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IETA Response Early Auction Consultation

The International Emissions Trading Association (IETA) welcomes the opportunity to comment on the timing and volume of early auctions as requested by the European Commission¹. This answer has to be seen in the context of previous responses by IETA on auctioning of emission allowances in phase 3 of the EU ETS.²

IETA is the leading voice of the international business community on the subject of emissions trading with over 160³ member companies from across the carbon cycle. IETA supports efforts to address the pressing environmental challenge of climate change and is dedicated to the establishment of environmentally effective market-based emissions trading systems that generate reductions at least cost to the community.

1. Key recommendations

Currently, there is a lack of trust in the basic infrastructure provided by the registries and confidence of market participants into the future and highly scaled-up European Union's Emissions Trading Scheme (EU ETS) infrastructure is key to the well functioning of the market.

In the current context of heightened security challenges for the EU ETS infrastructure, the Commission and Member States are asked to provide better visibility on the implementation process for a fully functional infrastructure.

To restore confidence that the transition to phase 3 will not suffer regulatory driven disruptions, IETA recommends the following steps:

- **Detail by April 2011, possible milestones for implementation** of both the central auctioning platform and the Union registry.
- This should include a **calendar for early auctioning**. This calendar should be coordinated with the sale of 300 million EU emission allowances from the New Entrant Reserves (NER300) as well as any sale of surpluses from national phase 2-New Entrant Reserves.
- In parallel, IETA calls for the set-up of a **user forum for EU ETS infrastructure**, allowing market participants to feed in user requirements into the design process and to build up confidence and foresight allowing adjustments to the new framework for phase 3.

Moreover, at the moment, we are faced with an unsolvable equation:

(i) Market participants have no information on the status of the Union registry and are left to assume it will be delivered very late in 2012, possibly later;

¹ http://ec.europa.eu/clima/consultations/0006/index_en.htm

² See www.ieta.org under position papers

³ The full list can be accessed on www.ieta.org.

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(ii) The European Investment Bank (EIB) does not seem to envisage starting the monetisation of the NER300 ahead of the registry commissioning through sales of futures;

(iii) Member States are opposed to procuring temporary forward/future auction platform(s).

In order to prevent significant market distortions, the Commission and the Member States must absolutely break this deadlock within the next two months.

2. Relevant factors for fixing early auction volumes

2.1 Infrastructure and NER 300

The decision on early auctions **cannot be taken independently from different factors which are outlined below:**

- **NER300 sale:** it is critical to receive clarity on *how many* EU emission allowances (EUAs) from the NER300 will be monetized, *when* and *by which sales channels*. With regards to the amount of EUAs to be monetized, IETA received mixed signals. As per the Commission's discussion paper⁴, the entire NER300 was intended to be monetised in 2012. However, according to the EC-EIB cooperation agreement⁵ "Monetisation of at least 200 million allowances shall be concluded no later than 10 months after the allowances have been transferred to the EIB" which provides no clarity on the volume of phase 3 EUAs that will be monetised in 2012. The answer to the early auction volume question is necessarily different whether 100 or 300 Mt from the NER300 are going to be monetised in 2012.
- **Implementation of Union Registry:** When will the the Union registry be ready? This will determine the possible start dates for both the NER300 monetisation and auctions. A delay in the operation of the Union registry is expected to delay the start of early auctions. As a result, volume of phase 3 EUAs released early will likely have to be smaller to avoid a sudden dumping of EUAs in quantities market participants will have difficulties absorbing. Thus, the question on volumes can only be answered in the context of a commissioning date for the Union registry.
- **Availability of temporary platform(s):** The Auctioning Regulation provides for the possibility to hold auctions under forward or futures contracts. The commissioning date for the Union registry would be less important to decide on early auction volumes if such temporary auction platforms were available. It should be clarified, soon after the deadline for opting-out of the common platform ending 19 February 2011, whether and how the Commission and Member States will procure a platform for transitional auctioning.

⁴ Released on 3 December 2010

⁵ Dated 31 December 2010



2.2. Market confidence

For market participants, the following factors are also of key relevance and not mentioned in the consultation paper:

- Intermediaries provide a critical service to the market in smoothing temporary imbalances. However if the overall auctioning structure is not established in a transparent and accurate manner, it will affect confidence of all market participants that phase 3 EUA volumes can reach the market in a timely manner and undermine the ability of intermediaries to play their role efficiently.
- Power companies have some degree of flexibility on the timing of their hedging policy. However, once they have made a decision to sell power forward they need to hedge the fuel and CO₂ components at the very same time, hence secure the corresponding volumes of EUAs.
- Based on the draft Commission regulation approved by the Climate Change Committee on 21 January, market participants can only use international offset credits (CERs and ERUs) from industrial gases subject to qualitative restrictions for their phase 2 compliance. As a result, a large quantity of CERs/ERUs will be swapped into EUAs before the end of phase 2, which should increase the volume of EUAs available ahead of phase 3.

2.3. Timing of Decision

The capacity of market participants to adapt to the eventual decision on early release is critical. If it comes too late, it will necessarily have an impact, even if it is the best decision based on fundamentals.

IETA expects a decision on early auctioning by April 2011. This would require the Commission and Member States to accept a certain degree of uncertainty when making that decision. However, we see this as a necessary trade-off as a later decision risks leading to significant market corrections when announced.

3. Volumes

It is not IETA's role to take a view on the volume (or range) that should be auctioned early. However, IETA would like to highlight that, without a reasonable confidence that the auctioning infrastructure is ready and operational in time, market participants will act in a very conservative manner and this would undermine the efficiency of the market.

To provide such confidence, it is important that early auctioning is scheduled and takes place well ahead of phase 3 to ensure that any issues arising during an early auction could be fixed in a timely manner with a view to deliver a functioning market infrastructure during Phase 3.