CER-Exchange rates not exploited by many operators in EU - Polymer chemical plants reinitiate fight over 100,000 tons of CO2

The exchange rates for CER/ERU into EUA published by the EU Commission on 02. May 2014 were a surprise for most emissions trading professionals, as these were still far below the general expectations. Instead of the expected quantity of up to 400 million tonnes for the tax year 2013* by European operators it was only 132.8 million tonnes, which was probably mainly due to the German plant operators or because of completely new legal rules for participants. About this new exchange method for "Old and New plants" in emissions trading and the chances of isolated high additional revenue - our Emission-News 06-2014 wants to inform you. Furthermore, we highlight the dispute, which is obviously emerged between the EU Commission and the DEHSt which deals with the polymer production in the German chemical industry, which is to be protected by the German legislature to fulfil an obligation for the EU Emissions Trading and we cover the politically sensitive sanction notices of DEHSt against a high number of airlines.

The economic aspect of CER/ERU exchange in Germany and the EU

At the time of May 2013 an amazing number of 139,7 million t not unused CER/ERUs open to the charge remained in the 1.869 plants in Germany for delivery years 2008-2012 - either from unknowing or because of previous legal clauses that limited the use of CER/ERU (Source: Own analysis of the numbers published by the EU in May 2013-it only considers 1.040 plants, with more than 100 t open exchange potential).

Even if you subtract most relevant 157 plants of EnBW, RWE, E-on and Vattenfall of the 1.040 plants, there remains an undrawn exchange amount of 49 million CER/ERU, which is distributed to 881 German plants. These are on average around 55.600 CER/ERU per plant or until May 2013 undrawn funding of 250.000 EUR per unit (CER/ERU price difference of 4.50 EUR/t expected to EUA).

Well you could still leave the 58 plants of large corporations disregarded which have not fully exploited their exchange potential of more than 100.000 tons for 2008-2012 until April 2013. It still came to 823 plants of the German middle class, which have a more open exchange potential of 11,33 million tonnes; this corresponds to 13.766 t CER/ERU or about 62.000 EUR per plant of a company!

So it is no wonder that insiders of emissions trading now in April 2014 estimated that the new swap quantity until the end of April 2014 would be up to 400 million tonnes (for the whole EU). However, this prediction turned out to be completely wrong: As announced by the EU Commission on 02.05.2014, only 132.8 million tonnes of CER/ERU were exchanged for EUA, that
means, only 33% of the expected amount! This meant that for the period 2008-2013 with 1.178 million tonnes approximately 75% of the estimated total 1.571 million CER/ERU total exchange amount from 2008 to 2020* was met until the end of April 2014 according to Point Carbon (These included the 4.5% exchange rates of "New plants" on whose verified amounts to 2020). Therefore up to around 393 million tonnes of CER/ERU are open for exchange in the EUA. This corresponds to a financial benefit of more than 1.75 billion EUR that the European companies (presumably mainly German companies) may yet collect in the opinion of Emissionshändler.com®.

The fact that European (and probably mainly German) companies took hardly advantage of this opportunity in April 2014 in the opinion of Emissionshändler.com® was allowed to have lain mainly because the education of the operators concerning the use of open exchange rates completely went wrong. There is also the still very unusual method of swapping CER/ERUs into EUA on the registry account (without an obligation for delivery) which most decision-makers of medium-sized plant operators have not understood simply due lack of information. And what one does not understand, one of course does not do well.

The legal situation for exchange of certificates
For the most operators, the Registry Regulation 389/2013 is still an unknown document, especially if it’s not about laws and regulations, but chances to generate additional revenue for once. The Article 60 of the Regulation of 02.05.2013 regulates the use of international credits by exchange against (EUA)-Certificates:

An operator may apply for an international credit until 31. March 2015 in Article 11a paragraph 2 of Directive 2003/87/EC and by 31. December 2020 in accordance with Article 11a paragraphs 3 and 4 of the mentioned directive to replace against a generic certificate. He proposes accordingly provides for a transfer of international credits from the relevant operator holding account to the EU-account for international credits for plant operators in the Union Registry.

The vast majority of operators has previously only known that CER/ERU instead of EUA allowances under a certain nationally defined rate (Germany: 22% of the amount of allowances 2008-2012) could be used for the return. Who as an operator had not exploited this rate until the end of April 2013 often went so far to assume that therefore the case was settled.

