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ECCP STAKEHOLDER MEETING ON AUCTIONING

Venue:
***Breydel* building, Auditiorium**
45, Av. d'Auderghem-1049 Bruxelles
28-29 September 2009

MINUTES

Day 1 – Monday 28th September, 9.30 – 18.00h

The Commission described the consultation process as follows:

- It had been an open consultation process
- There was an interrelationship between the questions that needed to be recognised in interpreting and reviewing the results
- There had been a wide variety of stakeholders responding, but the response from SMEs had been very limited and there were some instances where there was apparent duplication of responses, presumably reflecting collaborative discussions between stakeholders prior to their responses
- In some areas, including some key points, there had been limited substantiation of the answers provided by respondents and many of the remarks echoed arguments raised in the consultation paper
- There was a high level of consensus on many issues within the consultation

The Commission then provided an overview of the results of the consultation (see powerpoint presentation), reviewing the statistical results and sentiments expressed. Comments and observations on the results were invited, although discussion of the key points and views was to take place later in the meeting.

EFET – There were various submissions that highlighted the need for early allowance auctions to meet the hedging needs of power generators and industrialists, so EFET were surprised at the lack of confidence in the evidence submitted.

IATA – Airlines do need to hedge forward sales in a similar manner to power generators, so IATA question the lack of need for futures, although given the reliance of airlines on OTC trades help in this area could be needed.

The discussion on specific issues focused on the following:

<u>Auctioning futures vs spot and Early Auctions</u>

The Commission outlined the complexities and issues associated with futures sales by Member States, including the difficulty of funding variation margin on futures sold by Member States (MSs). An issue that could affect MSs differently is the relative cost-of-carry for futures sold by different countries compared to each other and to the market cost-of-carry on EUAs. An example was provided to illustrate the potential for MSs to gain or lose as a result of this difference.

The Commission suggested that forward agreements were an alternative to futures sales; an EUA forward contract is already traded on Nordpool. Nordpool forwards are collateralised instead of calling for cash initial and variation margin as is the case for futures. MSs could conceivably post EUAs as collateral without paying either initial or variation margin. An issue with the use of forwards as an instrument would be the impact on the liquidity of the secondary market for EUAs. Another issue is that the blocked account for EUAs will probably not be ready until 2012.

There is an apparent need for early auctions possibly commencing in 2011 from responses to the consultation but the level of evidence provided to substantiate this need was limited. There is also a question regarding whether fully standardised products are what the market needs. When auctioning efficiently, there would always be a stable relationship between secondary market prices and auction prices, and this applies to both spot and futures.

The Commission described a number of technical issues associated with futures sales, including the impact on inter-exchange competition and the extent to which any futures products used would be fungible with others in the market. The Commission asked why the market would not be able to solve the supply of futures, particularly if sufficient spot allowances are available. Another aspect to verify is the extent to which forward power sales are indexed to future CO_2 prices.

Eurofer – Forward power sales with CO_2 indexation tend to be on-hedged, so there is no change in the net demand for futures. Eurofer raised the question of whether EUAs can be used as collateral for auctions, particularly given the registry issues and suggested that credit terms are crucial for forward agreements, including the variation in risk profile between MSs.

The Commission stated that credit risk with MSs was not an issue because they hold not only an entitlement to allowances to offset commitments but a statutory obligation to allocate the allowances through auctioning.

EFET – The availability of the registry is a key issue, the primary driver for the use of futures will be if spot allowances are not available. There is a large demand for allowances in advance, suggested the demand from the power sector may be 1.5 billion allowances, with 500 million banked and an assumed 50% hedge that leaves 500 million allowances needed to be released early.

CMIA – The discussion has assumed MSs as clearing members. Clearing houses are restricted in their ability to accept EUAs as collateral, but MSs could agree with a clearing member coverage of margin using EUAs. An alternative could be to remove the current restriction on clearing houses such that they can accept EUAs. Important to remember that MSs have a commercial interest in this as well as the emitting installations. Not sure what level of spot allowances would have to be available for the secondary market to cover the futures need. Any intent to bypass the existing market structures raises issues on the time and cost to set up.

Climate Action Network Europe (CAN) – Looking at data on banked allowances, project credit availability etc it looks like there will be enough to cover a year's forward hedging.

