EUROPEAN COMMISSION

MEMO

Brussels, 25 July 2012

Q&A Emissions Trading: Commission prepares to change the time profile for auctions of emission allowances

Question 1: What has the Commission presented today?

The Commission adopted a proposal to clarify a specific provision in the EU Emissions Trading System (ETS) Directive[1] related to the timing of the auctions of emission allowances. In parallel, it also transmitted a draft for a possible future amendment of the Auctioning Regulation[2], which is an implementing act, for consultation to the Climate Change Committee. Finally, it released a Staff Working Document[3] that contains analytical information.

Question 2: Why has the Commission proposed a Council and Parliament Decision to clarify the ETS Directive and what is needed to adopt this Decision?

The Commission is considering a change of the auction time profile for phase 3 allowances. This is done by amending the Auctioning Regulation. Such a change has already been done on one occasion with the effect of advancing the timing of auction volume (see Question 8).

In order to provide a high degree of legal certainty after such a change, the Commission considers it useful to amend the Directive. This is done to clarify in explicit terms that, in order to ensure an orderly functioning of the carbon market, the Commission is in principle able to adapt the auction timetable in the Auctioning Regulation.

Question 3: What is the current time profile for auctions?

Article 10 of the ETS Auctioning Regulation establishes that the annual volume auctioned is the difference between the total amount of allowances resulting from the application of the linear factor and the amount of allowances handed out for free in line with EU-wide free allocation rules.

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[1] *Directive 2003/87/EC (consolidated version):*

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:02003L0087-20090625:EN:PDF

[2] *Commission Regulation (EU) 1031/2010 (consolidated version):*

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2010R1031:20111125:EN:PDF

[3] *Staff Working Document: "Information provided on the functioning of the EU Emissions Trading System, the volumes of greenhouse gas emission allowances auctioned and freely allocated and the impact on the surplus of allowances in the period up to 2020"*

The Regulation provides for one deviation from this rule, namely the "early" auctioning of 120 million allowances in 2012, with a corresponding reduction of the auctioned volumes in 2013 and 2014 by 60 million allowances.

Question 4: Why should the auction time profile be changed?

The EU ETS is faced with exceptional circumstances. Due to the transition from the second trading period (2008 to 2012) into the third trading period (2013 to 2020) the supply of allowances (and international credits) is expected to increase temporarily. Together with reduced emissions due to the macroeconomic circumstances this will increase significantly the surplus of allowances in this transition from phase 2 to phase 3.

This surplus build up during the transition from phase 2 to phase 3 is expected to coincide with a decrease of demand that can hamper the orderly functioning of the market. Changing the auction time profile, with less auctioning early in phase 3 and more later on, can improve the orderly functioning of the market.

Question 5: What is the status of the draft for a future amendment of the ETS Auctioning Regulation transmitted to the Climate Change Committee and when will this amendment be decided?

The draft for a future amendment is at this stage transmitted for consultation purposes.

Amendments, once proposed by the Commission, are sent to the Climate Change Committee where Member States decide by a qualified majority. In a second step the amendment is subject to a 3-month scrutiny by the European Parliament and Council. As the last step the Commission formally adopts it.

The Commission has transmitted the draft for a possible future amendment to the Climate Change Committee to get the views of Member States on the appropriate action to be taken before the end of this year. The Commission at the same time also invites stakeholders to express their views on this draft.

Taking into account the views by the Climate Change Committee, the Commission will decide on a proposal for such an amendment. The Climate Change Committee may decide on the future amendment before the end of the year.

Question 6: How can stakeholders express their views?

The Commission invites stakeholders to express their view on the draft for a future amendment of the Auctioning Regulation (EU) No 1031/2010.

Stakeholder views can be sent to the following email address: CLIMA-auction-backloading@ec.europa.eu.

Reactions should be sent by early October.

