly?</li><li>• Fortnightly?</li><li>• Monthly?</li><li>• Quarterly?</li><li>• Other?</li></ul> <p>What should be the <b>maximum</b> frequency of auctions?</p> <ul style="list-style-type: none"><li>• Weekly?</li><li>• Fortnightly?</li><li>• Monthly?</li><li>• Quarterly?</li><li>• Other?</li></ul> <p>Please provide arguments to support your case.</p> <p><b>Answer:</b> Please see Question 5 and 6</p>
8	<p>For futures auctions, what should be the:</p> <ul style="list-style-type: none"><li>• Optimum auction size?</li><li>• Minimum auction size?</li><li>• Maximum auction size?</li></ul>

	<p>If deemed appropriate, please indicate a range and/or distribution over different sizes. Please provide evidence to support your case.</p> <p><b>Answer:</b> Please see Question 5 and 6</p>
<p><b>9</b></p>	<p>Should volumes of spot allowances be auctioned evenly throughout the year? If not, how should volumes be distributed? (more than one answer possible) Please specify:</p> <ul style="list-style-type: none"> <li>• A larger proportion in the first 4 months of the year?</li> <li>• A larger proportion in December?</li> <li>• A smaller proportion in July and August?</li> <li>• Other? Please specify.</li> </ul> <p><b>Answer:</b></p> <ul style="list-style-type: none"> <li>• A larger proportion in the first 4 months of the year might be helpful leading up to compliance period.</li> <li>• The UK cannot see any benefits to holding an auction in December. In fact, in Phase II, the UK is not holding auctions in December (or August) due to the fact that the market is quiet during the holiday seasons.</li> <li>• A smaller proportion in July and August may be sensible as we would normally expect smaller sizes in the quieter summer months.</li> </ul>
<p><b>10</b></p>	<p>In case futures are auctioned, should the volumes for spot and futures auctions be spread over the year in the same manner? If not, how should they differ? (more than one answer possible)</p> <ul style="list-style-type: none"> <li>• No futures auctions less than six months before the maturity date.</li> <li>• A larger proportion in December.</li> <li>• A smaller proportion in July and August.</li> <li>• Otherwise? Please specify how and comment.</li> </ul> <p><b>Answer:</b> We cannot see any need for differentiating the way spot and futures auctions are spread over the year. Please see</p>



	Question 9 for our answer.
11	<p>Does the Regulation need to have provisions to avoid holding auctions during a short period of time before the surrendering date (30 April each year)?  If yes, how long should this period be:  One week <input type="checkbox"/> 2 weeks <input type="checkbox"/> 3 weeks <input type="checkbox"/> 1 month <input type="checkbox"/></p> <p>In case futures are auctioned, should there be similar provisions with respect to the period immediately prior to the maturity date?  If yes, how long should this period be:  One week <input type="checkbox"/> 2 weeks <input type="checkbox"/> 3 weeks <input type="checkbox"/> 1 month <input type="checkbox"/></p> <p><b>Answer:</b>  Provisions to avoid holding auctions during a short period of time before the surrendering date are operationally relevant for the central registry and intermediaries so they have sufficient time to onward deliver allowances and/or deal with any fails etc. Two weeks should give sufficient time for this and should be the maximum amount of time necessary following an auction to clear funds and deliver allowances. Auctions in this period could prove quite useful in the compliance process so any greater lead-time would be a constraint on providing an efficient and effective system. One of the key variables here is the practicality of delivering allowances and feeds into the workstream to deliver the single community registry. The UK would prefer a registry that delivers allowances in a matter of days (1-2), if not hours/minutes and if that could be achieved, then there would be less of a need to avoid having auctions close to the surrender date.</p>
12	<p>Which dates should be avoided? (more than one answer possible)</p> <ul style="list-style-type: none"> <li>• Public holidays common in most Member States?</li> <li>• Days where important relevant economic data is released?</li> <li>• Days where emissions data are released?</li> <li>• Other?</li> </ul> <p>Please specify the dates you have in mind in your answers.</p>

	<p><b>Answer:</b> The following dates should be avoided:</p> <ul style="list-style-type: none"> <li>• Public holidays</li> <li>• Days where emissions data is released.</li> <li>• Other days to avoid include futures delivery dates</li> </ul> <p>The use of ‘relevant economic data’ as criteria for choosing dates to avoid holding an auction, should strictly be limited to those days with greatest influence on the carbon price. It should be noted that the UK <sup>1</sup>currently auctions EUAs on Bank of England Monetary Policy Committee days.</p> <p>There will need to be a sensible approach to selecting those days where auctions cannot be held, in order to maximise the ability to hold a suitable number of auctions and avoid conflict/difficulties when creating the auction calendar.</p>
<p><b>13</b></p>	<p>Is a harmonised 10-12 hrs CET auction slot desirable? If not, what alternative(s) would you suggest?</p> <p><b>Answer:</b> The UK agrees that a harmonised time slot is desirable. This creates certainty and predictability for the market and can also be set to avoid other important times during the day e.g. when other data are released. UK Phase II auctions are currently held between 0900 and 1100 CET (0800-1000 GMT). The UK chose to auction at this time to avoid German power fixings and would therefore suggest a harmonised time of 0900-1100 CET.</p>
<p><b>14</b></p>	<p>How long in advance should each element of the calendar be determined?</p> <p>Annual volumes to be auctioned:</p> <ul style="list-style-type: none"> <li>• 1 year in advance</li> <li>• 2 years in advance</li> <li>• 3 years in advance</li> </ul>

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<sup>1</sup> For more information on UK Phase II auctions, please see Annex A

- more years in advance

Distribution of annual volumes over spot and futures (if applicable):

- 1 year in advance
- 2 years in advance
- 3 years in advance
- more years in advance

Dates of individual auctions:

- 1 year in advance
- 2 years in advance
- 3 years in advance
- more years in advance

Volume and product type for individual auctions:

- 1 year in advance
- 2 years in advance
- 3 years in advance
- more years in advance

Each auctioneer carrying out auction process (if more than one):

- 1 year in advance
- 2 years in advance
- 3 years in advance
- more years in advance

Please provide arguments to support your case.

**Answer:**

There is a need for certainty and advanced knowledge by the market, however this must be sensible and in some cases it will be difficult or inappropriate to hand out information too far in advance (especially in a developing system). There should be sufficient flexibility in the Regulation to change auction parameters in order to deal with for example, unexpected events. However, flexibility will need to be within bounds and the regulation will need to look to develop this. This is elaborated on in the bullet points below.

	<p>In delivering its current Phase II auctions, the UK is trying to strike the right balance between creating certainty and flexibility by announcing annual volumes in advance for the whole phase, and by publishing an annual calendar which sets out the distribution of annual volumes among different auction dates.</p> <p>The need for flexibility is highlighted in the fact that the UK calendar which announced annual volumes for the whole of Phase II had to be revised due to auctions starting later than originally planned. This had to be taken into account when making announcements to the market.</p> <ul style="list-style-type: none"> <li>• <b>Annual volumes to be auctioned:</b> a year ahead should be sufficient to provide some certainty and enough flexibility for change –but may want to provide ranges or indicative numbers for some years in advance.</li> <li>• <b>Distribution of annual volumes over spot and futures:</b> one year in advance should be enough</li> <li>• <b>Dates of individual auctions:</b> one year in advance with a provision to change if circumstances dictate (within bounds set by the Regulation).</li> <li>• <b>Volume and product type for individual auctions:</b> 1 year in advance with a provision to change if circumstances dictate (within bounds set by the Regulation).</li> <li>• <b>Each auctioneer carrying out auction:</b> an operational matter, so one year in advance should be more than enough.</li> </ul>
<p><b>15</b></p>	<p>What should be the volume of allowances to be auctioned in 2011 and 2012?</p> <ul style="list-style-type: none"> <li>• in 2011: __ % of the 2013 volume and __% of the 2014 volume</li> <li>• in 2012: __% of the 2013 volume and __% of the 2014 volume</li> </ul> <p>What percentage of these shares should be auctioned as futures?</p> <ul style="list-style-type: none"> <li>• in 2011: ____% of the 2013 share and ____% of the 2014 share</li> <li>• in 2012: __% of the 2013 share and __% of the 2014 share</li> </ul> <p>Please provide evidence to support your case.</p> <p><b>Answer:</b> The answer to this question follows on from our answer to Question 1 - some early auctions would be helpful in</p>

	<p>terms of reducing the IT/operational risk and assuring the markets that the system will be able to deliver the volume of allowances required when necessary. Early auctions would also encourage secondary market development and early price discovery.</p>
<p><b>16</b></p>	<p>What should be the rule with respect to allowances not auctioned due to force majeure?</p> <ul style="list-style-type: none"> <li>• They should automatically be added to the next auction on the calendar, irrespective of the auction process.</li> <li>• They should be auctioned within one month, though leaving flexibility as to which auction(s) the EUAs should be added.</li> <li>• They should be auctioned within three months, though leaving flexibility as to which auction(s) the EUAs should be added.</li> <li>• Other? Please specify.</li> </ul> <p><b>Answer:</b></p> <p>The answer to this question is dependent on the number of processes that are being used for Phase III auctioning. In a world with one platform, it would make sense to just add the allowances to the next auction on the calendar. However, a more realistic outcome is that there will be a number of auction platforms/processes operating across the EU. Member States auctioning on their own platforms will want to retain the ability to decide when next to auction their allowances and will therefore not support allowances being added to the next auction on the calendar, irrespective of the process.</p> <p>Therefore, our preferred approach is to leave the Member States the flexibility as to which auctions the EUAs should be added. This will depend on the volume of allowances to be auctioned. If there are a large number of allowances to be rolled over, then this could create an auctioning ‘event’ and potentially affect the price. It would seem more sensible to spread the allowances over subsequent auctions to avoid a large number being dumped onto the market at once.</p> <p>We would therefore advise that the allowances should be left to the same process/auctioneer who, depending on the volume has a 6-12 month window to distributes allowances amongst its following auctions.</p>

