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Significant Reduction of Free Allocation 2021 - Simplified Application Procedure foreseen for system operators

The ENVI package of the European Parliament's Environment Committee (Emissionshändler.com® reported in their Emission News 01-2017) became an EP package of the European Parliament on 15th February 2017.

The European Parliament (EP) agreed at first reading on 15 February upon change requests of the EU commission's proposal about the advancement of the EU system's negotiable emission rights (EU-ETS). Tough negotiations over months between reporters of the different fractions about compromise opportunities preceded the proposal.

Although the change package was already considered as an accepted compromise in the European Parliament's (ENVI) environment committee with a big majority of 53 to 5 votes by 7 abstentions, crucial votes on individual subjects still took place in the parliament's plenum. Change requests presented by industry-oriented representatives found

This change package of the EP would lead to a of the present commission's proposal if the EU Council will also submit its approval. The Council, however, fixed its own position due to major internal disagreements. Tough negotiations with the EP are expected, first of all inside the Council and then in

the course of It is in fact that all changes will become EU law after all. The tendency is, however, the bigger the majority for each change was in the EP, the bigger the chance to become law. Emissionshändler.com® reported already in their Emission News 01-2017 that not only a significant shortage of emission rights in total will take place but also a significant reduction of free allocation for

The EP package's contents includes the option

- that even a complete cessation of free emission rights could be the result of the changes!

Emissionshändler.com® explain this possibility in the following chapter “**Strong reduction or cessation of free allocation**”. Before, however, two items are supposed to be explained which had been subject of reports already and which would change considerably in the EU Parliament.

Significant shortage of emission rights as a whole

Already the EU Commission proposed to shorten the annual emission rights' budgets by means of a higher linear reduction factor than before which is 1.74%/a. From 2021 it should be 2.2% per year. The ENVI proposal to increase this factor to 2.4% per year found a relatively low rejection in a Parliament's crucial vote of votes. The application of the Christian Democratic EVP fraction to “verify this factor now constantly with the goal to increase it to 2.4% until 2024 at the



earliest” found a large majority instead. How and by means of which criteria these verifications are supposed to be realized at the moment.

Decision to delete 800 million EUA

In conformity with the ENVI proposal the parliament followed the recommendation and decided to delete 800 million EUA from the market stability reserve (MSR) until 1.1.2021. These EUA are the result of an accumulation in the running trading period until 2020 at least.

Consequently these EUA will again find no way to the system as it was originally planned for the course of the 4th obligatory period (2021-2030). This rule was decided with a surprisingly high majority of 75%.

As one of the most important supplementary applications to this decision was also the modification of the rules regarding MSR in a way that the percentage concerning the placements into the reserve of the EUA being in circulation in the years 2017-2020 is supposed to be doubled from 12% to 24%. This means a noticeable shortage of emission rights by means of reduction of auction quantities already in 2017. Furthermore a decision is on the way with the contents to until the market balance will reach a normal frame again. It means that also the re-introduction of withheld certificates to the market shall be This decision even found a majority of 4/5.

The strong reduction or discontinuation of free allocation

Even if the effects of the ENVI package having been modified to an EP package and thus becoming a legislative proposal are impossible to be recognised in detail, it becomes clear that the free allocation of EUA to ETS systems will be reduced and much more significantly than having been proposed formerly by the EU commission. Furthermore their complete abolition with the beginning of 2021 is no longer inconceivable!

As already referred to in **Emission News 01-2017**, the EP package makes clear that the free allocation will be admitted only “transitionally”. The commission formulated that preserving the free allocation to avoid the CL risk “will be maintained

only as long as

This means that if the situation does not change, the consequence may be a reduction as well as a complete discontinuation of free allocation of EUA.

Infobox

Possible variants of a proper and lawful VET entry

According to the since 01.01.2013 applicable EU accreditation and verification regulation EU / 600 + 601/2102 of June 2012, the CO₂-annual report should be approved by two verifiers. This is nothing new to the vast majority of operators. However, in the flow of the VET-entry results not only several versions, but also the possibility of misunderstanding, which leads to an immediate account lockout.

Once the system operator or contracted consultant who created the CO₂ annual report on his investment is ready, he passes the editing right on this report to its verifier. With this, he has previously signed a contract that governs this test technical and commercial, incl. liability issues.

This verification contract is now also specifying that a second verifier will now crosscheck the test results with the law. This second examiner (if necessary, also auditors) is visible in addition to the first auditor with a test access to the register account of the operator in the registry account under the menu item inspection / verifier. The test access of a verifier also implies that these entries can be made in the VET-table (Verified Emission Table) and can be confirmed.

