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Practical Information for Emission Trading

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Carbon Leakage and Windfall Profits in the EU-ETS - Taking Stock in the middle of the current trading

The "Carbon-Leakage Danger" for the European industry and the much maligned "Windfall Profits" are themes which are repeatedly a target for lobbyists, NGOs, and media of the European emissions trade.

According to the view of Emissionshändler.com®, the topics Carbon-Leakage and Windfall-Profits should be subject of a more objective consideration at the second half of the third trading period of the European emissions trade. This above all because studies were published which strengthen one or another myth and risk to lead the discussion about frame conditions for market participants of the 4th trading period in a wrong direction.

In the **Emission News 13-2016**, Emissionshändler.com® sheds some light on the rather unusual unity within the range of political parties in our neighboring country France, in terms of environmental and climate issues.

In its article, Emissionshändler.com also presents the opinions on how climate and environmental issues are viewed by ordinary French citizens.

The "Carbon-Leakage-Danger" and "Windfall Profit" Gifts

In conformity with the season, Emissionshändler.com® refers in its Christmas edition of the present **Emission News 13-2016** to possible Windfall-Profit gifts the European industry is

supposed having received so far - according to various different statements and according to a study, too.

On behalf of the climate protection organization Carbon Market Watch the Dutch consulting company CE Delft studied the consequences of the EU-ETS on the economic situation of system operators being obliged to the system. 19 of 28 EU member states took part in the study and Germany was one of them.

The result of the study is that on one hand no signs are recognisable so far for a relocation of production sites outside the EU due to burdens caused by the EU-ETS ("Carbon Leakage risk"). Instead the industrial companies achieved so-called "Windfall Profits" amounting to approx. 24 billion € within the period between 2008 and 2014. 4.5 billion € of this amount are attributed to ETS-facilities in Germany. The sum is divided as follows:

- 2,1 billion € to the iron and steel industry
- 0,9 billion € to refineries
- 0,4 billion € to the cement industry and
- 0,3 billion € to the petro chemistry

These Windfall-Profits amounted to more than 100 million € in 15 enterprises. Two leaders could be made out among them:

- ThyssenKrupp Steel with 673 million € at least and
- Arcelor Mittal Germany with 585 million € at least.



These amounts are put together by **three profit categories**:

- 1) Profits from overallocation of free emission rights which means an allocation of more emission rights free of charge to these enterprises than greenhouse gases had really been emitted by their ETS facilities;
- 2) Profits from the use of credit notes from international climate protection projects (CDM resp. JI projects) because many enterprises would have taken these credit notes (CER resp. ERU) instead of the gratuitously allocated emission rights. On this way they could sell the emission rights not needed to a higher price than the CER/ERU had cost;
- 3) Profits from the pricing of opportunity costs in their product retail prices at least for a part of the emission rights obtained free of charge.

Myth Carbon-Leakage Danger

The biggest part in the above-mentioned total profits can be found among the profits from the pricing of opportunity costs of the iron and steel industry, amounting to approx. 79%. The company specific shares, however, differ considerably. ThyssenKrupp had a share of 89%, Arcelor Mittal just 33%.

As a conclusion Carbon Market Watch realises that these results will let burst the industry's Carbon-Leakage myth like bubbles. It is said that industrial lobbyists made unsubstantial assertions within the last years about the influence of the EU-ETS on their competitiveness. Although they really made hundreds of millions Euros of Windfall-Profits, they still claim that the EU-ETS continues to affect their competitiveness.

Recommendations for new Rules in the EU Trading System

Basing on the knowledge gained before, Carbon Market Watch recommends three essential innovations for the revision and reorganisation of the EU-ETS:

- A withdrawal from the free allocation of emission rights by means of the gradual increase in the share of auctioning of emission rights currently standing by 57% to be extended to 100% in the future;

- the introduction of a multileveled Carbon-Leakage Rule with the aim to give free emission rights exclusively to those ETS facilities which are really in need for it;
- An annual reduction of the benchmarks on which basis the free emission rights are allocated, in conformity with the superordinate EU-ETS de-carbonization path (i.e. annual reduction with the factor 2.2% instead of 1% as proposed by the EU commission).