<p><b>17</b></p>	<p>Is 1,000 allowances the most appropriate lot size? If not, why not?</p> <p><b>Answer:</b>  The market has determined that 1000 strikes the right balance between providing participants with flexibility and reducing complexity and transaction costs. Therefore, a lot size of 1000 appears to be the optimal. However, it will be interesting to see whether the minimum lot size of 500 to be used in the German auctions (starting in 2010) is utilised, and this could be a solution to the issue of small emitters.</p> <p>In the UK, allowances in our competitive auctions are sold in lot sizes of 1000 (in line with the secondary market).</p> <p>For the non-competitive route, we have set the following bid sizes:</p> <ul style="list-style-type: none"> <li>• minimum = 1 allowance,</li> <li>• maximum = 10,000 allowances.</li> </ul> <p>The minimum size allows smaller emitters to get exactly the number of allowances they require. The maximum size restricts non-competitive bidding to small emitters. Note that non-competitive auctions are only open to permit holders in the EU ETS, so-called emitters or compliance buyers.</p>
<p><b>18</b></p>	<p>Is a single-round sealed-bid auction the most appropriate auction format for auctioning EU allowances?  If not, please comment on your alternative proposal?</p> <p><b>Answer:</b>  The single-round sealed-bid model is simple. Simplicity is an important requirement for EU ETS given that, as an allocation methodology, it should be straightforward for installations to access allowances. Simplicity is particularly important for smaller emitters, who might be put off taking part in more complex auctions. Moreover, many potential bidders are already familiar with this format, as single-round models are common practice in power markets and Government securities. Summing up, the single-round will ensure accessibility and increase the chances of high participation levels. High participation will present the additional benefit of reducing the chances of collusion.</p>

	<p>A second advantage of having a simple auction design is its potential acceptability by other EU Member States, which could help with coordination of auction methodology in future. Some Member States who auctioned in Phase I of the EU ETS used this model (e.g. Ireland, Hungary, Lithuania).</p> <p>Single-round auctions reduce the chances of collusion by ensuring high-participation –see above, and by preventing ‘gaming’. Their single round format makes gaming more unlikely than in multiple round auctions. It makes it difficult, for example, for participants to make ‘bidding signals’ and rules out the chance of bidders retaliating in later rounds against other players who fail to ‘collude’ (as could happen under multiple-round auction models).</p>
<p><b>19</b></p>	<p>What is the most appropriate pricing rule for the auctioning of EU allowances?</p> <ul style="list-style-type: none"> <li>• Uniform-pricing.</li> <li>• Discriminatory-pricing.</li> <li>• Indifferent.</li> </ul> <p>Please provide arguments to support your case.</p> <p><b>Answer:</b>  Uniform price. This again maximises participation as it enables even the uninformed to bid without fearing that they will pay massively over the odds. This is particularly relevant for smaller players. The main attribute of discriminatory pricing is that it may deter market manipulation. However, we believe that single-round models will be sufficient for this purpose.</p> <p>The evidence is unclear as to whether either system might produce more revenue. At first glance you would expect discriminatory pricing to raise more revenue. However, this system will also encourage participants to bid lower and so could actually raise less than the uniform price.</p>
<p><b>20</b></p>	<p>Should the rules for solving ties in the Regulation be:</p> <ul style="list-style-type: none"> <li>• random selection; or</li> <li>• pro-rata re-scaling of bids?</li> </ul> <p>Please comment on your choice.</p>

	<p><b>Answer:</b> Pro-rata scaling is much fairer and easier to implement. Random selection could be open to challenge and may require evidence of the selection process –which could raise issues around confidentiality.</p>
<p><b>21</b></p>	<p>Should a reserve price apply?</p> <p><b>Answer:</b> Yes. There needs to be some mechanism to protect against a very large discounted price that could shock the market and damage the credibility of the auction process. This is essential for dealing with uncovered auctions. The alternative is providing the auctioneer discretion to reject bids but this may well be less desirable from a market perspective.</p> <p>The UK's approach of announcing the calculation procedure without revealing the discount rates and target indexes is aimed at striking the right balance between transparency and preventing the reserve price to be used as an index around which to concentrate bids.</p> <p>A dynamic reserve price should be set to protect the system. This would be set at a suitable discount to the prevailing secondary market price. There should not be a fixed reserve price –so called price floor. Procedures could be agreed among auctioneers to set out a common reserve price methodology.</p> <p>Note that uniform-price auctions price always carry the risk that a final few percentage of bids may materially alter the clearing price to the detriment of the auctioneer. This further strengthens the need for a reserve price.</p>
<p><b>22</b></p>	<p>In case a reserve price would apply, should the methodology/formula for calculating it be kept secret? Please comment on your choice.</p> <p><b>Answer:</b> Yes. There is a risk that participants may use the information to submit prices around the reserve price on the off-</p>



	<p>chance that they could pick up some cheap allowances –knowing the reserve price is high enough to be accepted but guarantees an allocation at a discounted price in the event of an uncovered auction. Also, if the actual reserve price is published before the auction it becomes a minimum price rather than a reserve price. Finally, a reserve price fixed and published in advance could not incorporate the latest market information and would therefore not be set at the optimal level.</p>
23	<p>Is a maximum bid-size per single entity desirable in a uniform-price auction? Is a maximum bid-size per single entity desirable in a discriminatory-price auction? Please comment on your choice.</p> <p><b>Answer:</b> No, a maximum bid size is not desirable. A maximum bid-size per single entity is desirable in a uniform-price or in a discriminatory-price auction only if there is a risk of one entity squeezing the market of EUAs, which is unlikely given the high number of issuers, the size and liquidity of the secondary market, and the fungibility of the instrument.</p>
24	<p>If so, what is the desirable bid-size limit (as a percentage of the volume of allowances auctioned per auction – only one choice is possible): 10%: <input type="checkbox"/> 15%: <input type="checkbox"/> 20%: <input type="checkbox"/> 25%: <input type="checkbox"/> 30%: <input type="checkbox"/> More than 30%: <input type="checkbox"/> Please specify. Please comment on your choice.</p> <p><b>Answer:</b> See Question 23</p>
25	<p>In case only one of the two following options would be chosen, to limit the risk of market manipulation or collusion, which one would be preferable?</p> <ul style="list-style-type: none"> <li>• A discriminatory-price auction format?</li> <li>• A maximum bid-size per single entity?</li> </ul> <p>Please comment on your choice.</p>

	<p><b>Answer:</b>  The UK doesn't support either option. Market manipulation should be dealt with through other features of the auction process. On maximum bid-size per single entity – please see our answer for Question 23. On using a discriminatory-price auction –please see our answer for Question 19.</p>
<p><b>26</b></p>	<p>Are the following pre-registration requirements appropriate and adequate?</p> <p><b>Answer:</b>  The UK Government believes that robust checks should be applied to all EU ETS participants, irrespective of whether or not they bid at auctions. Consistent, harmonised and rigorous checks for all EU ETS account holders would boost confidence in EU ETS. These would also streamline the work of the auctioneers, as only a few additional checks would probably be required for prospective bidders. For this reason the UK would welcome the Commission tackling this issue at the appropriate level.</p> <p>The second-best solution –narrowing the scope to auctions only, should try to make the most of existing rules. Avoiding money laundering and terrorist financing represent two of the main reasons why checks are undertaken. We understand that entities covered by the Anti Money Laundering Directive (AMLD) are obliged to tackle these issues. However, not all potential auction processes would seem to include businesses covered by the current AMLD. We therefore think that it would be a good idea if all businesses undertaking checks on potential bidders were covered by the AMLD (as transposed in each MS), and would therefore suggest that the Regulation is made to extend its provisions.</p> <p>Additional objectives –e.g. to verify bidders' creditworthiness, can also be pursued through specific pre-registration requirements. The Regulation could take care of these objectives by setting minimum levels of pre-registration requirements, which are conducive to their achievement. This would strike the right balance between boosting confidence in the European auction process and giving Member States the flexibility of going further as necessary. Defining additional objectives and detailed pre-registration requirements will better be tackled during the forthcoming comitology process.</p>

27	<p>Do you agree that the pre-registration requirements for admittance to EU auctions should be harmonised throughout the EU?  Yes [ ] No [ ]  Please comment on your choice.</p> <p><b>Answer:</b>  See answer to Question 26 - the UK would suggest that the Commission develops a minimum set of requirements to avoid bidders shopping around, boost confidence in the whole system, and provide MS with the necessary flexibility.</p>
28	<p>Should the amount of information to be supplied in order to satisfy the pre-registration requirements for admittance to EU auctions depend on the:</p> <ul style="list-style-type: none"> <li>• means of establishing the trading relationship;</li> <li>• identity of bidder;</li> <li>• whether auctioning spot or futures;</li> <li>• size of bid;</li> <li>• means of payment and delivery;</li> <li>• anything else? Please specify.</li> </ul> <p>If so, what should the differences be?</p> <p><b>Answer:</b>  No. The proposals highlighted in answer 26 (extension of AML and minimum levels for additional pre-registration requirements) already provide MS with the possibility of discriminating between bidders. Fixed and uniform criteria set out in the Regulation would reduce effectiveness and efficiency of the checking system. A minimum set of requirements would strike the right balance between harmonisation and Member State flexibility to discriminate as appropriate.</p>
29	<p>Should the bidder pre-registration requirements under the Regulation apply in the same manner irrespective of whether or not the auctioneer is covered by the MiFID or AML rules?  If not, why not?</p>

	<p>Please provide arguments to support your case.</p> <p><b>Answer:</b>  Yes, we do not see any reason why this should not be case. However, our proposal envisages that all entities performing pre-registration are covered by the AMLD.</p> <p>On the other hand we do not think that MiFID, a directive to protect clients of investment firms, is really relevant when talking about pre-registration. First, bidding is not always an investment activity, and Governments are not investment firms. Second we believe that the main purpose of auction pre-registration should be to assess the integrity of bidders, not to protect them against Member State Governments. MiFID-based requirements will continue to apply in relation to MiFID business done by firms subject to MiFID. They will be inapplicable to an entity not subject to MiFID (e.g. a government auctioneer), or if no MiFID “financial instrument” is involved i.e. if auctioning spot allowances.</p>
<p><b>30</b></p>	<p>Do you agree that the auctioneer(s) should be allowed to rely on pre-registration checks carried out by reliable third parties including:</p> <ul style="list-style-type: none"> <li>• Other auctioneers?</li> <li>• Credit and/or financial institutions?</li> <li>• Other? Please specify.</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b>  Yes, checks by other regulated professions/parties should be admissible. The key requirement here is that a robust accreditation process must be undertaken for those carrying out such checks. If the AML Directive requires some form of vetting of the parties concerned –as in the UK, the reliable third parties could be defined as those covered by the AMLD. To undertake these checks, a relied upon institution must agree to being relied upon, and agree to provide the due diligence information on request. The relying institution still remains legally liable for due diligence.</p>
<p><b>31</b></p>	<p>In order to facilitate bidder pre-registration in their home country, should the auctioneer(s) be allowed to provide for</p>