The EU Regulation 1123/2013 and the German ICE list
Also the aforementioned new Registry Regulation 389/2013 and the Regulation 1123/2013 of 08.11.2013 about laying down the use rights for international credits now allows that unused CER/ERU-delivery rate can be further used in the years 2013 to 2020 by exchanging the accordingly remained open amount of CER/ERU from 2008-2012 in EUA in the registry account of the operator. According to Article 2 of Regulation 1123/2013, each Member State had one month after the effective date of the regulation on 08.11.2013 to inform its operators to what extent they are entitled to a certificate exchange over the whole period 2008-2020.

With a delay of a few months this has then passed through the DEHSt on 31.03.2014 and was done via E-Mail by providing the corresponding "ICE" pdf table (International Credit Entitlement) with the total exchange rates per link.

At this time, most operators were busy to deal with their VET entry in the account or even with the delivery of the certificates under the new rules of the Registry Regulation and the need to suddenly include a second account representative in the delivery process and not realized their extra chance of an additional financial revenue.

The German ICE list shows 65 pages to around 1.500 stationary plants and reports their total exchange potential from 2008 to 2020. It should be noted here that the prior information on March 2014 refers and that in this case not all the increased exchange volumes were taken into account for capacity expansions. The current status is available in each case in the public part of the EU-Register in the data of the respective plants, which is updated every 24 hours.
The exchange in the case of "Old plants"
The ICE-list is basically only helpful and valid for plant operators who have received a free allocation before 2013 ("Old plants") and does not apply to "New plants", which refers to plants that are newly acceded to the mandatory emissions trading in 2013. The exchange of CER/ERU starting from 01.04.2014 means that the open exchange amount of "Old plants" is no longer coupled to the discharge amount. Clearly said: CER/ERU are converted to EUA in the registry account of an operator meaning they are “gone” directly after being confirmed by a second transaction account representative and a corresponding EUA number is "there". Whether then suddenly additionally present EUA are saved or submitted for compliance in the next April or are sold does not matter at all.

What amount of CER/ERUs can be exchanged for EUA, can be calculated either by the operator or be seen in its registry account.
A calculation can be carried out according to the formula: CER/ERU quantity according to ICE-list minus already emitted CER/ERU in 2008-2012 = open exchange potential. The same result is reached when an operator looks into his register account and looks up the table in the lower left of the menu item balance where the still usable limit is reported.

<table>
<thead>
<tr>
<th>Name</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>CER/ERU-Gesamt-Limit</td>
<td>34 563</td>
</tr>
<tr>
<td>Abgegebene CER/ERU für 2008-2012</td>
<td>25 000</td>
</tr>
<tr>
<td>Umgetauschte CER/ERU in 2013-2020</td>
<td>0</td>
</tr>
<tr>
<td>Anzahl CER/ERU in Umtausch befindlich</td>
<td>0</td>
</tr>
<tr>
<td>Verbleibendes, noch nutzbares Limit</td>
<td>9 563</td>
</tr>
</tbody>
</table>

Table of open limit to use

This revision of the open exchange rates naturally has serious advantages especially for plants that emit very little CO2 due to special circumstances in relation to the allotment. This applies especially to plants using alternative fuels and biomass plants which also benefited on previous high allocations due to partial combustion of fossil and so far were hardly able to submit CER/ERU because seen from an absolute perspective they only had minimal emissions.

The exchange for "New plants"
Plant operators with "New plants" (Obligation for Emissions Trading from 2013) can also make an exchange of CER/ERU into EUA in their register account but only 4,5 % of their verified emissions and only after this amount has been officially established by the VET-entry at the end of March of each year (see also Emission-News 04-2014). In practice, this means that new plants cannot “finish payments” in a single transaction like some old plants can do independently from the number of arising emissions but have to work with smaller transactions always related to the real amount of the previous year.

Even more important is that new plants effectively handle this instrument of swapping CER/ERUs for EUA and don’t have to deal with the purchase or exchange of correspondingly smaller CER/ERU volumes every year in April. The here resulting mainly internal effort in the company will render the exchange benefit to naught.

For example: The verified amount of a new plant in 2013 is 10.000 t and will be approximately the same in the seven subsequent years 2014-2020 according to internal projections of the operator. Based on this scenario, the operator can now perform its exchange in two variants. Either as an annual transaction or as total transaction plus an additional purchase:

**Variant A - Annual transaction:** With a verified amount of 10.000 t in 2013 the operator needs to acquire 450 CER/ERU (10.000 t x 4,5% = 450 CER/ERU). This currently corresponds to a price of 0,15 EUR/t, that concludes in a purchasing volume of 67,50 EUR.

