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Minimising the Impact of Auctioning on EU Industry in the context of the EU Emissions Trading Scheme

It is our guiding principle that the non-ferrous metals industry should be subject to free allocation of allowances within the EU ETS to applicable benchmarks, encouraging increasing efficiency of production whilst avoiding the leakage of industry and carbon to jurisdictions with lower aspirations concerning climate change.

However, this will be to no avail if the internal market in EU allowances is such that the economic climate is seen as excessively risky to be attractive for manufacturing and this requires an orderly and transparent market.

Secondly, the issue of free allowances will be to no avail if the price of allowances that have to be purchased (above any free allowances) is unaffordable. In this context it is relevant that some sectors can pass on the costs of carbon to their customers, whereas much of large industry cannot, like the non-ferrous metals industry. In this context, the possession of an EUA is a licence to operate and not a marginal driver for efficiency. Bidding in an auction by a party that cannot pass through the costs against a party that can is evidently not a sustainable prospect.

The rest of this paper makes suggestions as to how these concerns may be alleviated. However, even if all suggestions are implemented, it will, in no way, decrease the need of monitoring and correcting the competitive situation, both inside the EU (the market for EUAs) and outside the EU (the international market for manufactured products). This correction must be done with a consistently high priority until the competitive distortion is removed.

To the extent that trade exposed industry is required to purchase allowances to cover differences in emissions from benchmark, we believe the impacts of auctioning on industry require specific attention, with the objective to maximise participation of industrials in auctions and to ensure that the auction process does not unduly impact the costs of compliance.

In this regard, we are particularly concerned that the EU ETS risks being dominated by large participants. Under such circumstances, the price of EUAs sold via auction and traded in the secondary market would be set not by the costs of abatement of the market as a whole but by the pricing strategies of dominant participants. We note that this risk has increased with the financial crisis already limiting the appetite of financial participants.

The impacts of auctioning on our industry can be partially mitigated by a sensible approach which maximises participation of all industry whilst ensuring through market rules and regulation that the dominant participants do not intentionally or unintentionally exercise market power within the market, which may lead to market distortion. To attempt to achieve this, the principles below should be followed:

- Market Transparency – we propose visibility of emissions reporting on a monthly basis to ensure information is fully available to all of the market, not just the larger participants. The results of auctions should be available to the entire market immediately following conclusion. This information should include a schedule and a price of allowances purchased by ultimate corporate entities.

- Market Abuse – we strongly support the proposal for a monitor of auctions and for the strongest possible application of the Market Abuse Directive (MAD) and other appropriate legislation to ensure that abuse does not take place both within the auctions and in the wider secondary market. This may include publication of net open positions on exchanges as is currently reported in commodities markets

- Futures vs Spot auctions – we support forward auction of some allowances, to provide direct access to forward delivery of EUA for industrials without having to trade through a bank or utility. We note that this should increase secondary market liquidity and have beneficial impact on liquidity on the forward market for power. We do not believe that the separation between Spot and Futures should be made by arbitrary calculations. We recommend an independent study to determine the optimum timing and volumes of release of allowances, taking into account the hedging requirements of all sectors and, especially, the power generation sector as they will impact on both the market price for emissions and for electricity.

- Direct Participation – consideration should be given to the ability of industrial installations to participate directly alongside the dominant sectors and financial participants. As industry has been more risk averse in its approach to emissions trading, seen as a non-core business, the rules should encourage its participation by limiting exposure to credit requirements such as collateral posting, creating simple and transparent rules, and by keeping transaction costs as low as possible. We believe that the need for collateral posting should be reduced and question its necessity at all for spot auctions. Furthermore, we believe that trade exposed industry should be encouraged to participate in Futures auctions through more flexible collateral options to reduce cash flow impact and costs of credit, including the ability to post EUAs from its free allocation where appropriate.

- Simplicity – we support single, simple, rules for all auctions, with clear timetable visibility and certainty as far in advance as possible. A single platform should be considered to maximise cost efficiency and effectiveness, if this is not possible homogenous rules are necessary to avoid arbitrage and disconnect. Auctions should be frequent, we suggest weekly, to ensure balance between liquidity and minimum market impact.

- Price Discovery - If reserve prices are necessary this should expressly be to prevent significant and unforeseen events leading to undue impact on auctions. As such the reserve price should be dynamic and a significant discount to prevailing secondary market prices. We propose that this be reciprocal and a ceiling be placed on auction prices to protect against a similar event leading to significantly higher prices. We have limited expertise to comment on the most appropriate price setting mechanism, however favour sealed bids and encourage that if a uniform price is chosen the broader auction design should protect against the risks of undue price spirals as a result of bidding strategies of individual participants.

- Cost – the relevant costs (including administration, IT platform, etc) of auctions should be covered through auction revenues not by an additional fee placed on successful bidders.

- Member State Participation – Member States should not be able to participate in auctions except in their role of releasing EUAs to the market. Enabling Member States to act as bidders in the auction risks increasing uncertainty and creating unnecessary distortions to market prices.

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