	<p>pre-registration by potential bidders in other (or all) Member States than the auctioneer's home country e.g. by outsourcing this to a reliable third party?  Yes [ ] No [ ]  Please comment on your choice.  If so, should such entities be:</p> <ul style="list-style-type: none"> <li>• Covered by the AML rules?</li> <li>• Covered by MiFID?</li> <li>• Covered by both?</li> <li>• Other? Please specify.</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b>  Yes. We think that such entities should be covered by AML rules -see answer to Question 30, but do not think that MiFID is relevant when talking about pre-registration -see answer to Question 29.</p>
32	<p>Should the Regulation prohibit the multiplicity of pre-registration checks in the case of Member States auctioning jointly?  Yes [ ] No [ ]  Please comment on your choice.</p> <p><b>Answer:</b>  As stated in our answer to Question 26, even if minimum standards are applied, Member States should retain the flexibility to be able to go further if needed.</p> <p>For example, if two Member States decided to build a common platform but auctioned their allowances on different dates, then we should allow for the possibility of different types of pre-registration being set out –where increased risk by a MS is perceived, they should retain the ability to go further in their checks.</p> <p>The situation would be different if the allowances of two or more MS were auctioned on the same date. In this case a</p>

	common type of pre-registration would probably be unavoidable.
33	<p>Do you agree that the level of collateral accepted in EUA auctions should be harmonised for all EU ETS auctions? If so, how should they be harmonised? If not, why not?</p> <p><b>Answer:</b> No. Different auction processes may present different counterparty risks and hence different collateral requirements.</p> <p>For example in the UK competitive model, primary participants are directly responsible for paying all winning bids - both their own bids and those submitted on behalf of indirect bidders. Given the high creditworthiness of the UK's primary participants, the UK Government does not require collateral for this model. On the other hand, in the UK non-competitive model, compliance buyers will be provided with direct access and will be financially liable for their bids. Given the open-access nature of non-competitive auctions, collateral will be accordingly required.</p>
34	<p>Do you agree that the type of collateral accepted in EUA auctions should be harmonised for all EU ETS auctions? If so, how should they be harmonised? If not, why not?</p> <p><b>Answer:</b> This issue needs further investigation and this will be carried out during the following months. Our preliminary view is that a consistent approach to the collateral requirements might be sensible.</p> <p>The Financial Collateral Directive (FCD) contains a degree of optionality, allowing different Member States to implement it according to local market needs. With respect to EUA auctions, however, it might be preferable to establish protections comparable to those in the FCD, rather than restricting acceptable collateral to those deposited with a central counterparty or clearing house covered by the FCD.</p> <p>It should be noted that as a result of recent liquidity constraints in the financial markets, market participants have</p>

	<p>been exploring the use of new forms of collateral, not all of which are adequately taken into account in existing regulations. It is important that any regulatory regime adopted does not act as a bar to commercial innovation and market solutions to constraints on the availability of traditional forms of collateral.</p> <p>Accordingly, advancing existing or equivalent protections to cover the relevant transactions may be preferable to restricting transactions to those capable of being performed under existing regimes.</p>
<p><b>35</b></p>	<p>Do you agree that 100% collateral in electronic money transfer ought to be deposited up-front at a central counterparty or credit institution designated by the auctioneer to access spot auctions? If not, why not? What alternative(s) would you suggest? Please provide arguments to support your case.</p> <p><b>Answer:</b> Different auction processes may present different collateral requirements (see answer to Question 34). Much will depend on (a) the settlement system i.e. who pays/delivers first, and (b) the creditworthiness of the bidder.</p> <p>On the second point, where bidders have established creditworthiness, as part of pre-registration, auctioneers may consider the posting of collateral unnecessary - as is the case in the UK competitive auctions. But if the auction model is to provide access for all, then some form of deposit would probably be required to avoid deliberate fails. The deposit would probably need to be greater than 100% to protect against price fluctuations and to ensure that people get the allowances they need.</p>
<p><b>36</b></p>	<p>In case futures are auctioned, should a clearing house be involved to mitigate credit and market risks? If so, should specific rules – other than those currently used in exchange clearing houses – apply to:</p> <ul style="list-style-type: none"> <li>• the level of the initial margin;</li> <li>• the level of variation margin calls;</li> <li>• the daily frequency of variation margin call payments?</li> </ul> <p>If you have answered yes, please justify and elaborate on the rules that should apply and the mechanisms to implement them.</p>

	<p><b>Answer:</b>  In order to auction futures, a clearing house is necessary in the transaction as a central counter-party (CCP). A CCP can mitigate counterparty credit risk and operational risk and provide greater legal certainty.</p> <p>As the trades a CCP will clear will have, depending on the volatility and liquidity of the instrument and counterparty risk of market participants, a changing risk profile, a CCP must be able to decide for itself what are appropriate initial margin, variation margin and daily frequency of variation margin call. For instance, in a normal market you may expect variation margin call to be only be called once a day; in an extremely volatile market it would not be unreasonable for a CCP to call for variation margin call payment every hour. To stipulate these levels does not acknowledge the risk-based nature of these fees and could make government liable for any exposure a CCP may have if these fees do not cover a member's default. The UK therefore does not agree that specific rules should be stipulated.</p>
<p><b>37</b></p>	<p>What are the most preferable payment and delivery procedures that should be implemented for auctioning EUAs?</p> <ul style="list-style-type: none"> <li>• Payment before delivery.</li> <li>• Delivery versus payment.</li> <li>• Both.</li> </ul> <p><b>Answer:</b>  Delivery versus payment is preferable to minimise credit risk for all market participants.</p> <p>For spot auctions, a depositary that can facilitate the simultaneous movement of cash and allowances in the same place needs to be in place in order for this to happen. This would require a link to a functioning registry and preferably central bank money so that the payments are effectively guaranteed.</p> <p>For futures auctions, where central counterparties/clearing houses are employed, delivery-versus payment would seem the more appropriate option.</p>



<p><b>38</b></p>	<p>Irrespective of the payment procedure, should the Regulation fix a maximum delay of time for payment and delivery to take place? If yes; what should it be?</p> <ul style="list-style-type: none"> <li>• 4 working days [ ]</li> <li>• 5 working days [ ]</li> <li>• 6 working days [ ]</li> <li>• 7 working days [ ]</li> <li>• Other, please specify.</li> </ul> <p><b>Answer:</b> Ideally, payment and delivery should be as close together as possible, and as close to the auction as possible. This will of course be dependent on the functioning of the single community registry. In the UK, the settlement date is two days after the auctions. Currently, delivery of the allowances takes longer due to the functioning of the registry.</p>
<p><b>39</b></p>	<p>Should the Regulation provide any specific provisions for the handling of payment and delivery incidents or failures? If yes, what should they be?</p> <p><b>Answer:</b> In line with current exchange practices, interest should be charged in the case of a payment failure. In the UK, where payment for allowances is not received by the settlement date, any outstanding amount is payable on demand and the Government may – a) require that account holder to pay interest for each day beginning with the settlement date and ending on the date on which payment is made at the relevant interest rate, calculated on a daily basis, b) decide not to transfer allowances to the account holder.</p> <p>Allowances will have to be delivered as soon as reasonably practicable after the auctions. Given the regulatory relationship between the entity auctioning allowances (the MS) and the bidder – see Question 40, participants should and would be entitled to usual remedies for the breach of public law in the event of non-delivery. From this point of view, the integrity of the registry is paramount and we encourage the Commission to ensure that all systems for which it is responsible are designed and operate so as to limit the possibility that a Member State is unable to</p>

	deliver allowances to successful bidders.
40	<p>Should the Regulation provide for all matters that are central to the very creation, existence and termination or frustration of the transaction arising from the EUA auctions? If not, why not?  If so, are the matters enumerated below complete?</p> <ul style="list-style-type: none"> <li>• The designation of the parties' to the trade.</li> <li>• The characteristics of the auctioned product:</li> <li>• Nature: EUAs or EUAAs, trading period concerned.</li> <li>• Date of delivery: date at which winning bidders will receive the allowances on their registry account.</li> <li>• Date of payment: date at which payment will be required from winning bidders.</li> <li>• Lot size: number of allowances associated with one unit of the auctioned good.</li> <li>• Events of 'force majeure' and resulting consequences.</li> <li>• Events of default by the auctioneer and/or the bidder and their consequences.</li> <li>• Applicable remedies or penalties.</li> <li>• The regime governing the judicial review of claims across the EU.</li> </ul> <p>If not, what additional matters should be foreseen in the Regulation and why?</p> <p><b>Answer:</b></p> <p>The Consultation Document to which this question relates suggests that a contractual relationship exists between the entity auctioning allowances and the bidder. In part this is because of the use of phrases such as "notice to auction" and "intention to bid" –which import the idea of a contract.</p> <p>We think that it is wrong to suggest a contractual relationship. The relationship between the entity auctioning allowances (ultimately the Member State) and the bidder is a purely regulatory relationship. This is because EUAs only exist by virtue of a legislative act (EU ETS Directive) which requires participants to acquire EUAs for compliance purposes.</p> <p>The UK Government has designed auctions to ensure that it is clear that this key relationship is regulatory, not contractual. So public law (the law governing the relationship between individuals and the state) not the private law</p>

of contract applies.

This has significant consequences. In particular, it means that remedies are appropriately limited. Apart from those expressly referred to in the UK legislation governing auctioning -see [here](#), the only remedies for participants are those for breach of public law –bringing a Judicial Review on the ground of either illegality, or irrationality, or unreasonableness, or procedural impropriety of the administrative decision.

When designing the UK model, it seemed to us that the only matters which could lead to the need for remedies are failure in the delivery of allowances and failure to pay for allowances. We therefore regulated for these situations with express and specific provision in our law (see answer 39 and our [legislation](#)). This means that there is no need for recourse to the courts in relation to the auctioning process unless there is a breach by the UK of public law.

There are real and worrying consequences for state liability, for example, for damages for breach of contract, if the regulatory relationship were to be characterised by the Regulation as a contractual one.

In the UK model the Government authorises, under regulatory legislation, Primary Participants. The relationship between the UK government and Primary Participants is set out in legislation and is not a matter of contract. It is Primary Participants who acquire allowances from the UK government under the provisions set out in the legislation.

The relationship between Primary Participants and indirect bidders is partially regulated by the UK legislation which governs the behaviour of Primary Participants and is partially a matter of the private law of contract. The regulatory requirements on Primary Participants governing their behaviour are to seek to ensure equal treatment, non-discrimination, fairness, equal access to auctions, transparency and to prohibit as far as possible the potential for abuse by Primary Participants of their special position (confidentiality and "Chinese Wall" requirements).

We think that this structure should be mirrored in any relevant provisions in a Community Regulation, subject to the Community model ultimately chosen for auctioning. In particular, the regulatory relationship between the bidders and the auctioneer acting on behalf of the Governments will need to be respected when formulating force majeure events, events of default, remedies or penalties.