Italy – Why should MSs bear the costs of selling futures (if cost of carry for MSs is higher than that of the market)? The different cost-of-carry for MSs could be an issue if there are multiple platforms.

EACH – The role of the counter-parties is to sit between buyer and seller and transform credit risk. Some DMOs are members of CCPs and the margin arrangements can be bespoke so the margin conversation may not be a major obstacle.

Eurelectric – Eurelectric spent a fair amount of time discussing early auctions and their submission reflected the consensus on the need. The consequences of being short of allowances could be dramatic. In Phases 1 and 2 the free allocation enabled companies to be comfortable, futures are the closest match in phase 3 to the allocation. The move to auctioning is a crucial issue for power companies, a big step change. Full hedging tends to be their approach, which means huge volumes of allowances needed and the secondary market may not cope. MSs have the responsibility to provide tools to enable companies to cope because they created the market.

EFET – The transaction costs for early auctions are not necessarily large, existing platforms can be used and are being used by some MSs already. There is a need to be careful on cost-of-carry calculations because this is already affected by hedging activity. It is in the MSs' interest to avoid issues that hit the power market.

IATA – There are similarities between aviation and power, aviation will be short and will need liquid markets to hedge. There is a need to think about the impact of any measures on non-exchange transactions as well as exchanges.

The Commission pointed out that free allocation reduces the hedging needs for aviation, but please provide evidence on need. Also for aviation we need to bear in mind the ability to use EUAs and EUA derivatives. The Commission also clarified that the Directive stipulates auctioning, which will have to be standardised products, so OTC will have to come from the secondary market.

Nasdaq OMX (representing smaller exchanges) – It is not optimal for MSs to auction futures or forwards. The issue is finding sellers to match buyers for futures products, MSs are not there to take price risk. Theoretically you only need allowances released just before surrender, but this does not provide a liquid forward curve which is a real issue for buyers.

The Commission stated that all agree there is a need to avoid an artificial shortage, the question is what volume of spot is necessary to achieve this? Moreover, is it the availability of spot allowances on the market or clear legal rules of how they will be made available that matters?

CMIA – Clear terms are needed for carbon market participants to add liquidity to the market.

Eurofer – If there is no physical release of allowances then massive short selling would be required, which is not going to happen. The advance sales need continues post-2012.

Eurometaux – Should there be a study to determine the need for early auctions?

The Commission stated that the timeline for the Regulation makes it hard to undertake an independent study, that is why early auctions were a focus in the consultation paper.

Eurelectric – Current EUA price based on fuel-switching, will move the long run marginal cost curve of reducing emissions and short and long run prices will be related.

Auction Frequency and Size

The Commission introduced the issues on auction frequency and size and asked for views from the stakeholders.

Germany – Prefer daily auctioning for the full amount which could be broken down to weekly auctioning per process for several processes.

CMIA – Support the points made by Germany, with multiple processes the auction calendar gets crowded.

The Commission asked for views on the optimal aggregate frequency for the EU ETS?

Denmark – Agree that frequency is linked to the number of platforms. If multiple processes, then Denmark with 15 million allowances, so probably one auction, could be in a fight over the 'best' time slot.

Germany – The auction processes need to be based near to the secondary market then frequent auctions will not be an issue. If they are very separate then that creates an issue. Germany wants auctions close to the existing the secondary market.

The Commission reminded that the response to the consultation was mixed with only few supporting very frequent auctions with most support for weekly.

BusinessEurope – Daily auctions was not actually an option in the consultation paper. However, transaction cost is a barrier to too frequent auctions.

CMIA - The transaction cost per EUA may not be very different between auction frequencies.

Austria – Agree with Denmark that the frequency question is hard to answer without knowing the model. In a centralised model probably weekly.

Eurometaux – The auctions should be weekly to limit transaction costs.

IFIEC – Very frequent auctions are difficult for non-traders to cope with.

Eurofer – Automated systems should mean that cost differences between frequencies are limited. The impact on the secondary market is important.

Eurelectric – Given the secondary market, weekly is okay.

CMIA – Need to be careful about the difference between 'I don't want to participate in weekly auctions' and 'I object to weekly auctions'.

