

Oslo, July 9, 2009

Nordenergi position on EU Emission Allowances Auctions

Nordenergi is the collaboration between the Nordic electricity industry associations. The members of Nordenergi are the Norwegian Electricity Industry Association, the Finnish Energy Industries, the Danish Energy Association, Swedenergy and the Federation of Icelandic Energy- and Waterworks.

The updated ETS-directive will increase the number of allowances to be auctioned from 2013 onwards. Auctioning, however, can be done in many ways and harmonized regulation in the EU is necessary. Nordenergi underlines that disturbance to the EUA market must be minimized as such disturbances would reflect to power market as well.

In the following we outline, in our view, the most essential issues for a successful auctioning.

For every subject there is a question number referring to the consultation paper from ICF International (on behalf of the European Commission).

Centralized auctions – one common platform (question 68)

Nordenergi believes it's essential that auctions are centralized in the EU, where member states pool together their EUAs. Centralized auctions will help liquidity and aid price stabilization, decrease administrative costs and lower transaction costs for participants. Moreover decoupling of the management of the auction from those benefiting from the proceeds will also ensure that potential conflicts of interest are avoided.

Even though some member states are not willing to participate in a central auction, it is important that as many member states as possible pool together their EUA:s in a common auction. The Nordic countries should promote such a solution and could arrange common auctions, but preferably more countries should join such an arrangement.

Furthermore a common European auction platform would make auctions more efficient. The platform should be electronic and linked to a single registry.

Small participants (section 1.4.6)

It is important that all companies, big and small, can participate in the auctions on equal terms. If small companies find that they don't have the resources to participate in auctions they should be able to use intermediates. Auctions need to be open for all financially fit actors in the market.

Auctions need to start early (question 1, 15)

Auctions need to be in place early, by mid 2011 for 2013/2014 allowances, as electricity companies need to hedge their positions ahead of time. It is common that generators sell out 60-80% of their electricity production a year in advance and some of the production even two and three years in advance. Early actions will give the market confidence that a system is in place and to be aligned with the hedging strategy of players, who need to purchase EUAs two to three years ahead. Failure to start auctions promptly could lead to EUA price spikes as the demand for phase 2 allowances increases significantly. As a consequence, customers will face higher electricity prices in 2013/2014.

What to auction – spot + futures/forwards (question 2, 3)

It is desirable to auction futures in addition to spot volumes so that market participants can hedge their positions without creating unnecessary requirements on up-front payment. Spot plus two forward products would be a preferable mix. For example 50% spot, 30% one year in advance and 20% two year in advance.

A firm auction calendar is necessary (question 5, 7, 14)

A firm auction calendar is essential to give transparency. The regulation on auctioning should specify auction dates and volumes preferably for the whole trade period 2013-2020. The quantum should be set on an annual basis. This should be announced at least 18 months ahead, but preferably even earlier. Besides, an indicative calendar should be announced for the later years.

If non-compliance with timelines and volumes occurs, penalties should apply. Such penalties could involve the loss by a member state of the volume of allowances not released on time.

If a centralized auction is not possible a firm auction calendar needs to be published well in advance specifying coordinated dates and volumes and penalties should also in this case follow non-compliance.

A relatively high frequency of auctions is needed in order to influence the price as little as possible i.e. to minimize distortions between the primary allocation prices and secondary market. On the other hand if there are too many auctions the participation will be too low. We suggest that auctions frequency should be weekly - monthly.

Auctioning types (question 18)

Nordenergi suggests that the design of auction should be built as single round auctions with multiple bidding allowed.

Single round auction is preferred (to multi-round) because it is simple and less administrative burdensome. Within the single round auction it should be possible with multiple bidding i.e. to allow bidders to set different volumes of allowances they are willing to buy at a given price. This setup works very well in the Nordic power market and we believe that it successfully can be transferred to the market for allowances.

Clearing price (question 19, 50)

Nordenergi suggests that the clearing price should be a uniform-price. This gives a non discriminatory price as all bidders are paid the same price. Moreover it is an advantage for small participants as the demand for insight in the market is small compared to alternative clearing price as pay-as-bid. This also implies that there will be no need to introduce non-competitive bids for small participants.

Reserve prices (question 21)

Any intervention in the market would reduce predictability and distort investment signals. This will increase risks and thereby prices. Reserve prices should as a basic rule not be used.

Use of market places (section 4.5.2)

Nordenergi suggest that existing market places should be used to handle the auctioning. This will minimize the expenses as potential bidders interested in futures auctions are in most cases already member of existing exchanges.

Existing market places have already set up necessary settlements and clearing infrastructure and are used to deal with the administrative and financial burdens associated with the auction process. Auctioned products can then be aligned with existing traded products. Besides, exchanges just provide the market place or auction process. They are not biased and can therefore offer objective products.

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Members of Nordenergi



Steinar Bysveen, Chairman of Nordenergi
Norwegian Electricity Industry Association

On behalf of:
Juha Naukkarinen, Finnish Energy Industries
Hans Duus Jørgensen, Danish Energy Association
Kjell Jansson, Swedenergy