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ECCP STAKEHOLDER MEETING ON AUCTIONING

Venue:

Breydel building, Auditorium
45, Av. d'Auderghem-1049 Bruxelles
30 June 2009

DRAFT MINUTES

INTRODUCTION, LEGAL AND MARKET CONTEXT

The Commission welcomed the participants and introduced the Commission staff present at the meeting. The agenda of the meeting was agreed on. Subsequently, a presentation was given explaining that the purpose of the meeting is to foster understanding of the issues at stake, to clarify any unclear issues, and to exchange preliminary views. The state of play on the consultation paper and an overview of the work on the forthcoming auctioning regulation were presented as well.

WWF asked whether auctions of aviation allowances would be held under the same system and the same rules of access as auctioning of EUAs with the only difference being the products auctioned. The Commission in principle confirmed and added that the processes are envisaged to be fairly similar, but that it will have to be taken into account the EUAs can only be used for compliance by the aviation sector.

Eurelectric asked, if the new entrants reserve of about 300 Mio. allowances would be auctioned under the same system. The Commission replied that the point of departure is that there should not be made any distinction, but it was also noted that this issue is part of the present work and that the view expressed is therefore necessarily a preliminary one.

1. WHAT AND WHEN TO AUCTION?

Early auctioning, spots and futures

A presentation was made by the Commission. Subsequently, the Commission asked for the opinion and comments of the participants, and a discussion with a Q&A session was launched.

Eurelectric made the comment that from the perspective of electricity producers early auctioning would be necessary to hedge risks in their forward electricity sale contracts, thereby ensuring liquidity on the market in terms of electricity. The Commission replied that this issue is dealt with in the consultation document and confirmed that it needs to be looked into.

Denmark asked if having early auctions would be practically feasible at all. The Commission confirmed that this is a valid concern for very early auctions, also because the auctioning system needs to be solid and robust. If needed, a transitional period between the auctioning of second and third phase allowances may be introduced to ensure that there is no artificial scarcity on the market. The Commission added that it hopes to have the auctioning rules agreed in the Climate Change Committee by early 2010 hopefully, which would give Member States some extra time.

WWF asked, in case futures were to be auctioned, if a single form or separate forms of regulation for spot and futures would be foreseen. They also voiced their concern of possible market abuse given that the electricity sector is a major bidder. Additionally, they encouraged Member States to gain experience by auctioning their phase two allowances. The Commission noted that Member States' NAPs may not foresee auctioning at the moment, and confirmed that futures are a different product, so they would be auctioned separately and would need specific rules.

The Emissions Trading Group recalled that the purpose of auctioning is to get allowances out on the market for those who need them to comply with Community legislation. It warned not to go too much into complexities but to keep the system simple and not to reinvent it. At the same time, it needs to be ensured that allowances are available to those who need them for compliance. It was also emphasised that the ETS is a compliance market, and as such composed of a compliance part and a financial part, which needs to be considered separately.

On the issue of spot vs. futures the Netherlands commented that, given third period allowances would only be issued in 2012, auctions of those allowances in 2011 would only be possible with futures. The Commission confirmed that it indeed does not seem feasible to issue third phase allowances before 2012 and referred to the consultation paper (footnote 26, p.21). However, it was again referred to the possibility of applying transitional provisions.

The United Kingdom said they see no reason why the secondary market should be able to provide futures, also in case of auctioning spot only. Eurelectric replied that for them the important issue is that allowances need to go into the market so they can be bought.

Other issues

The United Kingdom said that having a single Community registry in place by 2011 may be challenging. The Commission replied that this issue is addressed in the WG3 meetings with Member States, and that it would like to see voting taking place there before the end of the year.

The European Federation of Energy Traders commented that there may be large purchases at auctions, but that this not necessarily amounts to market abuse. They called for a more informed discussion when discussing the issue.

The representative for smaller carbon exchanges asked if VAT would be applicable and, if so, how the issue will be dealt with regarding buying nationally vs. internationally. The Commission replied that there is a Directive on VAT setting out the rules, and added that the VAT Committee has determined the position that transactions on the secondary market need to be charged with VAT. For transactions conducted through an auction, the Committee has not (yet) adopted a similar position. The United Kingdom commented that, to prevent distortion of competition with the secondary market, they presently charge VAT in their auctions.