EFET – A frequency between daily and weekly should be okay. It is important that auctions don't become a focal point that disrupts the secondary market.

Nasdaq OMX– The incremental costs of daily auctions versus weekly would be very small.

Auction Calendar

The Commission outlined the issue around the auction calendar and pointed out a slight paradox in the consultation responses given the preference for evenly spread auctions when compared to demand fluctuations in secondary market activity across the year.

Eurelectric – predictability is the priority. A weekly auction frequency probably takes you to an even spread.

Netherlands – The likely end result of this issue is lower auction volumes over Xmas / New Year and the summer, otherwise an even spread.

Eurelectric – Is it a responsibility for MSs to spread auction volumes evenly over available auctions?

The Commission replied that this is also influenced by the model, under a centralised model the MSs receive a revenue share rather than committing volumes to auction themselves.

CMIA – What happens if the calendar is breached, where is the flexibility that would make the scheme more robust?

The Commission highlighted that it was necessary that the calendar has meaning and is binding. There could be different options for enforcement depending on the overall model. The Regulation, by its nature, will be directly enforceable throughout the EU. Its enforcement does not depend on national law.

Germany – EUA market is not the same as government bond markets, EUAs are the same whichever MS issues them. Germany intends to use a platform that leaves open the option for other MSs to join.

Primary Participants Model

The Commission outlined issues and costs associated with the use of a primary participants' model. The costs for bidders may be limited, but there are concerns over revealing trading strategies to players who are also active in carbon markets. Level of confidence in Chinese walls remains an issue.

Eurofer – Direct access to auctions is necessary, it is not acceptable to have to rely on primary participants.

Eurometaux – Supports direct access, perception is that the costs of accessing the market are lower via the direct route. Many bidders have the trading operation and skills to bid direct so why go indirect?

EFET – Why force bidders to use a direct or indirect route, the market already provides a choice? There are established exchanges with relationships with bidders already so the advantages of the primary participants' model are limited.

CMIA – The primary participants' model does have some advantages, it can offer a flexible contract route to bidders and the primary participants can aggregate bids.

Italy – Questioned the impact of using a primary participants' model (with limited bidders) on the EUA price and the cost of implementing a scheme.

EFET – A model with direct and indirect bidding offers more flexibility than the primary participants' model, what is the advantage of restricting bidders, why do it?

UK – Want the Regulation to allow all forms of market, primary participant, exchange, direct etc. The UK primary participant auction is now producing prices that have converged on secondary market prices. The UK has submitted a paper that discusses the operation of the UK auction which is now working well. The cost for the UK model is roughly £200,000 per auction of 4m allowances. After 5 auctions the UK now has 15 nationalities bidding in the auctions.

Nasdaq OMX – The more successful the overall process, the lower the number of direct bidders will be. A mature market will have lots of intermediary activity and fewer industrials involved.

BusinessEurope – Large players can and should have the option to bid direct, the exchange format works too.

IFIEC – Echoed the question on why bidders should be restricted, compliance buyers should have access.

UK – Only 20% of the allowances sold in UK auctions to date have gone to energy companies. The UK does not advocate a single approach, the primary participants model can work for some parties.

Eurofer + Italy – Having different platforms and different approaches becomes very complex, unpredictable and unmanageable.

Use of Exchanges

The Commission introduced the issues involved in using existing exchanges.

Germany – To date Germany has sold allowances into the secondary market and has received the secondary market price. They have launched a tender process with a set of criteria (inter alia the transaction costs for bidders and the government). The offers so far show that both MSs and participants will benefit.

3rd Party Service Providers

The Commission discussed issues associated with using third party service providers.

- Could develop a bespoke system but potentially with synergies with existing systems for other markets
- Advantage of neutrality versus selecting an existing carbon exchange or platform

SME Access

The Commission introduced the issues for SME access to the auction process.

- Compared the position to the preferences expressed by large emitters, do SMEs have a right to direct access as well?
- SMEs have to buy allowances, they have no choice
- There is a question whether direct access = 'full. Fair and equitable' access as required by the Directive
- KYC checks and requisite trading skills both significant if SMEs go for direct access
- Intermediation could have advantages for SMEs, could be provided by banks, energy suppliers or even airport managers. Advantage can be in cost terms, capability terms or price risk spreading amongst multiple auctions.