Just here you can already see that someone responsible for shopping who still wants to deal with comparing offers from different providers is trading totally ineffective even though the exchange gain is 2.025 EUR (EUA 4,70 EUR/t minus CER 0,20 EUR/t incl charges = 4,50 EUR x 450 t). If you repeat this process every year it is clear that there must be more effective variants.

**Variant B - Total transaction plus purchase:** With a verified amount of 10.000 t in 2013 the operator needs to acquire 450 CER/ERU (10.000 t x 4,5% = 450 CER/ERU) which he conservatively extrapolates to the year 2020 and reaches a volume
of 3.600 CER/ERU. These CER1/ERU1 (which is valid until 31.03.2015) have a price of 0,20 EUR/t and CER2 (which is valid until 2021) have a price of 0,50 EUR/t. This gives an approximate purchasing volume of 1.530 EUR (450 t +450 t x 0,20 EUR/t in 2013 +2014 and 6 x 450 t x 0,50 EUR/t for 2015-2020).

The exchange gain is 4.050 EUR (EUA 4,70 EUR/t minus CER 0,20 EUR/t incl charges = 4,50 EUR x 450 t x 2 years 2013/2014) plus 11.240 EUR (EUA 4,70 EUR/t minus CER 0,50 EUR/t incl charges = 4,20 EUR x 450 t x 6 years 2015/2020) at a total exchange gain of 15.390 EUR.

In the event that the current conservative extrapolation turns out to be too low the operator can still make a small purchase in 2021.

**Conclusion for exchange**

Considering both versions listed above not only from the standpoint of effectiveness but the long-term price certainty it is clear that variant B has another advantage because the CER2 which are at least valid until 2021 are available at specialized dealers even as spot delivery. That way one has not only acquired a price certainty until 2021 for about 0,50 EUR/t by leaving the acquired CER on stock in the account but also can be done with the subject “exchange” for 8 years - a not to be underestimated advantage for many decision-makers in emissions trading.

From the perspective of a plant operator it’s now important to ensure that the relatively simple exchange process can also be explained simply in the registry account and that taking advantage of price differences of CER1 and CER2 with the exchange benefit can be included. For the exchange it must also be taken into account whether it is a plant with high EUA-surpluses for which a further decline in prices of EUA certificates would be a decisive disadvantage or a plant whose every year decreasing allocation leads to the fact that an even more possible exchange can move an EUA purchase slightly backwards in time.

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**Infobox**

**CER1/ERU1 and CER2 as Spot-Delivery**

The only until 31.03.2015 applicable CER1 and ERU1 certificates should be obtained now by operators with open exchange potential as these are either hardly available towards the end of their validity or could be exposed to high price volatility. The use of CER1 and ERU1 derived from reductive years before 2013 must be made quickly in March 2015 for new plants since they can be exchanged only after the VET-entry (old plants can already do that exchange). CER2 certificates are valid until 2020.

In any case it seems sensible to look at the existing exchange potential in its own tab in the account menu item account balance or extrapolate in new plants and to get the appropriate amount CER1/ERU1 and CER2 early as spot delivery. Emissionshändler.com® will gladly create a delivery offer for this under info@emissionshaendler.com.

The addressed problem can only be understood if one takes insight into the complicated process of how a national policy in the European context is created. This is sketched here in the emergence of the guidelines for the allocation of allowances for the third trading period.

The European-Commission published on 23.04.2009 the Directive 2009/29/EC amending Directive 2003/87/EC so as to improve and extend the community system for trading greenhouse gas emission allowance. According to this Directive the air transport as well as the aluminium and chemical...
industry are involved in emissions trading in the third trading period of the years 2013 to 2020 in addition to the previously known industries. In addition combustion installations with many new combustion activities are to be included in the third trading period through the new definition of the emissions trading scheme for instance drying plants and thermal units for post-combustion. No longer is the energetic recovery of the heat created during the combustion process prioritised but the conversion of carbon to carbon dioxide.

The corresponding text in the Annex 1 of the Directive stipulates the industry sector chemistry (bulk organic chemicals) as follows:
"Manufacture of bulk organic chemicals by cracking, reforming, partial or full oxidation or by similar processes, with a production capacity exceeding 100 tonnes per day."