	<ul style="list-style-type: none"> <li>• Events of force majeure and its consequences. As stated in answer 16, we would advise that the allowances not auctioned due events of force majeure should be auctioned by the same process/auctioneer within 6-12 months. There should be no other consequences/remedies except in public law (e.g. if the MS announces that it will postpone an auction alleging force majeure and this is irrational/unreasonable, a participant could go to court for a declaration that this announcement is wrong and seek a mandatory order for the auction to go ahead).</li> <li>• Events of default and its consequences. These include payment and delivery failures. We would advise that these are addressed in line with the UK approach as set out in answer 39 –with payment failures addressed by the way of interest charges or refusal to transfer allowances, and with delivery failures addressed by entitling bidders to usual remedies for the breach of public law.</li> <li>• Applicable remedies or penalties. In the UK model the Government has power to ‘name and shame’ Primary Participants who breach our rules, and criminal penalties imposed for breach of confidentiality provisions. However, the issue of which penalties should apply will strongly depend on the model chosen –i.e. on the opportunities for mischief arising as a consequence of its adoption.</li> <li>• The regime governing the judicial review of claims across the EU. We would be grateful if the Commission could clarify in what way do they think the Regulation would deal with the regime governing JR</li> </ul> <p>We would be happy to discuss this further with the Commission if we can be of assistance in clarifying this structure.</p>
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<p><b>41</b></p>	<p>Should the Regulation provide for rules on jurisdiction and the mutual recognition and enforcement of judgments?  If so, should these be:</p> <ul style="list-style-type: none"> <li>• specific to the Regulation;</li> <li>• by reference to the Brussels I Regulation;</li> <li>• by citing exceptions from the Brussels I Regulation;</li> <li>• by citing additions to the Brussels I Regulation?</li> </ul> <p>Please comment on your choice.  If not, why not?</p>
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**Answer:**

**See Question 40 for background to this answer.**

In answer to Question 41 - To the extent a Primary Participant -type model is adopted, given the Brussels Convention already applies to private contracts, it would appear that the provisions of that Convention would automatically apply anyway to the contractual relationship between the PP and the indirect bidder (but NOT to the regulatory relationship between Government/Member State and the PPs). If this is the case, there would be no reason for the Regulation to make any further provision in relation to the contractual relationship, or even to expressly cite the application of Brussels.

It is unclear as to whether the consultation document is saying that Brussels would not automatically apply to contracts between an intermediary and indirect bidders arising out of the auctioning of allowances. It would be helpful if the Commission could provide further information on this.

Brussels principles cannot be applied to legal disputes **other than** those arising in matters relating to a private law contract – the principles would not be capable of being applied to public law disputes (again, see Question 40 for details on this point).

**Brussels I regulation – background information**

1 Amongst other exclusions, the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (the Brussels Convention) **does not** apply to revenue, customs or administrative matters.

2 Jurisdiction. A person/company domiciled in a Contracting State may, in another Contracting State, be sued in matters relating to a contract, in the courts for the place of performance of the obligation in question - for example, goods purchased from a company registered in Italy to be delivered to a person domiciled in England may be sued in the English courts for breach of contract if the goods are not delivered. However, this basic principle is qualified. If one or more of the parties to a legal relationship is domiciled in a Contracting State, and the parties have agreed in writing that the courts of a particular named Contracting State are to have exclusive jurisdiction to settle any disputes, then

	<p>those courts will have such exclusive jurisdiction.</p> <p>3 As to whether a person is lawfully domiciled in a State, the court will apply the laws of that State to determine the answer.</p> <p>4 <u>Recognition.</u> Subject to some exceptions cited in Articles 27/28, a Judgment given in a court of a Contracting State will be recognised in another Contracting State without any special procedure being required.</p> <p>5 <u>Enforcement.</u> If a person fails to comply with a Judgment it will be necessary for the interested party to take enforcement action to compel compliance. A Judgment may be enforced in another Contracting State once it has been declared enforceable by a court in that other Contracting State. The procedure for making an application for such a declaration is governed by the law of the State in which enforcement is sought. The substance of the original Judgment may not be reviewed. The court has to give its decision without delay. The decision of the court (whether it enforces or refuses to enforce the Judgment) may be appealed.</p> <p>6 All Contracting States remains free to enter into further conventions with third countries to recognise and enforce Judgments in those territories.</p>
<p><b>42</b></p>	<p>Which auction model is preferable?</p> <ul style="list-style-type: none"> <li>• Direct bidding?</li> <li>• Indirect bidding?</li> <li>• Both?</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b> The regulation should allow for both, providing appropriate common rules for their implementation. The UK sees no reason why only one specific model should be prescribed in the regulation.</p>

	<p>The UK currently uses the Indirect Bidder model and see the following benefits:</p> <ul style="list-style-type: none"> <li>- It minimises credit, settlement and operational risks by interfacing with a smaller number of counterparties</li> <li>- It provides an efficient means of administering the auction process, including carrying out anti-money laundering obligations and collecting payment and delivering EUAs</li> <li>- It aids development of the secondary market by providing Primary Participants (PPs) a direct means of accessing EUAs at issue and business relationship to develop between PPs and IBs</li> <li>- It provides the auctioneer/issuer a direct relationship with key market participants and market intelligence</li> <li>- It provides greater flexibility for contingency measures due to the lower number of direct participants</li> <li>- The model is intended to be scalable in that the pyramid structure should allow a greater number of allowances to be channelled into the auction without a significant increase in resource to administer the auction.</li> </ul>
<p><b>43</b></p>	<p>If an indirect model is used, what share of the total volume of EU allowances could be auctioned through indirect bidding? Please provide arguments to support your case.</p> <p><b>Answer:</b> There are no linkages between model used and percentage of allowances to be auctioned.</p>
<p><b>44</b></p>	<p>If the primary participants model is used, what provisions would be desirable for mitigating disadvantages of restricting direct access (more than one answer is possible):</p> <ul style="list-style-type: none"> <li>• Allow direct access to largest emitters, even if they trade only on their own account? If so, who should have direct access and what thresholds should apply?</li> <li>• Disallow primary participants trading on their own account?</li> <li>• Impose strict separation of own-account trading from trading on behalf of indirect bidders?</li> <li>• Other? Please specify.</li> </ul> <p><b>Answer:</b></p> <ul style="list-style-type: none"> <li>• Allowing direct access to the largest emitters, even if they trade only on their own account, is operationally</li> </ul>

	<p>possible. However, it reduces the benefit to other primary participants of having larger clients. Most importantly, allowing direct access to some Indirect Bidders raises issues around discrimination. This is a matter of Community law, which would exist in any model where there is differential access to competitive auctions. Equal treatment and non-discrimination are fundamental principles of Community law.</p> <ul style="list-style-type: none"> <li>• Disallowing primary participants from trading on their own account is ineffective. If this were allowed no one would apply to be a primary participant because the role would only amount to being an administrator (akin to the third party model). Unless fees were very attractive, Member States would be highly unlikely to get anyone to perform the function.</li> <li>• Imposing strict separation of own-account trading from trading on behalf of indirect bidders is the most effective and practical solution and has accordingly been chosen by the UK. See Question 45 for further detail.</li> </ul>
45	<p>If the primary participants' model is used, what conflict of interest requirements should be imposed? (more than one answer possible)</p> <ul style="list-style-type: none"> <li>• Separation of client registration and trading on behalf of clients from all own account trading activities.</li> <li>• Separation of collateral management, payment and delivery on behalf of clients from all own account trading activities.</li> <li>• Separation of anything else, please specify.</li> </ul> <p><b>Answer:</b> Separation of trading on behalf of clients from all own account trading activities is desirable. Separation of other activities, including client registration, is not desirable – as this cannot reveal client's trading/industrial strategies.</p> <p>In the UK model, the primary participants have to abide by the terms set out in the Scheme<sup>2</sup>. They must prevent the disclosure of confidential information (as defined in the Regulations<sup>3</sup>) from the client side of the business to the side</p>

<sup>2</sup> The Scheme sets out how auctions will be conducted and the terms governing participation. The Scheme was published by HM Treasury on 29 July and can be found at:

[www.hm-treasury.gov.uk/d/euetsscheme050808.pdf](http://www.hm-treasury.gov.uk/d/euetsscheme050808.pdf)

The Scheme was amended on 23 April 2009. The amended Scheme can be found at:

[www.hm-treasury.gov.uk/consult\\_community\\_emissionscheme.htm](http://www.hm-treasury.gov.uk/consult_community_emissionscheme.htm).



	<p>that is responsible for the preparation or submission of any bid on its own account. The entity conducting an auction must be satisfied that the organisation has adequate internal systems and procedures in place to prevent the disclosure of confidential information provided by its clients during the bidding process.</p> <p>Organisations wishing to become Primary Participants have to describe, in practical terms, in their application to the Department of Energy and Climate Change, how their organisation will prevent the disclosure of information from the part of the organisation responsible for i) handling requests from account holders to bid on their behalf and ii) submitting bids on behalf of indirect bidders to the part of the organisation responsible for preparing and submitting bids on its own behalf. Applicants should show evidence in their application that adequate systems and procedures have been put in place to meet this requirement. An example of such evidence could be the physical separation of those responsible for the preparation and submission of bids on behalf of indirect bidders from those responsible for the preparation and submission of bids on the Primary Participant's own account during the bidding window. This could be supported by evidence such as the logistical arrangements by which bids will be submitted (e.g. bids will be submitted using different Bloomberg terminals and logins) and internal policies on communications and disclosure. These examples are not exhaustive.</p> <p>This requirement is intended to protect the interests of indirect bidders to ensure that their bid information is not used by a Primary Participant in such a way that the Primary Participant gains a commercial advantage as a result of its position in an auction.</p> <p>Subject to certain exceptions, confidential information (as defined in the Regulations) may not be disclosed. It is a criminal offence to wrongfully disclose confidential information. On conviction a person shall be liable to a fine.</p>
46	<p>What obligations should apply to primary participants acting in EU-wide auctions as:</p> <ul style="list-style-type: none"> <li>• Intermediaries? – where we are in the uk</li> <li>• Market makers?</li> </ul>

<sup>3</sup> The Regulations came into force on 11 July 2008 and can be found at: [www.opsi.gov.uk/si/si2008/pdf/uksi\\_20081825\\_en.pdf](http://www.opsi.gov.uk/si/si2008/pdf/uksi_20081825_en.pdf)  
The Regulations have subsequently been amended to allow for criminal penalties. The Amendment Regulations can be found at: [www.opsi.gov.uk/si/si2008/pdf/uksi\\_20081939\\_en.pdf](http://www.opsi.gov.uk/si/si2008/pdf/uksi_20081939_en.pdf)

