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Emission News 12-2014

Practical Information for Emission Trading

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EU Council sets a new framework for the climate targets until 2030 - EUA certificates prices raise significantly

Despite or even because of the half-baked and generally formulated proposals of the EU Council regarding a framework for a climate and energy policy in the EU until 2030 one can observe a trend of rising certificate prices in the market.

The schedule which has to be detailed by the Commission until March 2015 and the proposals to be completed by December 2015 could mean for plant operators who held back with necessary purchases of allowances, a significant financial burden if they postpone their demands further. This is significant mainly because the instrument of a market stability reserve MSR is increasingly becoming into the focus of market participants. To assess as an operator or market participant, to what extent one hand, these first ideas of the council and the following elaborated actual regulations can affect a EUA price upwards we need to take a closer look. The present emission letter 12-2014 examines this fact and on the other hand how the currently hidden 900 million backloading certificates can act in opposite market directions (with or without MSR).

So the "Conclusion Paper" from the Council of 23 / 24. Oct. 2014 is considered in more detail here, especially the first time mentioned possibility for a one-time withdrawal of certificates from the trading system.

The framework for climate and energy policy of the EU 2030

The so called „Conclusions", adopted by the EU Council, the body of EU Heads of State and Government, at their meeting on 23/.24. October 2014 deal in addition to the current topics Ukraine and Ebola mainly with the "framework for climate and energy policy until 2030 ".

Regarding the timeline this paper of conclusion states:

"The EU will present its contribution in accordance with the agreed timetable for the conclusion of a global agreement on climate change at the UNFCCC Parties in Warsaw no later than the first quarter of 2015. The European Council calls on all countries to submit in advance of the 21st Conference of the Parties in Paris ambitious goals and strategies. "

This gives the EU a position to meet its obligations under the Warsaw Summit in 2013 to present a schedule.

The EU Council conclusions

The conclusions of the Council meeting of 23 / 24.10.2014 can be subdivided with respect to the climate and energy policy to 2030 in seven different areas. These are:

1) GHG emission reduction target
2) EU-ETS
3) Sectors not covered by the EU ETS
4) Renewable energy sources and energy efficiency
5) Creation of a fully functioning and interconnected internal energy market
6) Energy Security
7) Governance (Official guide)

Only the first three point's pf the paper have been analysed by Emissionshändler.com® and they are therefore explained in greater detail below.

1) EU Council for GHG emission reduction target

The EU Council supports a "binding" EU target, to reduce the EU internal GHG emissions by "at least" 40% compared to 1990. The goal is to be achieved by the EU in the most cost effective manner possible. The 40% target is divided compared to 1990 into

- 43% compared to 2005 for the EU-ETS and
- 30% compared to 2005 for the non-ETS sectors

The EU Council has thus adopted the old EU Commission proposal of 22 January 2014 and enhanced 40% target by two political attributes:

- "binding"
- "at least"

The "binding" intends to stress the political seriousness of the target. The "at least" is intended to express that in a successful conclusion of an ambitious global climate agreement at the UN Climate Change Conference in Paris at the end of 2015, the EU could their climate change by 2030 may also increase the target.

Since the EU Parliament always called for stronger targets rather than the EU Council, it can be assumed with high certainty that the EU will not fall behind the 40% target, but perhaps even seeking higher goals. The breakdown of the 40% target between EU ETS and non-ETS sectors with each other, however, is less certain, as this should depend on whether and how much the EU ETS with its share of about 45% of the total emissions in Europe will be reformed in the coming years.

2.1) EU Council position to EU ETS with respect to the reduction of surplus stocks

The main two statements to point 2 of the paper are that to achieve the 40% target a "well-functioning, reformed" ETS "with an instrument to stabilize the market in accordance with the Commission's proposal" should be the main European tool and that the EU ETS will be the main weapon in the fight against climate change, ahead of the renewable energy and energy efficiency.

The "instrument" to stabilize the market is the already since January discussed MSR, i.e. the market stability reserve that was not introduced by the old Commission legislative proposal and is now awaiting a decision by the Council and Parliament. For further information see our box on the right and our detailed description in our emission letter 07-2014 dated June 2014th

Infobox

How serious can the commission proposal be taken

Regarding the analysis of the council's paper it should be first pointed out that such "conclusions" in the EU are not legally binding, but merely intended to represent orientations for the new EU Commission, who took up her post on 1 November 2014.

The Commission can deviate in their future EU legislative proposals, since only they have the so-called right of initiative. For the EU laws - also called EU directives - must be agreed not only the EU Council, but also the EU Parliament. The new EU Parliament but had not yet had the opportunity to comment on the 7 relevant thematic areas of climate and energy policy.