The following several procedure variants to complete a VET entry by 31 March successfully:

- 1) verifier 1 submits the amount of emissions (as specified annual report) and an authorized representative of the operator confirms this
- 2) verifier 2 submits the amount of emissions (as specified annual report) and an authorized representative of the operator confirms this
- 3) verifier 1 submits
- 4) authorized representative of the operator submits the amount of emissions (as specified annual report) and verifier 1 confirms this
- 5) authorized representative of the operator submits the amount of emissions (as specified annual report) and 2 verifier confirms this

From the mentioned five enumerated opportunities for a successful VET-entry, however, it is also clear that there may be a misunderstanding about the situation that verifier is in the belief that another party begins the process of entry / confirmation.

This situation can occur more likely when this order “who, what, when does” not addressed in the verification contract and the responsibilities are not distributed.

The result can then be that the VET-entry or its confirmation is not received by March 31 and then an **automatic account lockout is introduced**, which is likely to cause greater difficulties for the operator.



Now a new rule is applied for the EP package: even if a high CL risk continues to exist, the free allocation of EUA may nevertheless be ceased.

In fact the commission is obliged to re-evaluate the development of climate protection measures in third countries and areas by means of a report. If this revaluation concludes that a high CL risk still exists, the commission is obliged to present to the Parliament and the Council a legislative proposal for the introduction of the free allocation regime which shall coincide entirely with the WTO rules and which needs to be elaborated on the basis of a feasibility study.

This feasibility study is supposed to be initiated already at a time when the modification of the rules for EU-ETS are published in the official journal of the EU. Importers of products being made by CL sectors/sub-sectors are supposed to be concerned by this rule. This order to the commission was decided on request of the EVP fraction during the voting period with a very big majority of 83% to 16%.

Failure of the ENVI request for the introduction of an “import inclusion scheme”

On the occasion of voting on 5. February 2017 in the European Parliament the request for a definite introduction of an “import inclusion scheme” for CL endangered sectors/sub-sectors with a trading intensity of less than 10% (cement, lime, brick, and tiles), was rejected with a 2/3 majority. The request was part of the ENVI package. These sectors would not have obtained a free EUA allocation any longer. At present the industry associations concerned celebrate the rejection of the ENVI request as a victory.

But probably these still rejoicing associations may fail to see that the now decided request postpones indeed the introduction of a

and a feasibility study.

In this context it was completely ignored that WTO compatibility and feasibility study already experienced a positive assessment from other side. For example the German Industry Association for the Glass and Glass Products or also the Boston Consulting Group showed in their results being elaborated on

behalf of the European Industry Association for Cement Cembureau that the required conditions are fulfilled. Consequently the commission will come to a similar result which means that this decision is not annulled but just delayed.

Then it will also be clear that such a regime will not only include importers but also exporters of the CL endangered products. And rightly and fairly all sectors and sub-sectors will be concerned. This means that in such a case

- **only exporters of such sectors' and sub-sectors' products will obtain free EUA anyway but none of the CL endangered installation of a corresponding sector/sub-sector**

Basing on the fact that the decision for the introduction of such a regime after presentation of the corresponding commission report seems to be a completely right one

The application procedure for a free allocation

Many operators in Europe ask themselves at present not only how many free allocations may remain at their disposal after 2021 but also when and in which way a corresponding allocation procedure may start.

After analysis of the extensive EP decisions and the way of probable distribution of the certificates it slowly turns out to be clear that

- **System operators in Germany will submit an application a separate application procedure because all necessary data for determination of specific allocations are already at hand together with the annual statements of business and emission reports of the DEHSt!**

Consequently the German Emissions Trading Authority DEHSt could quite simply calculate the allocations “ex officio” and present them to the commission for approval. It is more likely, however, that for reasons of formal law the ETS system operators being entitled to a free allocation will in fact submit an application (the application is voluntary, by the way). But the latter could be simplified considerably and consist ordinarily only of a confirmation of the data already submitted. Only in case of a deviation from the data already known for whatever reasons, more detailed



information would be necessary to be submitted and justified.

This means that exclusively these data would need a verification by an inspection body and probably another double check by the DEHSt. On whatever way the check procedure may be realized in detail, the necessary effort will be one in comparison with the last allocation procedure. This would also mean, as a consequence, a comparatively high effort and verification. Moreover it must be considered that only a smaller part of system operators would have the right anyway to submit this application. Considering the rules for a free allocation, it turns out to be clear that only the system operators are entitled anyway to a free allocation. That is why the rules for these two groups deserve a closer observation.

Who will obtain a free allocation after 2021?