	<p>Please provide arguments to support your case.</p> <p><b>Answer:</b> <b><u>Intermediaries</u></b> In order to act as fully functioning primary participants, the obligation to act as an intermediary must be imposed. In the UK, the terms for primary participants are set out in the <a href="#">Scheme</a> rules. A primary participant is an account holder who is approved by the person conducting the auction (DECC) to submit bids in an auction on behalf of another account holder (i.e. is obliged to act as an intermediary). The primary participant must ensure that it has or will have in good time before the opening of the bidding window of the auction, adequate internal systems and procedures to enable it to process requests from account holders to instruct the primary participants to act as agent in an auction and to participate effectively in an auction and in particular to submit bids on behalf of and collect payment from and transfer allowances to Indirect Bidders from who it acts.</p> <p><b><u>Market makers</u></b> A market maker is obliged to make a two-way market (i.e. offer a price at which to buy and to sell regardless of their own position). This can expose market makers to market risks especially in volatile markets where the price is not stable. In the UK, we didn't feel this was an obligation that would attract firms to the Primary Participant role. There is nothing stopping anyone making a market in this way (i.e. most of our Primary Participants are probably quite prepared to offer two-way prices), but placing obligations to do so would be off-putting in such a young market.</p> <p>Eventually, an obligation for primary participants to act as market makers could be imposed once the market has matured further, although this may be difficult to practically impose and monitor.</p>
<b>47</b>	<p>Under what conditions should auctioning through exchanges be allowed (more than one answer possible):</p> <ul style="list-style-type: none"><li>• Only for futures auctions open to established members of the exchange?</li><li>• Also for spot auctions open to established members of the exchange?</li><li>• Only when the exchange-based auction is open to non-established members on a non-discriminatory cost-effective basis?</li><li>• Other? Please specify.</li></ul>

	<p>Please provide arguments to support your case.</p> <p><b>Answer:</b> Exchanges currently offer spot and futures and as such, exchanges should be permitted to hold both futures and spot auctions. This should be left open so as to add flexibility.</p> <p>On the third point, it is not entirely clear as to what is being proposed. We feel that this should be left to bargaining between procuring entities and the exchange. Current solutions do already exist in the shape of 'odd-lot specialists'. It is perfectly possible that exchanges will devise new solutions as the carbon market develops, for example forms of restricted membership allowing access to EU ETS auctions only.</p> <p>See Question 49 for more detail on the UK's position on small emitters.</p>
48	<p>Should direct auctions through:</p> <ul style="list-style-type: none"> <li>• third party service providers; or</li> <li>• public authorities be allowed?</li> </ul> <p>If not, why not?</p> <p><b>Answer:</b> Yes – direct auctions should be allowed through third party service providers and public authorities. These entities must have the right expertise, be operationally reliable, have a trusted reputation and satisfy the necessary criteria.</p> <p>In the UK, the Department of Energy and Climate Change (a public authority) has appointed the Debt Management Office (also a public authority) to act as its agent in running auctions for Phase II. The UK has so far successfully carried out four auctions and dispersed 16.4 million allowances to the market.</p> <p>The UK has also procured a third party service provider (Computershare Investor Services - CIS) to administer its non-competitive auctions.</p>

	For more information see on the UK's non-competitive auctions, see Question 49.
49	<p>Do the general rules for auctioning EUAs suffice for ensuring full, fair and equitable access to allowances to SMEs covered by the EU ETS and small emitters? If not, why not?</p> <p><b>Answer:</b></p> <p>In answering this question, the UK is assuming that the Commission is asking whether the regulation (the general rules?) needs to provide bespoke avenues for SMEs and small emitters to access allowances.</p> <p>The UK is not fully convinced that special provision is needed for small emitters. This is because:</p> <ul style="list-style-type: none"> <li>- The Austrian non competitive auction received very limited demand – only 5050 allowances out of 100,000 were sold.</li> <li>- Small emitters can access the secondary market.</li> <li>- The small emitter opt-out will reduce the number of small emitters.</li> <li>- There may be simpler solutions to providing access such as the German solution of a 500 minimum lot size.</li> </ul> <p>Based on the needs of small emitters, it remains to be seen as to whether accessing allowances through auction is the best and most appropriate route. Again, depending on the processes developed for each auction platform, there may be different ways for small emitters to access allowances</p> <p>In the UK, we have developed a non-competitive route for small emitters in Phase II. We intend to test this format during the next 6 months to gauge the actual level of demand for such a specific route. However, early indications suggest that this route may be less popular than first thought. This idea was developed in 2008 before the experience of the Austrian auction (where there was hardly any demand) and before the December deal on the revised EU ETS Directive.</p> <p>In this route, the UK government proposes to allow bidders to submit one non-competitive bid of up to 10,000 allowances (i.e. the bid will specify a number of allowances but will not concern price). A maximum of 30% of the auction will be allocated in this way. Should interest in the non-competitive element exceed 30%, priority will be given</p>

	<p>to non-competitive bids which fall below the minimum lot size of 1,000 (and is the minimum lot size in the competitive stage of the auction). These non-competitive bids would be allocated in full, at the auction clearing price that would be established by the subsequent competitive stage of the auction. In the event of over-subscription to the non-competitive pot, the remainder of bids would be scaled.</p> <p>The UK is intending to deliver this non-competitive element in early 2010. This will provide important evidence in developing a route to auction for small emitters. It will also be important to assess the functioning of the German model (minimum lot size of 500 to provide for needs of small emitters, starting in 2010) to see how this functions.</p>
<p><b>50</b></p>	<p>Is allowing non-competitive bids necessary for ensuring access to allowances to SMEs covered by the EU ETS and small emitters in case of:</p> <ul style="list-style-type: none"> <li>• discriminatory-price auctions?</li> <li>• uniform-price auctions?</li> </ul> <p><b>Answer:</b> See our answer to Question 49</p>
<p><b>51</b></p>	<p>If non-competitive bids are provided for in spot auctions, what maximum share of allowances could be allocated through this route?</p> <ul style="list-style-type: none"> <li>• 5% [ ]</li> <li>• 10% [ ]</li> <li>• Other? Please specify.</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b> This answer leads on from Questions 49 and 50 - The UK is not fully convinced that special provision is needed for small emitters.</p> <p>In the UK, our legislation provides for a maximum of 30% to be set aside for non-competitive auctions. The actual</p>

	<p>volume to be auctioned will be published two months before the non-competitive auction and will be based on demand. As mentioned in Question 49, this route will be tested during the next six months.</p>
<p><b>52</b></p>	<p>What rule should apply for accessing non-competitive bids (more than one answer possible):</p> <ul style="list-style-type: none"> <li>• Participants should only be allowed to use one of the two bidding routes?</li> <li>• Non-competitive bids should be restricted to SMEs covered by the EU ETS and small emitters only?</li> <li>• Other? Please specify.</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b> See Question 49.</p> <p>However, for information, the rules that the UK government has developed for non-competitive auctions allow participants to bid in both.</p> <p>In order to protect the smaller emitters' access to allowances, the non-competitive element has been designed for EU ETS permit holders only (to deny access to the financial sector). There is also a maximum bid size of 10,000 allowances, to restrict access to those smaller emitters with lower demands for allowances. These rules were developed in response to the fact that it is very difficult to define a SME or a small emitter.</p>
<p><b>53</b></p>	<p>What should be the maximum bid-size allowed for SMEs covered by the EU ETS and small emitters submitting non-competitive bids?</p> <ul style="list-style-type: none"> <li>• 5 000 EUAs</li> <li>• 10 000 EUAs</li> <li>• 25 000 EUAs</li> <li>• Over 25 000 EUAs, please specify exact size and give reasons for your answer.</li> </ul> <p><b>Answer:</b></p>

	<p>See Question 49. For information, the UK <a href="#">Scheme</a> rules specify 10,000 allowances as the maximum bid size. Flexibility to review the maximum bid size will be important.</p>
54	<p>Are there any other specific measures not mentioned in this consultation that may be necessary for ensuring full, fair and equitable access to allowances for SMEs covered by the EU ETS and small emitters? If so, please specify.</p> <p><b>Answer:</b> The provision of clear, concise, timely information is vitally important to enable small emitters to access auctions. It is essential that they are able to clearly understand how to access auctions and what is happening during and after the process. To that end, the UK would encourage a European hub for dissemination of all auction information linked to national information hubs.</p> <p>It is important that any fees for accessing the auctions are proportionate. In the UK, the design for Phase II auctions is such that there are no fees to access either the competitive or non-competitive elements. This was a specific policy decision so as to ensure that there were no barriers to access the auctions.</p>
55	<p><b>What should be the minimum period of time before the auction date for the release of the notice to auction?</b> 2 weeks <input type="checkbox"/> 1 month <input type="checkbox"/> 2 months <input type="checkbox"/> Other <input type="checkbox"/> Please specify. <b>Please comment on your proposal.</b></p> <p><b>Answer:</b> See answer to Question 40.</p>
56	<p>What should be the minimum period of time before the auction date for the submission of the intention to bid? 1 week <input type="checkbox"/> 2 weeks <input type="checkbox"/> 1 month <input type="checkbox"/> Other <input type="checkbox"/> Please specify. Please comment on your proposal.</p>

	<p><b>Answer:</b> See answer to Question 40.</p>
<p><b>57</b></p>	<p>Are there any specific provisions that need to be highlighted in:</p> <ul style="list-style-type: none"> <li>• The notice to auction?</li> <li>• The intention to bid?</li> <li>• Both?</li> </ul> <p>Please specify what they are.</p> <p><b>Answer:</b> See answer to Question 40</p>
<p><b>58</b></p>	<p>What information should be disclosed after the auction:</p> <ul style="list-style-type: none"> <li>• Clearing price (if allowances are awarded on a uniform-price basis or in the case of non-competitive bids being allowed)?</li> <li>• Average price (if allowances are awarded on a discriminatory price basis)?</li> <li>• Any relevant information to solve tied bids? This information should be available before the auction</li> <li>• Total volume of EUAs auctioned?</li> <li>• Total volume of bids submitted distinguishing between competitive and non-competitive bids (if applicable)?</li> <li>• Total volume of allowances allocated?</li> <li>• Anything else? Please specify.</li> </ul> <p><b>Answer:</b> All of the above could be disclosed. The only information which potentially should not be disclosed, is in the case where any of the information gives rise to concerns regarding the confidentiality of bidders' information.</p> <p>In the UK, the DMO releases a press notice straight after the auction (approximately six minutes from auction close). This notice contains the clearing price, the number of allowances sold, the total volume of bids, the exchange rate at the time of the auction.</p>