The Commission outlined some options to provide SMEs access, including a simple auction design and non-competitive bidding, although there would be costs involved in implementing non-competitive bidding.

Denmark – Why put SME clauses in the Regulation?

The Commission replied if the auction design seems to cater better for large emitters there may be a need to consider how SMEs can be helped to gain direct access cost effectively.

Germany – Every company has to make a decision on how to access the market. Putting auctions through an exchange can help because it allows this access to happen through existing arrangements.

Friends of the Earth – Can the Regulation differentiate between different sizes of companies?

The Commission explained that KYC checks can vary according to the scale of the bidder. Cross-border checks could pose a challenge.

UK – The UK has looked at options for non-competitive bids for SMEs. There is now a web-based interface up and running, this is online now and will test the need / appetite for this route. Surveys question whether there will be a need for this (limited response to UK surveys on this subject as for the EU consultation process itself).

CMIA – SMEs go indirect. Need to keep the burden of dealing with SMEs proportionate and make sure that any arrangements to deal with them also work for the market overall and counter-parties to their trades.

Nasdaq OMX– Exchanges allow for access for non-members now by contract with a member. The exchange rules cater for a variety of participants, dangerous to weaken or stipulate rules for dealing with types of bidder.

EFET – MiFID important for 3rd party service providers. The primary participant model could require major compliance buyers to submit to banking regulations if they want to go direct.

Commission – MiFID does not apply to trade in spot EUAs traded for immediate delivery and mainly applies to the provision of financial advice so may not be that relevant to energy companies activities.

CMIA – The concern is the uncertainty on the interaction of MiFID and carbon commodities via auctions and intermediation.

The Commission questioned what the position would be if it were clarified that MiFID did not apply.

CMIA – Clarity would be welcome, but how long would it take to get this?

EFET – Even if trades in spot allowances are not regulated, acting as an agent in an auction on a regulated market is different. Trying to find a fix to this given the movement on financial regulation could be hard, but some of the energy players have activities that require oversight by financial regulators already so might not be that big a deal.

The Commission clarified that regulation of the trade on the secondary spot-carbon-market will not be part of auctioning Regulation. There is a parallel work-stream on carbon market regulation happening, this could be addressed in that.

Italy – Also there is a freedom of choice issue for SMEs. Despite the discussion on financial markets, this is actually about the allocation of allowances on an efficient basis, including to SMEs.

Netherlands – Transaction costs are potentially an issue for SMEs, including membership fees etc. This can be an economic barrier.

The Commission stated that there is limited detail available on the relative costs of different routes. It is always possible as under the Primary participants' model that costs would be borne by MS. No decisions on who meets costs made as yet. At the moment the issue is to determine if special clauses are necessary.

Netherlands – There is a need to have a very low transaction cost. Including for SMEs who wish to participate directly in an auction.

CMIA – The difficulties to access a web-based auction are not very great, so that should not be overstated as an obstacle for SMEs.

Austria – There is a need to look at the position of SMEs. Simplified registration and low transaction costs are important.

Payment and Delivery

The Commission introduced issues on payment and delivery after auctions.

- Payment versus delivery was a strong favourite in the consultation
- But there is an issue with regard to collateral against trades in the event of an insolvency before completion, there may be a need to extend the definition of collateral to more than just cash.

Eurofer – Credit and collateral issues are big for OTC forward trades, terms can take a long time to agree.

Nasdaq OMX– Futures are traded with a daily margining system. Forwards are collateralised.

Eurometaux + Eurofer – Allow EUAs as collateral for auctions. This will reduce the collateral requirement for small emitters and overall.

CMIA – The EUA price moves and therefore the fact that the value of the collateral will change needs to be catered for. Any obligation imposed on exchanges that they must accept a particular type of collateral against payment obligations would be a concern.

EACH – MS default risk is very low because they have an entitlement to the allowances.

CMIA – MS and buyer risk profiles are different, but variation margin is an issue to be dealt with.

Day 2 – Tuesday 29th September 9.30-13.00h

The Commission reiterated that the purpose of the discussion and questions from the EC is to test stakeholders views on the issues involved in auction of EU allowances.