This Directive had to be implemented by each participating nation into national law. The nations had some leeway because adjustments to national circumstances must be taken into account especially in the licensing process for the construction of facilities. For Germany this reaction is carried out by the TEHG from 21.07.2011. The previously quoted specification for industry sector chemistry (bulk organic chemicals) found in Appendix 1 of TEHG under point 27 gives the following formulation:

Equipment for the production of bulk organic chemicals (alkenes and chlorinated alkenes, alkynes, aromatics and alkylated aromatics, phenols, alcohols, aldehydes, ketones, carboxylic acids, dicarboxylic acids, carboxylic anhydrides and dimethyl terephthalate, epoxides, vinyl acetate, acrylonitrile, caprolactum and melamine) with a production capacity of more than 100 tonnes per day.

So here the general terms of process technology which European Directive limits itself to were already replaced by concrete product concepts whose production is subject to emissions trading. The European Commission then looks at their implementation and compares them to their original intention. Well it turned out that obviously the chosen formulation in the European Directive provided too much room for interpretation, so that country-specific differences arose greatly.

Therefore the Commission had decided to issue a guideline dated 18.03.2010 that provides additional explanations. This document was only in the English language available to Emissionshaendler.com.

It is entitled: Guidance on Interpretation of Annex I of the EU ETS Directive

Now the spirits were beginning to separate on the undefined term "bulk organic chemicals". The Commission therefore felt compelled to closer explain the interpretation of bulk organic chemicals in this additional document. Section 5.1 of this Guideline states: What are "bulk organic chemicals"?

In summary the answer it boils down to is that they are chemicals that
- are produced in large quantities
- continue processing plants serve as base materials and
- is released during the production process in the chemical carbon (process emissions).

It is accompanied by the following illustrative list:

However it is very explicitly stated that the products mentioned in this list are only examples and the list is not comprehensive. But to consider whether the activities carried out in the plant processes make the system for emissions trading relevant to each individual case. The commission apparently already added the term „Polymers“ to this list.

And on this point arises the „Conflict“ between the Commission and the German Government mentioned above

In Annex 1 to TEHG the term polymers does not appear. The persons responsible in the Federal Environment Agency and the DEHSt are probably of the opinion that the polymer-producing companies are already largely covered by other
provisions such as requiring steam that flows through the boiler systems to detecting the fuel consumption in production (but there are also farms that belong to the polymer production which emissions of the chemical processes are not recorded).

The emissions of other companies where this is not the case but still release carbon dioxide in the chemical process in the preparation of polymers would be estimated to an amount of approximately 100,000 tonnes of CO2 in a number of around 100 not yet recognized companies to add to the list according to an unnamed lasting professional so the effort to additional detection does not justify in German opinion.

As is evident here a lot of discretion is in the game and Germany and the Commission have come to far different results in this judgment. An agreement has not yet been done but apparently to be forced by the actions of the Commission.

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Our offer
Please contact us without obligation at +49 (0)30-398 8721-10 or info@emissionshaendler.com as well as via mail or find out more about the Internet services under www.emissionshaendler.com.

Kind emission regards
Michael Kroehnert

Infobox
61 Sanction letters and penalty notices issued for airlines

On April 24, 2014 the DEHSt has issued 61 sanction letters with a penalty notice to aircraft operators that failed to complete their certificate surrendering obligations by 30.04.2013.

All those airlines, administered by the DEHSt have received penalties ranging from 100 EUR up to 825,000 EUR.

According to our investigation in the EU registry system, currently 167 airlines are administered by the DEHSt, out of which 61 now have received a formal penalty. This is an actual rate of 36% of aircraft operators that have failed to comply with legal requirements.

The main reasons for non-compliance according to our sources where that airlines had not opened the registry account in time, had failed to submit a verified emission report altogether or surrendered too few certificates too late.

In many instances one may also be suspected that some foreign airlines had simply been forbidden to meet their legal obligations by political leaders.

Of 13 German airlines which have been assigned a sanction notice it is not yet known which of these will issue an objection within one month. But looking for example at the case of insolvent OLT Express Germany which has been out of business for very long on the date 30.04.2013 it is clear that there can be very legitimate doubt in many cases concerning the extent to which sanctions of the DEHSt are entitled or even enforceable.

In addition to the payment of the penalty sum which is derived from the formula "100 EUR/t x (too little/too late surrendered quantity)" – also the missing quantity of allowances must be supplied.

(Emissionshändler.com® gladly supplies even small amounts when ordered).

Furthermore it is very unlikely especially for registered airlines in China, USA and Russia to follow the notification of the DEHSt freely on their own - or will not have the permission to do it. This now open chapter of EU-sanctions against airlines that are Non-European-based but administered by the DEHSt is likely to get a very special political note and a few surprises could still follow.

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