The representative for larger carbon exchanges disagreed with the alleged complexity of derivatives. It may not necessarily be perceived complex by everyone.

The United Kingdom commented that after selling spot the allowances would be in the market and a financial institution could cover the sale of futures. Those institutions may even provide futures at a smaller price premium than Member States. Selling allowances early may be agreed on, but it is not yet clear to the United Kingdom why this would have to be done through government's futures rather than spots. The European Federation of Energy Traders acknowledged the point made, as long as spot allowances actually exist. However, they would not be physically available until later. They added that when there is an imbalance between sellers and buyers, then there can be no guarantee for allowances to find ownership. In their eyes the only solution for this problem is to sell EUAs early.

WWF wondered how this relates to the ability of electricity producers to pass on the carbon cost when hedging, i.e. if they can adjust the electricity price ex-post. They requested more clarity from the electricity sectors on how they sell electricity.

2. AUCTION DESIGN

The Commission gave a presentation, and the floor was opened for questions and comments.

The representative for smaller carbon exchanges commented that from their experience in first and second phase auctions, the question is what price non-competitive bids will see. Combining uniform price and non-competitive bidding is clear, but it combining non-competitive bids with a discriminatory would be less clear. In addition, they see a higher risk of market collusion when using futures since there will be fewer participants bidding (mainly the electricity sector and financial institutions). Using spot instead means less collusion as there would be more small emitters present

SMEs and small emitters

Ireland proposed to use a uniform price as the best way to deal with SME size issues. This would take away the need for non-competitive bids, as SMEs would bid slightly above the assumed clearing price. The Commission replied that it expects SMEs and small emitters to lean towards the use of intermediaries and therefore demand for non-competitive bids may not be very large. The Commission emphasised the need to ensure

full and fair access for SMEs and small emitters. It is looking for input regarding this matter from the consultation process.

The representative for smaller carbon exchanges said that in Austria's phase 2 auctions there were SMEs participating in the non-competitive part, and according to them participation was rather easy since the price was transparent and there were not additional costs. Also, it was added that auctions proved to be a good instrument of getting the topic of emissions reductions on SME's and small emitter's agendas, which helps them develop strategies and advance their thinking.

The representative for larger carbon exchanges said that the market will come up with solutions for SMEs and small emitters by itself. The primary market should primarily be designed for large emitters. Also, they added that the design should be so as to allow adjustments and improvements in an easy manner, which was seconded by Ireland. The Commission commented that it is important to keep in mind that a too high level of flexibility will render the system less predictable.

The United Kingdom commented that they are developing their own structure for encouraging participation by SMEs. In the current model, participation by SMEs is very low, which is why it is important to offer the option to submit non-competitive bids.

Malta said that it needs to be defined what a small emitter is, and if the smallness differs across the sectors. The Commission explained that there may not be a need to define the term as long as there is equal access for everybody. Ireland and the representative for smaller carbon exchanges seconded this view. The representative for smaller carbon exchanges also added that defining SMEs would complicate the system, and that a system which is not over-engineered would allow SMEs to participate, as seen in the case of Austria.

The Emissions Trading Group also called for keeping the system simple and not to over-engineer.

WWF asked if civil societies that want to buy at auctions will be treated like small emitters. The Commission said that no special provisions are foreseen for them, maintaining the principle of open, transparent and non-discriminatory access.

Lot size and maximum bids

The Netherlands wondered if today's exchanges already have a lot size. The representative for larger carbon exchanges replied that the standard lot size is 1000 at the moment, no maximum bid size, and plenty of liquidity.

The Netherlands also commented that a maximum bid size would mean added bureaucracy and for larger buyers like the electricity sector the level might need to be rather high. The European Federation of Energy Traders and Eurelectric said that they are against a maximum bid size. In case a large player is constrained at an auction, others would buy more and there would then be more allowances available on the secondary market. Regarding market abuse they said that there are already rules in place on the secondary market and that this issue does not have to be dealt with for auctioning specifically.