<u>Overall Auction Model – Centralised Model</u>

The Commission outlined advantages of the centralised model for allowance auctions and outlined a possible timetable for the delivery of a centralised model and explained that the achievable start date would be influenced by factors such as the number of languages that are offered by the platform at the start. It is also possible for the Regulation to set out transitional measures in case the centralised auction model is not in place when auctions need to start.

Netherlands – It could be a body other than the EC that organises a centralised process, the Netherlands and Germany are already in discussions on a platform.

The Commission raised that direct coordination between 27 MSs seemed difficult and would be a challenge given the urgency of getting the Regulation developed by Oct/Nov 2009.

EACH – What is meant by the phrase ‘platform’? Is that the auction in a limited sense or clearing etc as well?

The Commission - The full process. But it is entirely possible that consortium bids and proposals would be made which include clearing houses.

EFET – It appears that this takes 2 years to deliver something that already exists. Are we sure that transitional measures can work?

The Commission – The UK system already works. Views on how that is operating would be appreciated.

The Commission – There is a need to ensure that transitional measures do not obstruct the development of the long term model. It is not possible for public authorities to deliver auctions as quickly as private companies because of the legal selection requirements.

Germany – Germany is not convinced that a centralised model is best. But hypothetically, would the actual auction type be determined in the Regulation for a centralised system?

The Commission – It is not decided if the type of auction process would be specified in the Regulation, it would be possible to allow proposals for different types of auction.

CMIA – It will be difficult to be definitive in the Regulation, the best approach will be a competitive dialogue procedure. Also need robust transitional measures.

The Commission – A competitive dialogue is the process envisaged.

Germany – How could MSs be involved in a selection process for a centralised model?

The Commission – Could be through an auctioning working group with care taken to ensure secrecy of bids etc. The fees for the service provider would not be from the EC budget so the need for the MSs to be involved is understood.

UK – The UK has implemented two types of auction. A competitive bidding process using existing infrastructure that took 6 months to set up and a bespoke non-competitive system that took longer, say between 6 months and a year. If there are a limited number of languages available for interaction this could be perceived as a barrier to some participants.

EFET – Existing market systems work. There is a need to get allowances into the market, can we get EUAs into the market or not?

The Commission – Yes. Existing routes can be used if necessary, German and UK legislation already allows this. Language is the responsibility of MSs.

Italy – Given that there will be costs incurred before revenue from the auctions is available, where does funding come from?

The Commission – These costs could be pre-financed but the agreement with the service provider could also be for payment on delivery of the service.

Italy – Can a MS participate in the development of the platform to build capacity?

The Commission – Yes. This needs to be a partnership model between MSs and the Commission. In the end this is to meet the needs of the MSs.

CMIA – The bottleneck in this is the MS role, the sheer number of MSs involved will slow the process down. The technical implementation of a system once decisions have been made can be relatively quick.

Eurelectric – The transitional measures are key. Getting registry issues sorted is very important.

<u>Overall Auction Model – Hybrid Model</u>

The Commission – The hybrid model would represent a compromise and could be where we end up. The hybrid process was described, a central auction clearing process taking bids from local auctioneers, producing a single price across all local auctions and being based on a single calendar for allowance sales. There would be some cost duplication but also some advantages in terms of bidders choice of location and access route. There were some questions on the incentive of exchanges to participate given the uncertainty on volumes allocated and hence revenue for individual exchanges. Also questions on how to ensure level competition between different types of local platform, e.g. DMOs and exchanges. Should fee structure be harmonised? Also variation in whether potential platforms regulated, some would be, others not. This could affect which platforms can play a role in futures versus spot auctions. A single price could lead to convergence on fees etc, plus specialisation where warranted, but could also lead to a collapse in the number of exchanges involved.

Nasdaq OMX – The interface between the local platforms and the central entity will need set-up and testing so this has a time impact. Queried who in this model would be the counterparty to trades, there has to be a defined entity to contract with. What will the fungibility of auctioned commodities be?

The Commission – Fungibility is desired, views on obstacles to this would be useful.

Nasdaq OMX – It is an area to think about.

CMIA – There are contractual differences between exchanges. It would be easier if they all used the same clearing house but at the moment they use different ones. Exchanges are very concerned about the Regulation defining their relationship with bidders. Spot allowances should be fungible, futures should be offered as exchanges normally do but in a way that is aligned with the Regulation.