Infobox

Milk Cows to be included in Emission Trading

The Food and Agricultural Organization of the United Nations FAO announced beginning of November 2016 that a measuring method they developed will soon be applied. This method allows to integrate the inclusion of dairy cattle into the emission trade.

Central point for this method is the reliable documentation of greenhouse gases which arise when milk cows are kept. Especially methane and carbon dioxide might be concerned.

The innovative measuring method has been certified by "Gold Standard", an organization which rates climate projects for the United Nations (UN). The measuring method would allow small enterprises the access to internationally accepted carbon credits. These could then be sold on carbon markets, as FAO says, thus building a potential revenue generator for the relevant farmers. The incentive newly created on this way is considered as high as the dairy-industry can be caused to organise its production still more environmentally friendly as well as rearrange the feeding process in a way that the exhaust of greenhouse gases will be minimized.

The enormous fluctuation in the worldwide greenhouse gas production is supposed to be the background of the idea to integrate milk cows in the emissions trading. Some countries only exhaust 1.7 kg carbon dioxide equivalent for 1 kg of milk, in other countries this value raises up to 8.5 kg for 1 kg of milk.

Critical Analysis of the CE Delft Study

When Emissionshändler.com® take a close and critical look on the CE Delft study and its results as well as on the conclusions and recommendations of Carbon Market Watch, they unfortunately have to find out that this study is as hardly convincing as the industry's statements about the supposed CL danger, bearing a good reason to be criticised.



Basically 5 points deserve a critical detailed attention and should be considered more closely:

1. Missing Transparency of the Study

The results of the study are not really explained transparently which means the calculations cannot be comprehended and checked. Neither is stated, for example, which prices serve as a valuation basis for the emission rights – the relatively high market prices at the time of the corresponding annual allocation or the presently considerably lower ones – nor can an indication about the emission rights' quantities be found. Large enterprises not only maintain many ETS facilities which are attributed to industrial sectors but conduct numerous combustion plants which provide their industrial plants with warmth and electricity. These plants obtained considerably less emission rights free of charge until 2012 than their facilities used to emit. After 2013 they obtained no more free allocation of emission rights regarding the electricity production. It is impossible to check if all these facts have been considered correctly, nor can be found out if the different equipment degrees have been accounted in the right way.

2. CER/ERU from international Climate Protection Projects are no Windfall-Profits

The above-mentioned profits of the second category are no Windfall-Profits because the CER/ERU have not been allocated free of charge but had to be purchased by ETS system operators at market prices. The proceeds of the CER/ERU sales financed the international climate protection projects which helped to avoid respectively reduce at a low price greenhouse gas emissions. Thus they can be put on the level with investments in own measures for the reduction of ETS facilities' greenhouse emissions, but at a lower price. This was politically intended and is correct and right under the aspect of climate protection. These cost reductions are consequently no “Windfall Profits”.

3. High Windfall-Profits are not a Long-Running Phenomenon

The biggest part of the above-mentioned Windfall-Profit appeared within the obliging period between 2008 and 2012. The rules for the running period from 2013 until 2020 had been changed considerably due to these experiences. The current Windfall-Profits turn

out to be much lower. Owing to the change from historic emissions, for example, to historic production volumes with ambitious product-specific benchmarks as a calculation base, the structural over-allocation of emission rights decreased considerably. In fact an over-allocation still exists in these days, too, this because of the difference between high historic production before the global economic crisis and the nowadays lower production after the global economic crisis. In the future this proportion could turn in case of a worldwide economy's recovery. Even in case of completely unchanged CL-rules the Windfall-Profits of the above-mentioned category 1 will probably become practically irrelevant in the future. The evaluation of the study results, however, causes implicitly the impression as if the above stated high profits running into billions will be achieved in the future, too