	<p>The answer to this question also ties in directly to the provision of information before an auction, which must be in transparent, open and accessible fashion.</p>
<p><b>59</b></p>	<p>What should be the maximum delay for the announcement of auction results?  5 minutes <input type="checkbox"/> 15 minutes <input type="checkbox"/> 30 minutes <input type="checkbox"/> 1 hour <input type="checkbox"/> Other <input type="checkbox"/> Please specify.  Please comment on your proposal.</p> <p><b>Answer:</b>  Thirty minutes should be the absolute maximum – but auction results should be announced as soon as possible following the auction. As mentioned in Question 58, in its Phase II auctions, the UK releases the auction results to the market after approximately six minutes. The delay is due to the quality assurance undertaken by the DMO to ensure that correct information is sent to the market. This is equally as important as the time delay. The retraction of incorrect information would be very damaging for the credibility of the auction process/the auctioneer and could cause a number of significant disruptions to the market.</p>
<p><b>60</b></p>	<p>Do you feel that any specific additional provisions should be adopted in the Regulation for the granting of fair and equal access to auction information?  If so, what may they be?</p> <p><b>Answer:</b>  Language is a crucial element that must be addressed to ensure fair and equal access to auction information.</p> <p>The time delays inherent in providing accurate translations must be taken into account when developing the auction processes. Therefore it would seem sensible that harmonised auction information is provided in all of the official languages of the EU but that instant information (i.e. auction results) should be in the language of the Member State conducting the auction, <b>plus</b> a language customary in the sphere of international finance (i.e. as a minimum; English).</p> <p>It will also be important to limit jargon and where market language is essential, it must be clearly spelt out.</p>

	<p>In terms of providing information, a specific site which contains all the auction information and results, accessible to all, across all platforms and approaches could be developed to limit confusion (see answer 54 for further details). Consideration will also need to be given to international access for aviation participants.</p>
<p>61</p>	<p>Should an auction monitor be appointed centrally to monitor all EU auctions? If not, why not?</p> <p><b>Answer:</b> <b><u>Current Phase II auctions in the UK – an Independent Observer</u></b><sup>4</sup></p> <p>In the UK, the auction legislation specifies that the Treasury must appoint an Independent Observer (IO) to oversee any allocation(s) under the UK regulations. The terms of this appointment are determined by the Treasury. The IO must report to the Treasury on the conduct of the allocation. The person conducting the auction must provide access to any information relating to the allocation that is reasonably required by the IO for the purpose of carrying out his functions under the regulations.</p> <p>The IO's role is essentially to monitor the conduct of the auctions, to provide assurance that the published procedures have been followed and that all Primary Participants have been treated fairly and equally in accordance with the regulations and the scheme.</p> <p><b><u>Phase III</u></b></p> <p>The UK would favour the establishment of similar institutions in other Member States holding their own auctions, which could then be subject to checks by Commission officials on an 'as needed basis'. This would tie in with the reports that Member States have to provide following each auction (in line with Article 10 (4) of the revised EU ETS Directive). The UK does not feel that it would be either operationally practical or necessary to create a new central body to undertake this role. Any provisions in the Regulation concerning this issue should be further discussed during</p>

<sup>4</sup> For further details on the UK's Phase II auctions, please see Annex A

	the comitology process.
62	<p>Do you agree that the Regulation should contain general principles on:</p> <ul style="list-style-type: none"> <li>• the designation and mandate of the auction monitor; and</li> <li>• cooperation between the auctioneer(s) and the auction monitor?</li> </ul> <p>If not, why not? Should these be supplemented by operational guidance, possibly through Commission guidelines? If not, why not?</p> <p><b>Answer:</b> Please refer to Question 61</p>
63	<p>Is there a need for harmonised market abuse provisions in the Regulation to prevent insider dealing and market manipulation? If not, why not? Please comment on your choice outlining the provisions you deem necessary and stating the reasons why.</p> <p>Could there be any market abuse between the state and the auctioneer? What is it that is the potential problem? What are the risks?</p> <p><b>Answer:</b></p> <ol style="list-style-type: none"> <li>1. It is important firstly, to define where and if market abuse is likely to occur within the context of an auction of EUAs. In particular, what it is specifically about <i>auctioning</i> allowances which will lead to market abuse, and the shape and form of that market abuse in terms of the risks and the facts.</li> <li>2. Secondly, it is of paramount important that abuse of the carbon market is covered at the highest level, not just at the level of the auction. In fact, market abuse is more likely to occur in the secondary market and so any measures brought in for the primary market (auctioning) must also be brought in for the secondary market. Therefore, it is clear that the auctioning Regulation is not the place to regulate for such abuse.</li> <li>3. Thirdly, market abuse relating to financial products (futures) is generally treated differently from that occurring in non-financial products (spot). For allowance-related products which are financial instruments market abuse issues are best considered in the context of the current review of the Market Abuse Directive</li> </ol>

	<p>(MAD).For allowance-related products which are not financial instruments there may be a case for having a market abuse regime but this should be separate from the MAD regime itself (there are parallels here with the CESR/EREG proposals on energy). However, in line with our first point, it is important to assess whether spot auctioning could actually be open to abuse. It may well be possible to design spot auctions so as to mitigate any real risk of market manipulation.</p> <p>4. Finally, the UK strongly advocates that correct auction design is the key to mitigation of market abuse risks and would encourage the Commission to do as much as possible to limit these risks through auction design before contemplating introducing any market abuse regime. Any regulation of market abuse should address the whole market and it is for that reason, that the UK would also encourage the Commission to align the review of the carbon market (that it is performing under Article 12 (1a)) with the review on MAD.</p>
64	<p>Should the Regulation provide for harmonised enforcement measures to sanction:</p> <ul style="list-style-type: none"> <li>• Non-compliance with its provisions? <b>NO</b></li> <li>• Market abuse? <b>NO</b></li> </ul> <p>Please provide arguments to support your case.</p> <p><b>Answer:</b>  The UK does not agree that the Regulation should provide for harmonised enforcement measures for non-compliance with its provision nor for market abuse. Ordinarily, enforcement is left to Member States due to reasons of subsidiarity. Unless there is a case for treating this regulation any differently from other regulations, the UK would advocate that enforcement is left to member states as with the rest of the EU ETS</p> <p>Please see Question 63 for further information.</p>
65	<p>Should the enforcement measures include:</p> <ul style="list-style-type: none"> <li>• The suspension of the auctioneer(s) and/or bidders from the EU-wide auctions? What happens if the member state is the auctioneer?</li> </ul> <p>If so, for how long should such suspension last?</p> <ul style="list-style-type: none"> <li>• Financial penalties?</li> </ul>

	<p>If so, at what level should such penalties be fixed?</p> <ul style="list-style-type: none"> <li>• The power to address binding interim decisions to the auctioneer(s) and/or bidders to avert any urgent, imminent threat of breach of the Regulation with likely irreversible adverse consequences?</li> <li>• Anything else? Please specify.</li> </ul> <p>Please provide arguments to support your case.</p> <p><b>Answer:</b> Please see answer to Question 64.</p>
66	<p>Should such enforcement measures apply at:</p> <ul style="list-style-type: none"> <li>• EU level?</li> <li>• <b><u>National level?</u></b></li> <li>• Both?</li> </ul> <p>Please comment on your choice.</p> <p><b>Answer:</b> Enforcement measures should apply at the national level. Please see Question 63 and 64 for detail.</p>
67	<p>Who should enforce compliance with the Regulation (more than one answer is possible):</p> <ul style="list-style-type: none"> <li>• The auction monitor? <b>no</b></li> <li>• The auctioneer? <b>no</b></li> <li>• A competent authority at EU level? <b>no</b></li> <li>• A competent authority at national level? <b>no</b></li> <li>• Other? Please specify <b>Member states</b></li> </ul> <p>Please provide evidence to support your case.</p> <p><b>Answer:</b> Again, this should be enforced at the Member State level. Please see Questions 63 and 64 for detail.</p>

68

Which of the three approaches for an overall EU auction model do you prefer? Please rate the options below (1 being the most preferable, 3 being the least preferable)

- Limited number of coordinated auction processes. [ ]
- Full centralisation based on a single EU-wide auction process. [ ]
- The hybrid approach where different auction processes are cleared through a centralised system. [ ]

Please give arguments to support your case.

**Answer:**

The most important part of the UK's position for Phase III auctioning is to retain our ability to hold our own auctions.

Of the three approaches listed in the question, the approach which best meets the UK's needs is the limited number of coordinated auction processes. This would:

- allow existing architecture to be used which would facilitate early auctions, reduce costs and the risks of systemic failures should some of its part fail to deliver.
- create innovation and competition between auction platforms, whilst avoiding fragmentation and drive efficiencies across auction processes to the advantage of bidders and the taxpayer.
- ETS is classified as a tax by the UK Treasury and the Office of National Statistics and ceding control over the revenue stream associated with a tax policy would run counter to long established UK policy on Europe and tax policy.
- Coordination between the different platforms and transparency of process are unlikely to present significant practical problems as it may be anticipated that only a limited number of non-centralised platforms are going to be established

The other three approaches have the following problems:

- A fully centralised auction approach would not drive efficiencies and would not suit differentiated needs of market participants.
- A fully decentralised approach is unlikely to be practical, as some Member States do not want to organise their own auctions and may find it challenging to do this before 2013. The number of different auctions would be overwhelming for participants.

- A hybrid approach has the same disadvantages as a fully centralised auction approach but increases costs for Member States in collating information from auction participants.

To address some of the short-comings of the above approaches, the UK would like to propose a 'fifth approach'. This is for the regulation to provide for a central auction platform developed and run by the Commission that Member States can opt to use, whilst also allowing Member States to continue to hold their own auctions (Member States could access both the centralised auction as well as auction their allowances through other Member State platforms). This approach would balance the requirements of UK and some other Member States to hold our own auctions, whilst allowing the majority of Member States to use different routes. The UK would be willing to consider criteria for Member States to hold their own auctions.

Under this approach, the UK supports the need for flexibility to allow the system to evolve. We advocate that all processes (PP, exchange and third party service provider) should be allowed under this approach, although do support the argument that existing architecture should be retained as and where possible to avoid delays in implementing Phase III auctioning and 'reinventing the wheel'. Multiple exchanges happily coexist in the secondary market at the moment and we see no reason why multiple processes shouldn't also be able to do the same thing.

We also advocate that the regulation should provide for the central platform and Member State auctions to be able to auction spot and/or futures i.e. the operators of the platform should be able to choose. Furthermore, the regulation should not be so prescriptive as to strangle the development of the primary market. Whilst providing common rules around the EU calendar, timing and information, the regulation should strike a balance to allow flexibility to develop the platforms whilst ensuring gaming and market abuse are prevented. Clear, concise, transparent and timely information will be essential as part of this approach.