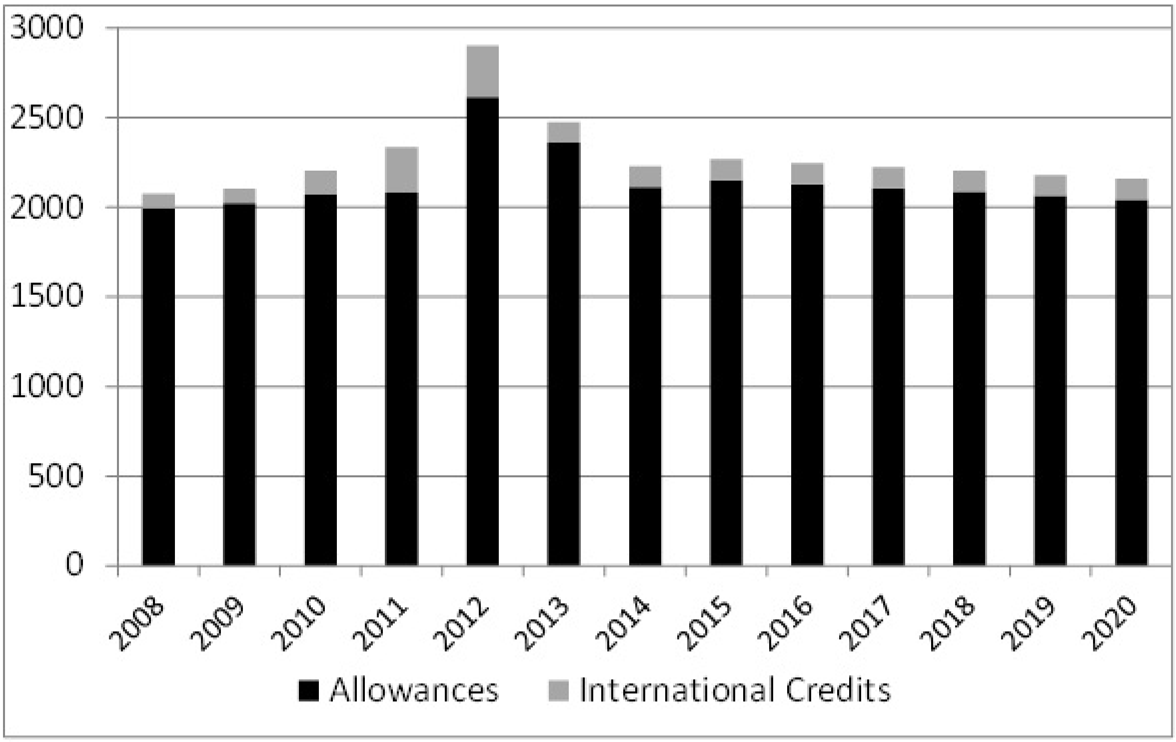
Question 7: Is the Commission preparing an impact assessment?

The Commission is preparing a proportionate impact assessment which will largely build on the present Staff Working Document with further input received during the consultation. This tailor-made impact assessment is under preparation to enable the Climate Change Committee to decide on the future amendment before the end of the year.

Question 8: How many allowances (and credits) are put on the market year by year?

Allowances are allocated for free or auctioned. 2012 and 2013 see a large increase. In part this is due to the inclusion of new sectors (incl. aviation) and gases, while there is also an exceptional increase because of some particular provisions in relationship to the transition from phase 2 to phase 3.

A graphical presentation can be found below. It should be noted that final allocation and use of international credits are subject to a degree of uncertainty.



Question 9: Is a change to the auction time profile not a market intervention and will the Commission intervene again in the future?

The auction time profile is not decided in the ETS Directive itself, but rather determined in the Auctioning Regulation. It means that the legislator saw merit in a more flexible decision-making process for the time profile, if deemed necessary, for example to address grave imbalances in exceptional circumstances. Therefore, changes to the auction time profile were enabled in the Directive. Using this certain degree of flexibility should by no means be equated with market intervention.

The Commission will only use this option to change the auction time profile in exceptional circumstances, such as the present situation in the transition from phase 2 to phase 3, where supply outstrips demand not only due to lower than expected emissions, but also because of regulatory aspects specific to the transition into phase 3.

Situations of artificial and large temporary imbalances warrant a change in the timetable.

Question 10: How many allowances should be back-loaded?