4. Opportunity Costs are legitimated and intended

The profits mentioned in category 3 cause the impression that the pricing of opportunity costs itself turns out to be a “bad thing”. But it is a completely correct and right process and even intended under climate political aspects. Otherwise the final consumers of goods and services with their demand-related behaviour will be unable to consider the cost of greenhouse gas emissions which use to occur in relation with production processes. The “only” fault is that the ETS system operators use to receive emission rights free of charge also for that part of their products for which they can enforce a pricing at the market. This proves the inefficiency of the current CL rule which only knows the classification between “CL probable” and “not CL probable. The fact that such a simple black and white classification does not exist in reality, finds no consideration. In the meantime numerous studies show to what extent the industry can enforce the pricing of the emission rights' costs at the market. This varies of course in the different sectors respectively product groups and is not constant but changes all the time in the market economy and, above all, allows no reliable prediction. No CL rule, however its content-related design may be, is able to eliminate completely the CL risk nor the Windfall-Profit risk. But we have to live with certain residual risk situations and are able to do so.



5. Administration Cost will not be considered

It remains unconsidered that the operators of ETS facilities have also ETS related administrative costs which probably reduce the Windfall-Profits. These are costs for the establishment and update of surveillance plans, the monitoring of emissions (measuring instruments, monitoring personnel), the establishment of annual emission reports, their verification by inspection bodies, the administration of the accounts in the union register etc. These expenditures may appear as relatively low and thus insignificant for big enterprises with emissions amounting to million t CO₂/year. Those numerous ETS system operators with emissions of 10, 20, or 30 thousand t CO₂ a year they are a cost factor which may overlap the Windfall-Profits probably arising in their enterprise.

Conclusion: No Windfall-Profits but also no CL Risk

Despite the deficiencies shown up in 5 items the CE Delft study deserves in any case the great merit that the previous economic effects of the EU-ETS on industrial sectors and especially on the big industrial groups will be followed by a quantitative analysis.

The concrete numbers of the Windfall-Profit estimation might be a bit uncertain and, generally spoken, all in all too high. But they show one thing quite clear:

The CL risk alleged by industrial lobbyists does not exist until now, at least not at all to the extent proclaimed. Neither is it recognisable for the future – even in the light of the UN Paris Climate Summit results and in the light of the growing number of states who intend to introduce in some way or other a pricing of greenhouse gases in their country, too. A justification to continue with a “generous” allocation of free emission rights cannot be given. Instead of sweeping complaints about the Carbon Leakage risk expressed by industrial associations, this group should better participate constructively in a revision of CL rules and offer proposals how the CL risk as well as the Windfall-Profit risk can be held as small as possible.

Environment and Climate in the Conscience of the French Society

An article by Pierre Henri Bernard, Emissionshändler.com®, co-writer: Michael Kroehnert

The history of the green movement in France

Similar to Germany, first ecological movements arose in France in the seventies, resulting from the student movement of 1968. Originating from federations and associations, the bearers of this movement slowly made their way into the national political scene. The political engagement for the protection of nature had been anchored politically on the left since the very beginning, this in conformity with the defence of the third-world countries and the rural areas against a growing power of globalization and the world markets.

That is why the political ecology in France presented itself as a form of promotion of a new social justice which finds its expression in the protection of the earth, serving as the existing medium. Simultaneously to this process an opposition against mass production grew up, being against the increasing use of nuclear power and against the American way of life which was considered as a danger for the environment's balance.

René Dumont was the first “green” candidate being allowed for a nomination of the presidential election in France in 1974. He made an unobtrusive begin with 1.32% of the votes but the ecological movement was able to enter the political stage in France. The schools of thought were completely scattered, however, thus preventing the movement to become a relevant force at that time. The party “Les Verts” (“The Greens”) achieved good election results under the leadership of Ms Dominique Voynet (environmental minister 1997-2001) and the German-French politician Daniel Cohn-Bendit only at the end of the 90ies.

The Green Party does not reach its target group

But the political green movement always had its difficulties to convince the citizens. In the course of national elections the party “Les Verts” never gained more than 7% of the votes. The success came to a bigger and bigger extent on the occasion of European elections. The party could gain clear



16.28% of the national votes in its best year 2009. “Les Verts” even participated with two ministerial positions in the first government of François Hollande in the year 2012. Due to disagreements, however, they left the government already in the year 2014.