As it may take some time to build a central platform from scratch, the UK suggests that the central platform could be an exchange based platform which would be procured through an open, tender process as that should be a quicker solution than a third party model. Of course, a central platform should be financed by contributions from those Member States that want to make use of it. This platform would also be able to auction spot and futures. This would utilise existing architecture and so timely implementation would only be dependent on the procurement process as opposed to

	<p>the development and testing of new software, systems and processes.</p> <p><b>The advantages of this fifth approach are:</b></p> <ul style="list-style-type: none"> <li>• Would incorporate the positive features of the coordinated and centralised approach, whilst mitigating the disadvantages of the two options taken separately.</li> <li>• The Commission could develop a platform for member states to opt-into. This would remove the burden from those states unable to build their own auctioning platforms.</li> <li>• Existing auctioning processes (and architecture) could continue to be used</li> <li>• Could limit the degree of differentiation between different processes allowing greater simplicity, transparency and control over market abuse and manipulation.</li> </ul>
<p><b>69</b></p>	<p>If a limited number of coordinated auction processes develops, what should be the maximum number?</p> <ul style="list-style-type: none"> <li>• 2</li> <li>• 3</li> <li>• 5</li> <li>• 7</li> <li>• more than 7, please specify.</li> </ul> <p>Please give arguments to support your case.</p> <p><b>Answer:</b> Please see answer to Question 68</p>
<p><b>70</b></p>	<p>Is there a need for a transitional phase in order to develop gradually the optimal auction infrastructure? If so, what kind of transitional arrangements would you recommend?</p> <p><b>Answer:</b> This is dependent on the approach that is agreed under the Regulation. If the ‘fifth approach’ suggested by the UK (see Question 68) is adopted, then there will be at least two experienced platforms auctioning allowances. The UK would be auctioning spot – although this will be dependent on development of the single community registry and</p>



	<p>Germany would be auctioning futures (for delivery in same year). Furthermore, if the central opt-in platform is an exchange, the procurement exercise could have been completed in time for auctioning in 2011. The 'fifth approach' should therefore provide for EU-wide auctioning to commence in 2011 (dependent on procurement processes) and hence a transitional phase may not be necessary.</p> <p>It is important to note that one of the key activities to undertake in a system as new and as constantly evolving as the EU ETS, is to ensure that we are 'learning by doing' and that these 'lessons learned' are then integrated into the system to improve it. There is therefore a valid need for some flexibility (as mentioned in Q. 14) where experience can be integrated, without having to redraft the regulations and as such strangle the development of the system.</p>
71	<p>Should the Regulation impose the following requirements for the auctioneer(s) and auction processes?</p> <p>Technical capabilities of auctioneers:</p> <ul style="list-style-type: none"> <li>• capacity and experience to conduct auctions (or a specific part of the auction process) in an open, fair, transparent, cost-effective and non-discriminatory manner;</li> <li>• appropriate investment in keeping the system up-to-date and in line with ongoing market and technological developments; and</li> <li>• relevant professional licences, high ethical and quality control standards, compliance with financial and market integrity rules.</li> </ul> <p>Integrity:</p> <ul style="list-style-type: none"> <li>• guarantee confidentiality of bids, ability to manage market sensitive information in an appropriate manner;</li> <li>• duly protected electronic systems and appropriate security procedures with regards to identification and data transmission;</li> <li>• appropriate rules on avoiding and monitoring conflicts of interest;</li> </ul> <p>and</p> <ul style="list-style-type: none"> <li>• full cooperation with the auction monitor.</li> </ul> <p>Reliability:</p> <ul style="list-style-type: none"> <li>• robust organisation and IT systems;</li> <li>• adequate fallback measures in case of unexpected events;</li> <li>• minimisation of the risk of cancelling an individual auction once announced;</li> </ul>

- minimisation of the risk of failing functionalities (e.g. access to the bidding platform for certain potential bidders); and
- fallback system in case of IT problems on the bidder side.

Accessibility and user friendliness:

- fair, concise, comprehensible and easily accessible information on how to participate in auctions;
- short and simple pre-registration forms;
- clear and simple electronic tools;
- (option of) accessibility of platforms through a dedicated internet interface;
- ability of the auction platform to connect to and communicate with proprietary trading systems used by bidders;
- adequate and regular training (including mock auctions);
- detailed user guidance on how to participate in the auction; and
- ability to test identification and access to the auction.

Please elaborate if any of these requirements need not be included.

Please elaborate what additional requirements would be desirable.

**Answer:**

The answer to this question is very much dependent on which approach is chosen to auction Phase III allowances.

Depending on the specificities of the design of the auction(s) this looks to be a suitable list of criteria but will need to be discussed further in the comitology process, particularly with regards to whether any of these criteria should be made mandatory. It should be noted that any mandatory imposition of criteria will limit the auctioneer's flexibility and so should be considered carefully.

In response to the list of criteria in the question, the UK would not want the following to be included:

- Option of accessibility of platforms through a dedicated internet interface: not necessary to specify internet - accessibility for those eligible to participate should be the key requirement.
- Ability of the auction platform to connect to and communicate with proprietary trading systems used by bidders should not be mandatory

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What provisions on administrative fees should the Regulation include (more than one answer is possible)?

	<ul style="list-style-type: none"> <li>• General principles on proportionality, fairness and non-discrimination.</li> <li>• Rules on fee structure.</li> <li>• Rules on the amount of admissible fees.</li> <li>• Other, please specify.</li> </ul> <p>Please provide arguments to support your case.</p> <p><b>Answer:</b>  The regulation should only provide general principles. It shouldn't contain rules on fee structure or the amount of admissible fees, firstly because each process will have different costs, and secondly because national law and financial services regulations as well as national and EU competition law will regulate unfair pricing.</p> <p>In the UK, neither the competitive nor the non-competitive routes have fees/charges. This was instigated to ensure that there were no barriers to entry to the auction.</p>
73	<p>Should there be provisions for public disclosure of material steps when introducing new (or adapted) auction processes? Should new (or adapted) auction process be notified to and authorised by the Commission before inclusion in the auction calendar?</p> <p><b>Answer:</b>  Yes to both questions.</p> <p>The Commission should authorise the inclusion of new processes into the calendar but the extent to which a process can be seen to be 'adapted' needs to be discussed in the comitology process. Furthermore, these 'adaptations' could tie in with the flexibility that the UK has suggested in answer to Question 14. The Commission need to clarify what they mean about 'public disclosure of material steps' but any new processes must be properly communicated to stakeholders to retain transparency and openness in the auction process.</p> <p>It will be important to factor in any external approval and notification processes that exchanges may have gone through to develop new processes. This process could be overseen by the Commission so as not to duplicate work.</p>

74	<p>Which one of the following options is the most appropriate in case a Member State does not hold auctions (on time)?</p> <ul style="list-style-type: none"> <li>• Auctions by an auctioneer authorised by the Commission.</li> <li>• Automatic addition of the delayed quantities to those foreseen for the next two or three auctions.</li> </ul> <p>What other option would you envisage? Please specify.</p> <p><b>Answer:</b> It is important to distinguish between a failure to hold a single auction for legitimate reasons and failure to hold auctions at all. Where a Member States has failed to show itself able to hold its own auctions, then these allowances should be auctioned via an auctioneer authorised by the Commission e.g. in the ‘fifth approach’ probably the central platform.</p>
75	<p>Should a sanction apply to a Member State that does not auction allowances in line with its commitments? If so, what form should that sanction take?</p> <p><b>Answer:</b> In answer to this question, we interpret ‘failure to auction’ as referring to a Member State that does not hold auctions at all. For failure to hold a single auction, please refer to answer 39.</p> <p>The consultation document emphasises the importance of a credible auction calendar of auction processes that will need to be achieved by Member States leading up to bringing allowances to market. Provided these matters are drafted in such a way as to impose legal obligations on Member States to comply, then a failure to do so will cause a Member State to be in breach of the EC Treaty. Under Article 226 the Commission may commence infraction proceedings against the Member State and therefore a sanction already exists.</p>
76	<p>As a general rule throughout the trading period, in your opinion, are early auctions necessary? If so, what should the profile of EUAA auctions be:</p> <ul style="list-style-type: none"> <li>• 5-10% in year n-2, 10-20% in year n-1, remainder in year n</li> <li>• 10-20% in year n-2, 20-30% in year n-1, remainder in year n</li> <li>• 20-30% in year n-2, 30-35% in year n-2, remainder in year n</li> </ul>

**Answer:**

The UK does not have a firm view on this matter. Given that 85% of the allowances will be given for free and there is already a liquid EUA market, this suggests that early auctions are not essential. However, some early auctions may be useful to assuage the market's fears that auctions will not happen on time etc.

It is not possible at this stage to produce a detailed analysis of the impacts of different options given the complexities of the aviation industry. It is important that evidence is sought from the industry itself in terms of the different business models and how they might be affected differently. There are likely to be different issues for different operators which only they will be aware of. However, stakeholders from the aviation industry that we have met with have suggested that large operators hedge their fuel out to about one year in advance.

Please refer to Question1 for further details.

Other? Please specify.

**CONFIDENTIAL QUESTIONS**

**Request for potentially confidential information 3**

Please send the answer to this question in paper and electronic format, marked on the envelope "Strictly Private and Confidential – Auctioning consultation", directly to the European Commission, DG ENV, Directorate C, Unit C2, to the attention of the Head of Unit, Office BU-5 2/1, 1049 Brussels, Belgium. It will be treated confidentially and will not be disclosed publicly.

For aircraft operators covered by the EU ETS:

Have you determined a corporate hedging strategy for carbon needs?

Yes [ ] No [ ]

If so, what share of your expected emissions covered by the EU ETS in a given year n do you (intend to) hedge and how much in advance?