Nasdaq OMX – If the auctioning system is aligned with existing futures contracts then it will give the existing dominant exchanges a huge advantage.

The Commission – An option seems to be to define the relationship between the MSs and the exchanges in the Regulation, including a basic definition around products, and let exchanges do the rest, including collateral, payment etc.. A forward instrument would have to be developed.

Nasdaq OMX – For a new product the lack of fungibility would affect liquidity.

EFET – Who is the actual seller in this model?

The Commission – Ultimately the MS but the EUAs will be in a central registry and could go direct to bidders or via a local platform.

Nasdaq OMX – That is not an issue for bidders, they pay a local platform and receive the allowances from them. The rest is more an issue for the clearing house.

CMIA – The MSs need to use one entity as the central counterparty, that entity then is a member of each exchange to enable transactions to take place. There is no reason why the hybrid model cannot work, just need a small group to work out the options.

BusinessEurope – How will bidders know what will be auctioned where? What is the process for deciding which overall auction model will be used?

The Commission – It does not matter which platform you go through, EUAs are pooled and all are accessible from each platform, so it is actually a simple system in terms of knowing volumes available etc.

The Commission will present a proposal for the overall model by the end of October.

France – France sees the advantages of a hybrid approach in terms of a single price etc. In this respect, the hybrid and centralised approach have some common features. What is the role of the MSs in this model?

The Commission – MSs will need to decide on the local auctioning platform, e.g. DMO or exchange that will link to the system. Allowances will be distributed by the central entity to the highest bidders, fees will be paid proportionately to revenues.

France – Transaction risk appears to increase with the number of platforms, how can this be controlled?

The Commission – The number of platforms would be limited and there would be strict standards.

Italy – Some level of flexibility has been suggested for local platforms, but products will have to be homogenous?

The Commission – Yes, there will be separate spot and futures auctions but otherwise homogenous.

Austria – What would actually be incorporated into the Regulation if this approach were followed?

The Commission – Some elements would be the same and would be in the Regualtion, e.g. products, reserve price, price setting mechanism.

WWF – A lot of parties are not in favour of the hybrid option, but if it is chosen the penalties for exchanges that abuse the rules should be clear.

Netherlands – Who do the MSs pay, do they have to pay a platform that they didn't choose depending on the auction outcome and distribution of allowances?

The Commission – The payment arrangements have not been decided yet. However, one option would be for Mss not to pay any fees but for bidders to bear the fees. There are advantages from the scale of the auction process. The fee terms for exchanges to connect to the auction could be negotiated.

Eurometaux – from the industry perspective fees should come from auction revenues.

CMIA – Collusion between exchanges is a non-issue. The fee structure will be set. Exchanges would probably accept no fee for offering allowances but there are other costs, e.g. clearing and settlement, that will need to be covered and that could vary between exchanges.

WWF – There is a need to prevent any favouring of industries by MSs through exchange terms.

UK – The hybrid model is not ideal for exchanges because of the dislocation between the volume of bids collected and the actual volume of allowances sold. The IT risks are high compared to the coordinated approach and this will take a significant time to develop.

The Commission – A significant advantage of the hybrid approach versus the centralised or coordinated approach is the ability to access all allowances through the platform of choice.

Eurofer – Prefer the centralised approach. Which would be faster to set up, centralised or hybrid?

The Commission – Centralised.

Eurofer – Then very little appeal of the hybrid model.

Italy – The internet was created to reduce risks by dispersing IT capability (in the US military). Within the hybrid approach re-routing of bids is an option if a single platform fails. A back-up system will be in place. Italy does not see why a single price for EUAs is not an important feature.

Germany – The secondary market provides a single reference price for EUAs. The hybrid model looks very complicated. The auction process needs to be very integrated with the secondary market, a limited number of coordinated auction platforms will deliver this.

Italy – Prices should converge in auctions.

Germany – Yes, and be as close as possible to prices in the secondary market with high information flow between the two.

The Commission – There is general agreement that the auction prices should be very close to secondary market prices.

UK – Marginal differences in prices exist today as exchanges meet the needs of different participants. Corollary can be seen in EUAs. A limited number of platforms allows some differentiation to meet participants needs.