Today the party goes through an internal crisis which bases on the cooperation with the socialists and the independence of the greens from other parties.

At present “Les Verts” govern only in the town of Grenoble, in other areas they are represented poorly as there are in local or city governments, together with the socialists. The candidate for the presidential election 2017, Yannick Jadot (former chief of Greenpeace France) would obtain only 2 or 3% of the votes which is significant for the status of the Greens in the French society.

The poor success of the Greens in France may also find its reason in the fact that their themes have been taken over little by little by other parties themselves. In addition, the lack of profile and structure of the French Greens as well as the fact that they never could decide ideologically if they want to belong to a left wing in the party spectrum or prefer remaining independent is another reason for their unchanged low significance.

Subjects about the Environment and Climate touch the whole French Society

At the same time all French parties used and occupied those subjects being allied directly with the protection of the environment which, as a consequence, reflected all areas and sectors of the economy and civil society.

International facts as there are the Chernobyl disaster, the Kyoto Protocol, the UN framework convention and other significant milestones of the environmental and climate policy played a more and more important role because the political and national tradition of France – which means Paris – always used to decide in the end which way to go.

The local “governments” do not dispose of any open space for decisions and realisations of more or less regional environmental measures. That is why it is clearly to be seen that the interest of the French population in environmental questions always uses to rise as soon as these subjects find observance by the Parisian politic.

The year 2000 then becomes a decisive one: Al Gore in the USA and the television presenter, environmentalist, and movie maker Nicolas Hulot in France use the media in order to inform about the consequences of our life style which mean a danger for our earth's future.

In 2007 the conservative Sarkozy government strongly stands for the protection of climate and environment, this by creating and organizing a national round table, the “Grenelle de l'environnement”. This environmental conference is supposed to bring together all actors as there are NGOs, associations, scientists with government institutions in order to discuss about future steps for the environment in France.

It was remarkable that all economic branches were invited to this conference: traffic, agriculture, energy, construction. The various engagements having been signed on the occasion of this conference found a more or less consequent acceptance and realization later. As a result the subject “environment” became a must for every person of the public life in France.

The successful conference showed also that all political parties in France are concerned by environmental themes and that all political directions can find an advantage in the realization of environmental measures.

Every Party Program offers Environmental Politic

Today, six months before the presidential elections in April 2017, it is obvious that environmental themes in France don't stand in the focus of the election campaign. The tragic events that stroke France within the last 18 months pushed other subjects in the focus.

As many parties are still in the phase to designate a candidate, not every party has yet experienced a final program. But all parties are occupied with environmental themes, they achieve a larger and larger presence.

- **The Greens** stand first of all for a better air quality, for renewable energies, for phasing out nuclear energy, and for a prohibition of genetically modified crop plants.
- The **Left Front** “Front de Gauche” proposes for the first time significant environmental measures by means of an ecological planning. Represented by the left candidate Jean-Luc Mélançon, their program is considered as a revitalization of the economy on an environmental friendly basis.



- The **Socialists** for their part stand for an energy revolution which is supposed to be realized in cooperation with the enterprises and the engagement of the citizens.
- The **social liberal** candidate Emmanuel Macron supports the end of the economic and tax-related advantages for Diesel vehicles and a bottom price limit of costs for one ton CO₂ (emission rights).
- For the **Republicans** (former UMP) François Fillon, the conservative ex-prime minister and candidate for the presidential elections 2017 determines that the protection of the environment means a big challenge and a duty for the next generation. But this program item should not be carried out at the expense of the French economic force. He nevertheless aims France to become a master of the CO₂-free economy in the world.
- Even the **Front National** and its boss Marine Le Pen presents a new image of the so-called “patriotic ecology”:
An energy-independent France, the improvement of air quality and the food's quality as well as a nationalisation of the EDF shares (“Electricité de France”, still the monopole electricity supplier in France) being presently still in private hands. Thus a party of the extreme right wing stands for the first time for environmental measures – but in its own way and under its ideological basic principles.

Although the themes security, identity, and unemployment use to be focused in the debates, all political parties and the society agree that environmental and climate protection build a central question for the future of France.