In the event that these two institutions Council and Parliament should disagree, a compromise always has to be negotiated by them. Once again, in doing so they are completely free, and could be departing from the Commission's proposals. Thus, even if nothing is final yet decided, the Council conclusions give important insight on where the development of the EU climate and energy policy until 2030 is heading.

Furthermore, according to the Council document the factor by which the amount of the provided EU emission allowances will be reduced annually should be increased from the current 1.74% to 2.2% from 2021, which will lead to a clearer shortage in the market, this in turn is a potential for price increases of certificates. The EU Council also thereby follows the old EU Commission proposal in January 2014th

2.2) EU Council for EU ETS free allocation with respect

Even after year 2020, there will be free allocation of emission allowances, but this only for carbon leakage systems.

It is clear now that in contrast to previous interpretations of the guidelines plant operators in the years from 2021 basically will not get any free allocations. This will effect heat supply systems and industrial plants which cannot benefit from carbon leakage advantage.

At closer consideration of the Council conclusions it is clear that the relevant regulations should be modified, and these changes are only indicated and also the changes disagree in part. For example, the:

- benchmarks in terms of technological progress in the respective industry sectors are to be periodically reviewed and adjusted if necessary (for the duration of the periods will not say anything)
- direct and indirect CO2 costs are to be taken into account (but only in accordance with the EU rules on state aid)
- incentives to innovate for the industry should remain in full
- administrative complexity should not increase
- affordable energy prices are to be guaranteed
- windfall profits are to be avoided

Particularly unclear is the meaning of the sentence: "Future allocations are designed to ensure better alignment / adjustment to changing levels of production in different sectors."

Here, in particular, one may ask the questions, whether the allocation to the assets should be to the ex-post level of production or whether the CL status of individual sectors with regard to altered levels of total production sectors should be checked.

Overall, it probably will be seen that in the result of modifications will reduce the circle of CL plants, but this does not lead to a reduction in the EEA amounts, because this process only appropriate amounts will be redeployed from the free allocation of the amounts to be auctioned. This will increase the demand on primary and / or secondary market, but the offer on the primary market (auction quantities) is increased at least theoretically, to the same extent.

2.3) EU Council regarding EU ETS exceptions to the free allocation

From the principle, to only allocate free emission allowances to only CL systems, EU states can (but do not!) vary with a per capita GDP below 60% of the EU average, and opt to not auction a maximum of 40% of the available auction amount of emission allowances and instead use this free allocation for the energy sector until 2030.

This proposal applies to all Eastern European countries and Croatia. Since Germany is well above the 60% mark, free certificates are issued only to CL systems in this country.

All other systems receive nothing. However, the allocation of modalities including their transparency should be improved to ensure that this is used to promote real investment for the modernization of the energy sector and prevent distortions in the internal energy market. How this will be achieved at the same time, is not disclosed currently and will remain a mystery for now.

Infobox

The Market Stability Reserve (MSR) in short form

The proposal and strategy of a market stability reserve MSR consist of the idea that an excess amount of 400-833 million emission allowances in the EU ETS are to be "managed".

This is accomplished by this the action to take the excess amount "Surplus" (Allowances in Circulation / AiC) from the market, if it has a height of at least 833 million EUA (which is currently of course the case) and at later times when certain conditions the volume is again returned into the market.

Specifically in numbers, this means that if the AiC exceeds an amount of 833 million tonnes, then 12% of the AiC in the following year will be transferred (t + 1) into the MSR and therefore deducted from a regulated auction amount and not auctioned.

The transferred emission rights are released into packets to 100 million tonnes from the MSR again and will go to auction if the following two conditions are met:

- The number AiC in the reserve are less than 400 million tonnes
  and / or
- similar to the Article 29a of Directive 2003/87: "If the price of emission rights exceeds for more than six consecutive months, three times the average price of emission rights of the two preceding years on the European CO2 market"

The second condition means that the MSR for example, had already been introduced, the EUA price would be about ***18-20 euros****, so that the EUA from the MSR would have taken back out on the market. This already indicates a potential and possible price level for future years.*

Detailed description about the MSR can be found in our emission letter 07-2014 dated June 2014th

2.4) EU Council regarding the EU ETS auction amounts

90% of the yearly auctioned allowances by Member States in the period 2021 to 2030 are to be

allocated among the EU countries according to historic emissions. The remaining 10% are received by the Member States with a per capita GDP of less than 90% of the EU average (all eastern and southern European countries excluding Italy). But beforehand already 2% of the total available emission rights should be retained and converted into a new EU-reserve, from which their auctioning revenues should be used in projects to improve energy efficiency and modernization of energy systems of Member States with a per capita GDP below 60%.
Unfortunately it is not possible to derive from these proposals, what will be the total amount of initially available EUAs- per year for auction in 2021.
Only after the establishment of the new CL-regulation and thus the establishment of the amount of EUAs, which is distributed free of charge, this will be possible. This amount must be deducted from the total amount of 2,020 x 97.8% to obtain 100% of the EUAs to be auctioned.
These are then distributed to 90% according to historical emissions and to 10% of the 90% -Pro-capita GDP countries. This then leads to the proportion of available for auction EUA amount for Germany.