The Staff Working Document gives information about the potential range of back-loading by looking at three options.

The back-loading concerns the distribution of auctioned allowances across the eight years of phase 3 (2013-2020). It sees auctioned volumes reduce in the first three years of phase 3 and bringing them back later in phase 3.

The examined options reduce the volume of auctioning in the first three years of phase 3 by 400, 900 or 1200 million allowances. At present the total volume of expected auctioning of phase 3 allowances up to 2015 is more than 3.5 billion[4]

Before making a final proposal on what an appropriate amount would be, the Climate Change Committee and stakeholders are being consulted.

Question 11: What does back-loading mean for the carbon price, costs for ETS companies and auction revenue for Member States?

The purpose of back-loading is to improve the functioning of the carbon market, and not to increase the price.

Back-loading is expected to increase the price in the short term when auctioned volumes are decreased, and reduce it when the volumes are increased again. It is not possible to determine with certainty the absolute impact of back-loading on carbon prices over time.

Over the longer term, the impact of a back-loaded auction time profile is likely to be limited given that total quantities over the 8 year period do not change.

Compared to a no-action scenario, back-loading would deliver a steadier price signal throughout the third trading period. Also auctioning revenues for Member States would be expected to have a steadier pattern across phase 3.

As regards the analysis of impacts on EU industry, such a proposal is not expected to have a major or lasting effect. Market analysts confirm that any short-term price increases are expected to be rather limited if not accompanied by a structural measure.

Not only does the change in the auction time profile not affect the total amount of allowances to be auctioned (it only affects the timing of auctioning), it would not impact the amounts of free allocation to industry. Furthermore, many industries actually have a surplus of allowances allocated for free which would alleviate also part of any cost impacts.

Question 12: When will the carbon market report be adopted?

The report is expected to be finalised later this year.

[4] *Including aviation allowances and NER300. Not taking into account allowances that some Member States can transitionally allocate for free for electricity production).*

Question 13: Does the Commission see no need for measures beyond back-loading to address the structural surplus in the EU ETS?

Structural measures would impact the functioning of the market in a more fundamental manner. The Commission intends to look into this matter in its Carbon Market Report.

Question 14: Why did the Commission already change the auction time profile by frontloading 120 million allowances?

The profile for auctions was changed once already to accommodate growing hedging demand at the end of phase 2.

Hedging demand exists where companies that forward sell some of their production want to hedge already at the same moment some of their expected emissions. They thus need to acquire allowances already today for obligations in the future. For example, a power company in 2012 sells in advance part of their power production in 2014 and at the same time buys emission allowances to cover those emissions in 2014.

As long as the forward sales related to sales in phase 2, they were covered by free allocation. Therefore hedging strategies never materialised into real demand on the secondary market for allowances, because companies were already sure that they would get the allowances for free in the future.

But by the second half of phase 2, power companies started to forward sell production that would take place in phase 3. Given that they would not receive allowances for free in phase 3, they had to start buying on the market to hedge these forward sales.

Hedging demand has thus translated into a growing demand on the market for allowances or international credits towards the end of phase 2. This demand probably has been absorbing part of the build-up of surplus allowances.

In 2011, when prices for allowances were still stable at around €15, it was projected by some market participants that this hedging demand could increase prices temporarily, if only phase 2 allowances or international credits were available to meet this demand. Therefore, it was assumed prudent to meet some of this hedging demand by already auctioning phase 3 allowances in 2012, i.e. the 120 million early auctioning.

After the decision was taken to change the auction time profile through this early auctioning of 120 million allowances, a number of counterbalancing elements materialised. Most notably, the use of international credits for compliance purposes increased markedly in 2011 and the economy continued to stagnate. Emissions in 2011 decreased by 34 million tonnes and also projections for the next decade for the emission growth decreased.

In 2013, hedging demand of course will continue to exist, but whereas in phase 2 those companies that needed to acquire those allowances had only a limited supply of auctioning that could serve this demand, from 2013 onwards the increased amount of auctioning is considered to largely meet the remaining hedging demand. Therefore, hedging demand will not absorb large quantities of surplus allowances from 2013 onwards.

See also IP/12/850