- year n : \_\_\_\_\_%
- year n-1 : \_\_\_\_\_%
- year n-2 : \_\_\_\_\_%

	<p><b>Request for potentially confidential information 4</b></p> <p>Please send the answer to this question in paper and electronic format, marked on the envelope "Strictly Private and Confidential – Auctioning consultation", directly to the European Commission, DG ENV, Directorate C, Unit C2, to the attention of the Head of Unit, Office BU-5 2/1, 1049 Brussels, Belgium. It will be treated confidentially and will not be disclosed publicly.</p> <p>What share of the annual quantity of allowances you intend to purchase via auctions would you wish to buy spot or futures respectively?</p> <p>SPOT FUTURES</p> <ul style="list-style-type: none"> <li>• year n : _____%   _____ %</li> <li>• year n-1 : _____%   _____ %</li> </ul>
77	<p>Do you think there is a need to auction EUAA futures? If so, why?</p> <p><b>Answer:</b> Please also refer to our answer to Question 2.</p> <p>Aviation stakeholders (that we have met with) were split about the need to hedge kerosene. It appears that only large operators will do this and this likely to be around a year in advance. The huge number of smaller players don't appear to have a need to hedge their fuel. Futures may therefore be useful to larger players however in order to encourage secondary trading and liquidity, it will be important to ensure that early spot allowances are dispersed to the market. The UK government's current preference is to auction spot allowances. See Question 2 for further details.</p>
	<p>What should be the optimal frequency and size of EUAA auctions:</p> <ul style="list-style-type: none"> <li>• 2 auctions per year of around 15 million EUAAs?</li> <li>• 3 auctions per year of around 10 million EUAAs?</li> <li>• More than 3 auctions per year? Please specify.</li> </ul> <p>Please comment on your choice.</p>

	<p><b>Answer:</b> This will depend on the approach chosen, but it would be possible for up to 6 auctions to happen per year with a limit of around 4/5 million allowances per auction.</p>
79	<p>What would be your preferred timing for EUAA auctions:</p> <ul style="list-style-type: none"> <li>• Equally spread throughout the year?</li> <li>• November – March?</li> <li>• Other? Please specify.</li> </ul> <p><b>Answer:</b> Due to the low volume of allowances to be sold and the subsequent low number of annual auctions, it would be advisable that auctions are held between November and March. As we said for the main scheme, auctions should be avoided in the quiet summer months and in December. Please see Question 9 for further details.</p>
80	<p>Should any of the EUAA auction design elements be different compared to EUA auctions (see section 3)? If so, please specify and comment on your choice.</p> <p><b>Answer:</b> On the main processes, UK government's position is that aviation auctions should ideally be as similar as possible to those for EUAs. This is a more efficient, cost-effective way of delivering this process.</p> <p>However, there are two main differences which will need to be taken into account in designing aviation auctions for 2011. The first is that for the first time mobile, international operators will be included in the EU ETS. This leads to a need for clear, relevant, informative and timely communications <b>internationally</b>. It is essential that operators are aware of their obligations and how the ETS auctions will work so that they are able to make the most of the opportunities for participating in both the auctions and the market more generally. The second difference is that the aviation industry will have a far greater number of small emitters than the main EU ETS.</p>

81	<p>Do you agree there is no need for a maximum bid-size? If not, why not?</p> <p><b>Answer:</b> Yes, the UK agrees that there is no need for a maximum bid-size.</p>
82	<p>Is there any information regarding aircraft operators made available as part of the regulatory process to the competent authorities that could facilitate the KYC checks performed by the auctioneer(s)? If so, please describe what information is concerned and whether it should be referred to in the Regulation or any operational guidance published by the Commission.</p> <p><b>Answer:</b> The UK does not have a view on this issue at present.</p>
83	<p>In your opinion, is there a specific need to allow for non-competitive bids in EUAA auctions? Would this be the case even when applying a uniform clearing price format? Please provide arguments to support your case.</p> <p><b>Answer:</b> The UK does not have a firm view on this matter. There will be a greater number of smaller operators than the main scheme but we are not sure whether they will access auctions to buy their allowances or simply buy from secondary market.</p>
84	<p>Do you agree that there is no need for any specific provisions for EUAA auctions as regards:</p> <ul style="list-style-type: none"> <li>• Involvement of primary participants, exchanges or third party service providers?</li> <li>• Guarantees and financial assurance?</li> <li>• Payment and delivery?</li> <li>• Information disclosure?</li> <li>• Auction monitoring?</li> <li>• Preventing anti-competitive behaviour and/or market manipulation?</li> </ul>



	<ul style="list-style-type: none"> <li>• Enforcement?</li> </ul> <p>If not, please describe in detail what rules would be needed and why.</p> <p><b>Answer:</b></p> <p>As a general principle we have not identified any reasons why EUAA auctions should be subject to specific provisions which differ from those applicable to EUA auctions. We do, however, note that in EUAA auctions there is a greater likelihood that bidders will be domiciled in third countries. Once a preferred auction approach has been identified, we believe it might be necessary to consider this question again in order to take into account any questions that may arise as a consequence of international law, whether the recognition and enforcement of judgments in third countries not signatories to the Brussels or Lugano Conventions ought to be taken into account, or for any other reason not capable of currently being identified due to the generality of this consultation.</p>
85	<p>Taking into account the smaller volume of EUAA allowances to be auctioned compared to EUAs, which of the three approaches for an overall EUAA auctioning model do you prefer? Please rate the options below (1 being the most preferable, 3 being the least preferable)</p> <ul style="list-style-type: none"> <li>• Limited number of coordinated auction processes. [ ]</li> <li>• Full centralisation based on a single EU-wide auction process. [ ]</li> <li>• Hybrid approach where different auction processes are cleared through a centralised system. [ ]</li> </ul> <p>Does your choice differ from the approach preferred for EUAs? Please provide arguments to support your case.</p> <p><b>Answer:</b></p> <p>See answer to Questions 68 and 80. Our choice does not differ from the approach we prefer for EUAs.</p>
86	<p>Do you agree that there is no need for any specific provisions for EUAA auctions as regards:</p> <ul style="list-style-type: none"> <li>• Requirements for the auctioneer(s) and auction processes?</li> <li>• Administrative fees?</li> <li>• Rules to ensure appropriate and timely preparation of the auctions?</li> </ul>

If not, please describe in detail what rules would be needed and why.

**Answer:**

See answer to Question 80

## **ANNEX A**

### **Background on Phase II Auctioning**

The UK is the first Member State in the EU to auction allowances in Phase II of the EU ETS. The UK National Allocation Plan (NAP) for Phase II (2008-2012) of the EU ETS sets aside 7% of the total allowances for auctioning, amounting to approximately 86 million over the phase (total UK cap for Phase II = 1.2 billion).

Approximately 25 million allowances will be auctioned in 2009. An auction schedule with dates and volumes for future auctions, up to April 2010 is published on the UK Debt Management Office's [website](#).

The Government considers that it is important to learn from early experience of auctions and has the flexibility to adjust elements of the auction schedule if necessary.

#### **Q: How was the auction model developed?**

A: Government conducted a public consultation on auction design at the end of 2007, and has worked with an Auctioning Working Group including representatives from industry, public sector and academia.

#### **Q: Who can bid in UK EU ETS auctions?**

A: The auctions are open to anyone who holds an EU ETS Registry account.

#### **Q: Who carries out the auctions?**

A: HM Treasury has appointed the Department of Energy and Climate Change (DECC) as auctioneer. The UK Debt Management Office (DMO) will be acting as DECC's agent to run the auctions. The DMO is an Executive Agency of HM Treasury and, as Government Debt Manager, has been responsible for auctioning UK Government securities (Gilts) since April 1998 and Treasury bills since April 2000. HMT has appointed an Independent Observer to oversee the auctions. The Independent Observer provides additional assurance to the market and the general public that the UK's EU ETS auctions are conducted in accordance with the Regulations and the Scheme.

#### **Q: When will the number of allowances available at auction be announced?**

A: An auction schedule with dates and volumes for future auctions, up to April 2010 is published on the UK Debt Management Office's [website](#).

**Q: Where are the results of the UK EU ETS auctions published?**

A: The results are published on the UK Debt Management Office's (DMO) [website](#).

**Q: Is there a reserve price for allowances?**

A: Yes. Government will set a reserve price for each auction. This is necessary to reassure Parliament and the public that Government is not prepared to sell allowances at any price. If the auction clearing price is less than the reserve price, the reserve price will be the price to be paid for each allowance at auction. The reserve price will be calculated by applying a discount rate and markdown to the prevalent secondary market price before the close of the bidding window. Government will announce if the reserve price has been triggered after the close of each auction.

**Q: What happens if not all the allowances are allocated at an auction?**

A: Unsold allowances will go back into the 'auctioning pot' and will be allocated via future auctions in Phase II.

**Q: Will UK auctions coincide with auctions or alternative sales being held in other Member States?**

A: Government will endeavour to coordinate timing of sales and auctions with other Member States as far as possible.

## **Legislation**

**Q: What legislation covers UK Phase II auctions?**

A: The powers to auction are within the Finance Act 2007. The legislative framework for auctions comprises Regulations and a Scheme made by HM Treasury.

The 'Community Emissions Trading Scheme (Allocation of Allowances for Payment) Regulations 2008', which came into force on 11 July 2008, set up the general framework of the auctioning process. Amendments to the Regulations 2008 came into force on the 11 August 2008.

The 'Community Emissions Trading Scheme (Allocation of Allowances for Payment) Scheme 2008' (PDF 258KB) , which came into force on 1 August 2008, regulates the carbon auctions in greater detail.

The 'Community Emissions Trading Scheme (Auctioning of Allowances) Scheme 2009' (PDF 336KB), which came into force on 23 April 2009 replaced the Scheme 2008 to improve upon some aspects of the UK auction model. The Scheme 2009 also implements a previous government commitment to establish a non-competitive bidding facility especially designed for smaller emitters and can be found at the link below:

All the relevant legislation can be found [here](#)

**Q: Is the Scheme set in stone?**

A: The Government considers that it is important to learn from early experience of auctions and has the flexibility to adjust elements of the auction procedure if necessary.

**Primary Participants**

**Q: What is a Primary Participant?**

A: Primary Participants are EU ETS account holders who have been appointed by DECC to facilitate the competitive element of the auctions. Any organisation with an EU ETS Registry account and an office base in an EEA state can apply to DECC to become a Primary Participant; applications are assessed against the eligibility criteria set out in the Scheme.

**Q: Why are Primary Participants being used in the auction model?**

A: Government believes that intermediaries can best carry out the critical role of implementing checks to guard against potential money laundering activities and providing assurance of the financial standing of bidders.

**Q: How can organisations apply to be a Primary Participant?**

A: Information on how to apply to be a Primary Participant is available on the Defra [website](#)

**Q: What checks do Primary Participants have to carry out on potential indirect bidders?**

A: Primary Participants have to carry out “Know Your Customer” checks to ensure they comply with anti money laundering and anti-terrorist financing legislation, for example the Money Laundering Regulations 2007, in UK law.

**Q: How do Primary Participants pay for the allowances won for my own account and on behalf of indirect bidders?**

A: Primary Participants must pay Government for all allowances won at auction both for themselves and on behalf of indirect bidders, within two days of the auction. Payment to the Government may be made by a Primary Participant in either Euros or Pounds Sterling. The exchange rate used will be the rate published by Reuters on the Bank of England Sterling Exchange Rate Index at the publication point immediately following the close of the bidding window.

**Indirect Bidders**

**Q: How do Indirect Bidders place a bid/participate in an auction?**

A: Competitive bids in an auction must be placed through an intermediary, known as a Primary Participant. Detailed guidance for indirect bidders on how to participate in the auctions is available on Defra [website](#)

**Q: How do Indirect Bidders select a Primary Participant?**

A: The contact details for each approved Primary Participant are available on the Debt Management Office’s (DMO) [website](#)

**Further information**

**Q: Where can I get further information on EU ETS auctions?**

A: For details on the auction process please contact the DMO Press Office at [pressoffice@dmo.gsi.gov.uk](mailto:pressoffice@dmo.gsi.gov.uk)

For all other enquiries please contact the Defra EU ETS team at [EU.ETS@decc.gsi.gov.uk](mailto:EU.ETS@decc.gsi.gov.uk)