3.1) EU Council on the "non-EU-ETS" sectors regarding burden sharing

For fixing the national emission reduction targets for the sectors not covered by the ETS the previous complex method of the burden-sharing-decision until 2030, being based on a relative per capita GDP (GDP = gross domestic product), should in principle be continued. However, no Member State should be granted more emission increases, but all States should be given reduction targets between 0% and 40%.

3.2) EU Council on the "non-EU-ETS" sectors with respect to a "flexible" target fulfilment

The existing possibilities for a 'flexible' achievement of their national targets (0-40%) should still be expanded and improved. This is designed supposedly to cover the cost effectiveness of common EU effort. Stating this, in the opinion of Emissionshändler.com®, is an admission that this has not been the case previously.
Indeed, the specific differences in costs for emission abatement are in fact enormous both within states and between states and anything but cost effective. It is not to see how this could not be improved in the future, also not through the new way to shift allowances one time out of the ETS sector in the non-ETS sector.

For this purpose, the inference-paper states in point 2.12:
"The availability and use of existing flexibility instruments in the sectors not covered by the ETS is to be significantly improved to ensure the cost-effectiveness of joint EU action and the convergence of per capita emissions by 2030. A new flexibility in achieving the objectives - for Member States whose national reduction targets are significantly higher than the EU average as well as on their cost-effective reduction potential, as well as for Member States that have not received a free allocation of allowances to industrial installations in 2013 - is a created ***before 2020 through a limited one-time reduction in EU ETS allowances****, while the reliability of expectations and the ecological integrity is preserved.*

Notice

In our Emission News 11-2014 we reported about alleged entanglements of EnBW and appropriate ongoing investigations by authorities in connection with VAT fraud in electricity trading. For this purpose, EnBW issued the following statement:
"The EnBW has no knowledge of suspicions against EnBW and an ongoing investigation in this regard. Due to an already present coverage of other media, EnBW immediately has initiated contact with the prosecutor Mannheim / department of economic crime. There EnBW learned that the Mannheim prosecutor performs no investigative proceedings against EnBW in connection with potential sales tax fraud in electricity trading. Other investigations of other authorities are unknowns at the prosecutor office in Mannheim. "

This aforementioned objective of the EU Council could be implemented in practice as follows:
The quantities of a state available for auction in the period 2021-2030 will be reduced by deletion of a determined amount of EUAs in the EU-ETS. The corresponding amounts of allowable emissions in non-ETS sectors (i.e. z. B. in traffic) are to be increased.

However, this option is not available to every state, but only to the States which are with their national reduction target in the non-ETS sectors significantly above the EU average and above their "cost-effective reduction potential"; such as Germany.

How and when the "cost-effective reduction potential" of the States will be determined, it is not yet known. For example, this may be the case for a study of "scientific institutes". How then this flexibility should work exactly in practice, is currently still unclear also among professionals.

Regarding the probability that i.e. Germany and other Member States make use of this unique withdrawal of EUAs from the EU-ETS exercise cannot yet be said.

In any case, there exists a main case argument and a main case counter argument.

- Speaking against it is that a State would forego with this method on parts of the auction proceeds.
- Speaking for it is that perhaps the otherwise necessary additional subsidies of measures in the non-ETS sectors would cost more money

A possible indication of a onetime withdrawal can be found in the recent policy statement by Chancellor Merkel of 10.16.2014, where she states:

"The federal government counts on a clear signal for a rapid and sustained reform of the European emissions trading scheme. It is and remains the central instrument of climate protection in Europe and must make by 2030 its contribution to the new climate targets.

Here we have to be able to reduce the existing surplus of allowances as quickly as possible and to bring emissions trading back on track. "

It therefore seems that also here (regardless of the instrument of a market-stability reserve) a possible and also great potential for a price increase in certificates is visible, which operators should keep in mind at all times.

3.3) EU Council on "non-EU-ETS" sectors, especially the transport sector

The transport sector according to the wishes of the Council is to reduce GHG emissions. The Commission will examine further instruments and measures for a comprehensive and technology-neutral approach.