Ireland asked how many bids a party can make. The Commission replied that this is one of the few issues not raised in the consultation paper. It is not clear at the moment, if

there is an interest in limiting the number of bids per bidder and if this is an issue at all, but the Commission invited everyone to submit their comments on this issue over the course of the consultation.

Reserve price

WWF asked why not to disclose the reserve before the auctions. The Commission replied that one argument against disclosure is to prevent the reserve price from becoming the focal point for collusion.

Ireland said that, since the market will find out the reserve price anyway, one may as well disclose it in advance. The Netherlands proposed to use the secondary market price of the preceding one or two days for the reserve price. Taking into account the volatility of the carbon price, the European Federation of Energy Traders did not favour this suggestion and prefers to have no reserve price, as this may distort the market. The United Kingdom said that they have a reserve price. It is not published but the methodology is broadly revealed and linked to the secondary market. The reserve price should only be triggered in case of extraordinary circumstances.

Germany commented that in their view the primary market should be designed as closely as possible to the secondary market, and added that there is no need to have the reserve price revealed.

WWF asked if the price methodology would be set by the Commission and if it would be the same for all Member States' auctions. If so, they added, this would cause huge distortions. The Commission replied that a reserve price, if provided for at all, needs to be governed by harmonised rules. It was also added that in case a fully centralised platform were used, there would only be a single reserve price. With a hybrid model supply and demand were to be aggregated at the Community level and there would as well be a single reserve price. Even with a decentralised system it would still be possible to have a reserve price set according to a common methodology for all Member States.

Eurelectric said there should be no price difference between the primary and the secondary market.

3. HOW WILL AUCTIONS BE IMPLEMENTED?

The Commission gave a presentation, and the floor was opened for questions and comments.

Germany emphasised the need to refrain from setting up a completely new infrastructure from scratch including all basics, but to rather build on existing frameworks and regulate only the issues that need to be regulated. The Commission replied that it aimed to provide an overview as a lot of issues need to be considered at the beginning already in order to not neglect any issues and to get a good picture of the various views from all stakeholders. This should be regarded as an opportunity to avoid errors in an early stage instead of having to solve problems afterwards.

Germany also thought that existing gaps in the money laundering Directive should be closed before setting up any rules related to this issue for the purpose of the auctioning exercise, which was supported by the representative for smaller carbon exchanges. The Commission argued that the purpose of the stakeholder forum is to discuss the subject

matter of the issues, and that the question of which legal act to incorporate any outcomes into would be a step after that. The Commission emphasised that they also have to consider possible future linkage to third countries' systems (e.g. the U.S.), which is why all pros and cons need to be discussed and weighed. WWF voiced their concern over the general public's rather negative view of the EU carbon market in its first years, and therefore suggested to take a step back and have a look at the more general questions before going into all the details. The Emissions Trading Group commented that one issue when considering linking to a possible U.S. carbon market may be the fact that there is no secondary market. The Commission replied that linkage is rather distant at the moment, but that such issues need to be kept in mind.

Belgium said that the participants in auctions would by and large be the same as in the current registries, which is why expertise on KYC issues would already be available in Member States. The Commission said that it will consider this expertise, but KYC for auctions would have to go much further than the basic identity information currently requested for the opening of registry accounts, the reason being that auctioning involves not only allowance transfers but also money transfers i.e. not only the identity but also the integrity and risks associated with the bidding profile of the bidder are relevant.

Preregistration

The Netherlands said that preregistration should be harmonised and cost-effective. Since preregistrations are already done, the actual issue is rather one of harmonisation, i.e. if preregistrations should be regulated, which would be favoured by the Netherlands.

The representative for smaller carbon exchanges said that preregistration should require a European bank account, since this way KYC issues would be already dealt with. They added that there are already lessons learned from current preregistration practices, which should be considered.

Eurometaux voiced their concern of an unbalanced regulation, favouring auctioneers over bidders. They also asked for a high degree of transparency. The Commission replied that its aim is to setup a framework for auctions to be conducted in an efficient manner, and that there will be regulation for both sides. With regard to the second issue, the Commission confirmed that a high degree of transparency will be maintained throughout the whole process.

The United Kingdom said that the revision of the Market Abuse Directive may be able to take into account some regulation for auctions. Regarding the issue of collateral they said that paying 100% of the price in advance can be a sufficient guarantee, which is done in the United Kingdom. The Commission confirmed the review of the Market Abuse Directive and reported that they are in touch with the relevant services.