Environmental and Climate Policy in the Peoples' Homes

As in France the society always uses to walk one step ahead the policy, ecological themes had been anchored in the peoples' daily life first of all by associations and other private initiatives. Slowly, at the end of the 90ies, the aspect of global warming came up in poster campaigns and media reports. Schools taught more and more about environmental compatible behaviour in daily life.

Children were urged to give a lecture about melting ice, common waste collections were held in the afternoons and, above all, children learned about environmental protection in a way that they could convey the problems about climate and environment to their parents at home. This was always very important as it was intended that children at school, in sports clubs or at scout meetings gained more and more information in order to make their parents and grandparents

familiar with environmental themes. These always showed doubt for environmental issues.

The waste separation has always been the best example. It was introduced already in 1974 but the people concerned showed no interest at all in it in the beginning of the years 2000. Still today we have city parts and villages where people use to plug all sorts of waste in the same bag – if a bag is disposable at all. But the big majority of the French use to deal positively with the waste separation in the meantime because every household nowadays gets its own garbage can and its rubbish collection plan.

Infobox *Transaction Periods for Christmas and Turn of the Year*

Authorized account holders of system operators who intend to initiate a transaction still before their Christmas holidays are required to observe the transaction periods of this year.

Due to the retarded execution of the transactions within the period Monday to Friday, delays will occur around the holidays and turn of the year.

Considering the public holiday in the German register, it must be noted that the following days do not count as working days in the sense of the register.

- 24.12.2016 Christmas Eve
- 25.12.2016 First Christmas Holiday
- 26.12.2016 Second Christmas Holiday (Boxing Day)
- 31.12.2016 New Year's Eve
- 01.01.2017 New Year's Day

Under consideration of the 26-hours rule, delays of up to 5 days will have to be taken into account. This becomes relevant particularly if - for fiscal or accounting reasons - transactions are supposed to be realized/can be realized still in the old year or already in the new year.

Mobility versus climate protection

Education around the air quality has always been much harder, however. France is a car-land, although this is rather said for Germany. The development of so-called “economic zones” at the edge of French cities at the beginning of the sixties caused the French to use their car more and more for purchase reasons and for leisure activities.

These economic zones can hardly be reached by public traffic means or by walking. They have an extension of several square kilometres. Moreover the smaller railway lines in rural areas were closed or tore down, so the car was the only possibility to reach these centres from the town.



Younger people in France are indeed aware of the health effects that air pollutants cause by individual traffic. The support of public transport means even outside the cities is quite new, however, and the transition to environmental friendly vehicles experienced no support for a long period of time.

Concerning the building of ride sharing, the French turned out to show themselves as very progressive, however, especially in the introduction of so-called ride sharing meeting points. Car drivers can meet at a special plate in order to drive to work together. The website Blablacar, a French start-up enterprise, has been active internationally for a longer period and becomes more and more successful.

But it is nevertheless a long way to go until all French people become conscious of the dangers for health and climate, a consequence which is caused by the burning of fossil materials.

This is also recognisable in the tendency that French use to take the plane more and more often. The reasons are the lower prices and the growing number of flight destinations.

The Germans serve indeed as an example

The French are very closely associated with their traditions, especially if food is concerned. Although agriculture opens more and more for the multinational nutrition companies, the majority of the French stands for a high protection of traditions and against the use of pesticides. According to a representative inquiry, 93% of the French favour the decision to mark clearly on packages the use of dangerous pesticides. Furthermore 94% of the French require the labelling of products originating from factory farming. New health food stores arise everywhere in the country – like in Germany – and the principle of the direct sale of food in farm shops is growing.

Local value-added chains are promoted by local governments in order to shorten transport ways and to strengthen the local economy. Such efforts then support also the development of local brands and products which again lead to a benefit for the producers on site.

In France Germany is considered as the “green” neighbour: “over there” they all use to cycle, they all eat biological food and are all against nuclear power. The tendency though shows that the French will soon be as “green” as the Germans.

We wish all our customers and their families an enjoyable Christmas and a happy and prosperous New Year 2017.



Basilica Sacre-Coeur, Montmartre, Paris

Photo: Kroehnert

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