For this purpose, it should be noted that such an approach has long been on the table - namely the inclusion of the transport sector in the EU ETS. The Member State Denmark had proposed exactly that. But apparently it was too early for such a decision. Germany was not able to make decisions in this regard and the other states remained silent. Interestingly instead it was merely reminded that the Member States after current EU law can unilaterally include the transport in the ETS. It remains to be hoped for, that the initiated debate by the Federal Emissions Trading Organization bvek gains momentum in Germany and with the support of the Danish initiative, will still be successful.

Infobox

Climate Tax for Airlines remains

Commercial aviation, an industry that has been hard plagued by charges and legal regulations industry must face yet another blow since Wednesday 5/11/2014. On Wednesday, the Federal Constitutional Court ruled that the passenger tax collected since 2011 does not violate the fundamental rights of the airlines or the passengers (Ref. 1 BV 3/11) and continue to be applicable (and collected) as tax for climate control or general tax.

The relevant passenger tax, which is levied on all commercial passenger flights taking off in Germany, meaning, airlines pay a levy per each passenger. This applies regardless of whether the provider is a German or a foreign commercial aircraft operator. According to the news magazine Focus, the tax alone, costs the four German airlines Lufthansa, Air Berlin, Condor and TUI-Fly about 500 million euros in 2012, criticized the Federation of German aviation industry (BDL). That is significantly decreasing profits and prevents investment in an industry that every year again must face the additional challenges and costs of EU emissions trading. As a matter of fact, legislative initiatives such as the passenger tax in Germany or the EU emissions trading lead to a distortion of competition for airlines with flights to Germany / EU. Whether or not at the end of the day such costs can be passed on to the passenger is very questionable.

4.1 Germany already wants the Market Stability Reserve in 2017

Regardless of the paper of the EU Council conclusions of 23/24.10.2014, the Federal Government reaches the conclusion, in the recently published Green Paper of the Federal Ministry of Economy and Energy for the electricity market and the energy transition, that the excess quantities of

allowances in the EU ETS must be reduced significantly faster, as previously planned. For this purpose, it is written on page 36 under 2.2:

"... .. The Federal Government is committed to a rapid and sustainable reform of the ETS. It aims to introduce the proposed by the European Commission's market stability reserve by 2017 and to convert the 900 million backloading certificates in this reserve.. Furthermore the market stability reserve, especially when considering the shall the thresholds and withdrawal amounts, must be designed to degrade the surpluses significantly and quickly ... "

Whether the Member State Germany within the EU will win the argument to use the MSR before 2020, of course, is not sure. But if it will be the case that an expected opposition from Poland should not be overly strong, then this is also an effective price signal for the EUA to move upward.

The effects of the conclusion-paper on the EUA price

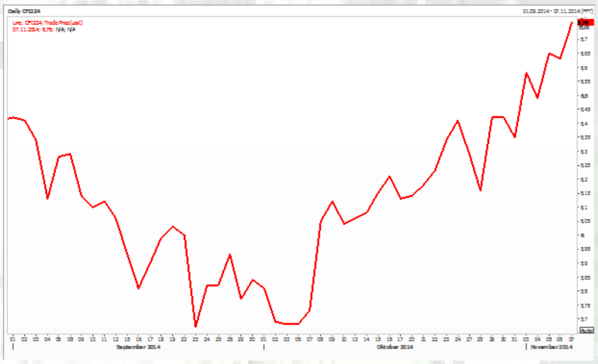
Despite or even because of the half-baked and generally formulated proposals of the EU Council this conclusion-paper provides a large room for interpretation by market participants, which is also fuelled by the possible pre-emptive introduction of the MSR in 2017.

Raising Prices since 08.10.2014

After years low on 03/28/2014 with a closing price of 4.40 EUR / t for the DEC14 it first went straight uphill to 5.77 € / t on 04/27/2014.

After the surrendering period for the operators in Europe had concluded on 30/04/2014, prices dived middle of May 2014 again under 5 € / t before a permanent increase in the price began until late August to 6.46 € / t.

After a period of weakness in September the EUA decreased from 5.67 € / t on 09/23/2014 starting a new run and ended on 11.07.2014 with 6.76 € / t.



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Conclusion

The partially thoughtful ideas of the EU Council, which do not always seem logical in itself, will have to be structured and detailed by the European Commission in the coming months.

However, these conclusions contain enough food for thought to indicate that the times of stagnating EUA prices in the foreseeable future will be over. In particular, and for sure this will be the case if the MSR will be introduced already in 2017 and the unique withdrawal of EUAs from the EU ETS should materialize. But even if both measures or do not materialize in the end, the other ideas of the conclusion paper are poised to raise the price level significantly over 7-8 euros.

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Kind emission regards

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