Eurelectric – Would pre-registration be harmonised or up to the exchange?

The Commission – There would be minimum requirements in the Regulation.

EFET – Who would hold the collateral? Would a bidder's relationship be with the exchange or with the central entity?

The Commission – There is no credit risk with the MS, they have an entitlement to the allowances to meet their commitments. Bidders would have a relationship with the exchange, but the exchange may need to implement measures contained in the Regulation.

EACH – There will be a chain of collateral arrangements between different parties.

Nasdaq OMX – Exchanges have an obligation to run a 'fair and orderly market', if this is in doubt at any time they need to suspend operations. Who is operating this market?

The Commission – need to think about how that responsibility works in this case.

Nasdaq OMX – It is necessary to consider suspension procedures.

EFET – There will be a central counter-party behind each exchange. There will also be a central entity with a relationship with each exchange and with the MS.

The Commission – there is no delivery risk with MS, they have the allowances.

Italy – Agree that there is no delivery risk with MS. Think the discussion is getting slightly side-tracked because of the attempt to apply financial market terms to the allowance auction. Maybe there is the space in the hybrid model for the central entity to organise the overall market and take responsibility for its functioning.

Netherlands – What do the existing exchanges think of the possibility of one auction process (given that there are several of them)?

The Commission – Feedback from platforms is that one is obviously simpler but a hybrid model can work. There is a parallel to a hybrid model in the electricity markets already.

BlueNext (representing the larger exchanges) – All exchanges will compete to offer either the centralised or hybrid model. The parallel with the electricity markets is market coupling but it took 2.5 years to connect 3 countries (versus 27 for EUAs).

Nasdaq OMX – Both models are feasible. Main aspirations should be no disruption to the secondary market and cost efficiency. The advantage to the hybrid model is the immediate contact with traders through existing relationships.

CMIA – Market coupling in power is different to the hybrid model in EUAs because of the physical and regulatory aspects to electricity flows. All models can work. There is an advantage to the hybrid model because risk is spread amongst multiple platforms.

<u>Overall Auction Model – Coordinated Model</u>

The Commission – This was the least popular choice in the consultation process. There are a number of issues associated with it including coordination of the auction calendar, lower harmonisation of rules and processes, potential discriminatory access, set-up timetable, cost duplication and higher monitoring costs. A key issue is how the number of platforms gets chosen and allocated. If there is opt-in and opt-out of a centralised process that creates volume uncertainty that could impede the development of a centralised process.

Germany – The description of the model misses the positive aspects, unlike for the other models. Some of the uncertainties can be countered by the Regulation. Certainly Germany has no interest in discriminatory auctions. The coordinated model can easily use existing infrastructure and relationships. The calendar issue can be addressed in the Regulation. Monitoring is at least as hard as in the hybrid model. A level of competition between platforms is a good thing, it spreads risk and maintains links to the secondary market and can make advantage of the still maturing infrastructure and the development of new services.

UK – Supports the German comments, the positive aspects of the coordinated model need to be taken into account. Spreading the timing risk is important given the need to deliver allowances and the overall timetable. Certainty on the volumes for the centralised process can be created by setting deadlines for opt in/out. It is important to note that support for this option in the consultation process was higher amongst MS than it was for the overall sample.

The Commission – This has not been dismissed as an option and the EC is obviously aware of the need for MS support.

Italy – Not sure why volume certainty is so important. The opt-in approach looks difficult given 27 countries to start with. It is hard to see how a centralised model and a non-harmonised UK/Germany/other approach would work in parallel.

WWF – Agree with Italy. Difficult to see what the impact of a country opting out would be. Maybe the countries wanting to opt out need to explain why the impact would be limited.

Belgium – Wants a centralised approach. In terms of fees, bidders will adapt bids to compensate for the fees they have to pay so net auctions revenues likely to be unaffected by whether bidders pay fees.

The Commission – Competition higher in the hybrid model where platforms compete for bids rather than having rights to auction a set volume.

Eurofer – Transaction costs will be higher in the coordinated approach versus the centralised model so preference for a single process. Transaction costs include the internal costs of companies dealing with a variety of processes.