The representative of the larger carbon exchanges said that preregistration and KYC checks is absolutely critical to any market, although this also means that some will be excluded through this process, which should be borne in mind as many of those will be SMEs. The Commission acknowledged the point made.

4. WHO AUCTIONS? AUCTION PROCESSES AND INSTITUTIONS

The Commission gave a presentation, and the floor was opened for questions and comments.

The Netherlands said that they are in favour of a hybrid system, but asked why the payment and delivery system is not brought together with the central clearing platforms, i.e. having one auctioning platform for both purposes. The Commission responded that these both could be done by one single entity such as an exchange for instance. The Netherlands also added that Dutch electricity companies are in favour of a fully centralised approach, and acknowledged that, although it looks interesting, the hybrid system may be too complex to set up given the short timeframes.

The Emission Trading Group said that United Kingdom business would prefer a single platform with full centralisation, and insisted on sanctions being part of the regulation.

The representative for larger carbon exchanges supported a centralised approach, and noted that for the buyers it is irrelevant where they buy their allowances from or which Member State receives the revenue. They also highlighted that currently around 20% of bidders come from outside the EU, which should be borne in mind, since for auctioning they also expect a high volume of activity from outside the Community.

Eurelectric supports a centralised model because of better efficiency, most harmonisation, lower administrative costs, and because it would ensure that allowances get out on the market early.

Malta commented that they support a fully centralised approach.

Germany again stated that the aim should be to set up auctions that make best use of existing structures and institutions, like it has been done in Germany. The Commission clarified that the hybrid approach does not imply doubling efforts and institutions.

Belgium asked if a hybrid approach were compatible with single Member States having their own platforms. The Commission said that the presented approaches would not be mutually exclusive.

The United Kingdom asked if the hybrid approach essentially aimed to delegate KYC checks to the Member States, whilst ensuring that the auctions themselves are centralised. The Commission replied that in the hybrid approach the auctioning relationship would be between the bidder and the national auctioneer. The central clearing platform would not be the auctioneer, but would be the supplier of an algorithm that would aggregate all demand and supply across the Community to achieve a single clearing price.

WWF asked if all the allowances that are foreseen to be auctioned include the 10% solidarity share as well. The Commission confirmed that all allowances which are not allocated for free need to be auctioned, and this also includes the 10% redistributed for solidarity and the 2% based on achievements under the Kyoto-protocol.

WWF also asked if the Commission could comment on the estimated costs involved for the various approaches, and if there would be financial burdens for the bidders. The Commission replied that for bidders it should be rather attractive to be able to access all allowances on one single platform. There are no cost calculations or estimates, but with multiple platforms each would have their own IT systems etc.

Denmark reminded that the secondary market can always compete with the primary market, even with a fully centralised platform. Participants will compare the prices of actions with those of exchanges.

5. AUCTIONING AVIATION ALLOWANCES

The Commission gave a presentation, and the floor was opened for questions and comments.

The United Kingdom asked if the auctioning of aviation allowances will consider the outcome of the Copenhagen summit (e.g. agreement on a global carbon market for aviation). The Commission replied that it considers the situation as it is at the moment, and that it needs to make progress even in the face of uncertainty.

Denmark commented that since there are fewer allowances to auction for aviation, the auctions may be held less frequent, and EUAAs could be auctioned together with EUAs. The Commission acknowledged the thought.

Belgium said that aviation could use the same system used for the auctioning of EUAs, but with different time slots to be efficient.

Malta commented that in case there will be an international agreement this may complicate the situation for aviation, since the sector will be under the ETS in 2012 but may be under an international scheme in 2013 or later.

A representative from the International Air Transport Association said that they hope to have a simple system, but they will also rely on EUAs. It was brought forward to keep the compliance costs low, and not to make it any more difficult than needed.

The United Kingdom mentioned that also for aviation access issues for small participants need to be borne in mind when designing the auctioning of EUAAs.

6. CONCLUDING REMARKS

The Commission gave a concluding presentation.

Stakeholder Meeting on Auctioning

30/06/2009

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