Germany – Germany refers to the ETS Directive that stipulates harmonisation between Member States on the one side. On the other side, they want MS flexibility to decide whether to join a centralised model or not. The right level of harmonisation is important. Germany has tendered for the operation of their auctions with an initial 2 year service and an option to extend for another year, this is important because the market is evolving. Germany does not believe that it is possible now to stipulate the best way to organise the auctions for an extended period, e.g. 9 years out. The auction process should develop in parallel to the secondary market and adopt the best bits from that.

UK – Thanked the EC for the work on the various options but stressed the need to recognise political realities in some of the MSs. There will be criteria in the

Regulation to ensure that any countries running their own auction process do so in a fair way, the UK is thinking about what rules may be appropriate.

Netherlands – Agree with the advantages of flexibility and being dynamic but that could be achieved by limiting the term of the agreement for a centralised platform so would be able to adapt approach.

The Commission – Suggested potential advantages of the coordinated approach seem to be:

- Competitive
- Lower risk
- Existing infrastructure
- Close to the secondary market
- Flexibility

Do people agree that these are real?

Eurofer – If MSs are paying the fees then they should want efficiency and the selection process for a centralised platform would be competitive. IT systems in various markets are very reliable, there would be a back-up system in place and there is the secondary market as an alternative source of allowances.

The Commission – The scale of the centralised model could produce advantages on fee level.

Germany – Germany is reviewing tenders against overall cost not just the cost to the MS.

UK – The secondary market is hard to use, there is only one route allowed to get allowances into the market in Phase 3, which is auctioning.

Eurometaux – Their perception is that the centralised model is the most efficient and timely. If others can match that then they could be considered.

Eurelectric – The need is to get allowances into the market for 2011 and 2012. Therefore, there is a need to be pragmatic. A centralised system is preferred but whatever is chosen must be made operational quickly.

WWF – With the necessary level of harmonisation hard to see what MS opting out gain.

UK – The UK has 14 bidders from MSs participating in auctions now. No interest for the UK in any activities against the spirit of the auction process.

WWF – The carbon leakage experience raises questions on the motivation for countries wanting to opt-out. If the single platform was in their country would they still want to opt-out.

UK – Variety in market solutions is a good thing and a centralised model certainly unproven.

Germany – Agree with the UK on the positive benefits of variety. No need for new infrastructure, the auction process needs to be close to the secondary market. Where the computer is that runs the auction algorithm does not matter.

WWF – Do not see why we cannot have a centralised model that interacts smoothly with the secondary market. Can Germany provide any figures to show the comparative benefits of a coordinated approach?

The Commission – Time is limited, so for now will need to note divergent views. Everyone is invited to contribute views on how the eventually selected model can work smoothly with the secondary market.

Nasdaq OMX– The process should be designed to make life easier rather than result in a profusion of auctions, too many platforms would disrupt the EU ETS.

Netherlands – The centralised system seems to be very close to the German model but on a European scale.

The Commission – The centralised model has not been specified as yet. An exchange based approach could be used.

Italy – If the coordinated approach emerges as the solution there is a question over the number of approaches. Italy would want to have its own platform in these circumstances.

IETA – Strongly encourages the adoption of a centralised model. Big concern on 2011 and 2012 allowances so we need to understand the transitional provisions.

The Commission thanked all participants for their participation.

Stakeholder Meeting on Auctioning
28-29/09/2009
LIST OF PARTICIPANTS

Commission
DG ENV
National experts
Austria
Federal Ministry of Agriculture, Forestry, Env and Water Management
Belgium
Flemish Ministry of Environment
Federal Ministry of Environment
Czech Republic
Ministry of Environment
Denmark
Danish Ministry of Finance
Danish Ministry of Transport and Energy
Finland
Energy Market Authority
Ministry of Employment and the Economy
France
Ministry for Ecology, Energy, Sustainable development and spatial planning
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Federal Ministry of the Environment
Federal Ministry of Economy and Technology
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Ministry of Economic Development
Department for EU affairs
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Ministry of the Environment

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Ministry of Finance, the Economy and Investment
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KASHUE
Ministry of Environment
Romania
Ministry of Environment
Ministry of Economy
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The Netherlands
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Ministry of Economic Affairs
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Embassy of Iceland
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