According to the status of 15.02.2017 only the following target groups obtain principally a free allocation

- a part of the previous Carbon-Leakage endangered facilities (CL facilities)
- district heating facilities

Emission News 01-2017 explains in detail how a **CL facility** is defined according to the ideas of today so that at least a partial free allocation is guaranteed. Also the new rules for the so-called trading intensity and the possible classification of parts from the sub-sector as a CL danger were treated in that article. The commission's estimation that the circle of the CL endangered sectors/sub-sectors will reduce from 90 to less than 50 is worth to be mentioned once again in this context. Consequently almost a halving of the previous NACE codes which, by the way, will be published per 15.02.2017 (see also page 10 of the ENVI package).

The emission-news also treated the **annual production quantity** as a factor for the calculation of the freely to be obtained allocation.

So the following statement deserves to be repeated

- that the free allocation for CL facilities is calculated from the annual production quantity X of the

Beneficiaries of free allocations have no reason to feel too safe, however, as they have not reached a secure haven. Another rule is lurking as a result from the 116th change request having been decided on the occasion of the EP advisory debate: *“With the beginning of 2021 the member states guarantee additionally that every system operator announces his production activity in every calendar year so that the allocation can be adjusted in conformity with article 10a paragraph 7.”* This means nothing else but the risk that the free certificates obtained from the efforts of a hard fight can be lost faster than anyone may think.

Infobox

The VET entry for the three different emissions of CO₂, N₂O and PFC

Plant operators have been creating their emissions report in order to pass the examination by their verifier should take an interest especially for the pdf version of the report, which includes a special feature. On page 8 under the heading Summary of greenhouse gas emissions (possibly also on pages 7 or 9) emissions from the installation with N₂O (nitrous oxide / nitric oxide / nitrous oxide) and PFC (short for perfluorated and polyfluorinated chemicals), can be found now in addition to the CO₂ emissions.

Since these emissions do not occur in most of the emissions trading systems, these are not listed in the pdf-version of the annual report in the summary of greenhouse gas emissions, i.e. the respective corresponding blank field is not filled in. One would think that the form software should be able to write a "zero" in the field, but this is not the case.

Plant operators (who do not have such issues) that do not put attention on this fact think that these N₂O and PFC emissions must also be entered in

The user is well advised while submitting N₂O and PFC emissions - if the report also does not exist - "0" can be also successfully registered instead of writing "no" for the system for the total emissions (and especially CO₂ emissions). In any case, it is necessary to confirm the entry and get a task number.

Besides the known CO₂ emissions, emissions of N₂O and PFC are also registered with "0".

Why most operators are not aware of this fact is likely to remain a mystery. In Germany at least, DEHSt created a "Guide to developing monitoring plans and emission reports for stationary installations in the 3rd trading period (2013-2020)," dated 17.12.2014, in which these and other issues are mentioned.

However, this only covered required investments for the reporting of N₂O emissions from installations for the production of nitric acid, adipic acid and glyoxal or glyoxylic acid. It was not known in principle that now all the other systems need to make a correct entry in its register Account menu item "Compliance".



The Product Benchmarks

In consideration of the intermittent progress in efficiency of the 10% most efficient facilities the present product-benchmarks are also adjusted separately for [redacted]. The EP package now prescribes that this adjustment will not be realized across the board with 1%/year but will be determined separately for every benchmark as follows:

The adjustment for the first partial period is made on the basis of verified emission and production data of the years 20 [redacted]. The product-benchmarks resulting from these data will be compared with the present ones. The commission calculates the annual reduction rates in %/year.

These percentages will be applied on every year between 2008 and [redacted]. On this way the unitary benchmark value for the years [redacted]-2025 will be determined. But if the resulting annual percentage rate turns out to be lower than 0.25%, the benchmark will be adjusted to this value (minimum value). If it is larger than [redacted] % this value will be applied (maximum value).

The adjustment for the second partial period will be applied accordingly on basis of the verified emission and product data of the years 2021-2022 and an application of the annual percentage rate for the years between [redacted] and 2028.

Shortages of the present benchmarks are calculated from this formula for the first partial period of at least [redacted] % and 23.37% maximum as well as at least [redacted] % for the second partial period and 29.75% maximum.

The unified sector overlapping correction factor

In order to avoid the necessity of a unified, sector overlapping correction factor, the commission proposed to realize a transfer of EUA originating from member states' EUA quantities being provided for an auction. The transfer is supposed to be made for the case if the EUA quantity being held in readiness for a free allocation within one year turns out to be insufficient and cannot be covered by means of lower allocations from former years either. Now the EP package prescribes that such transfers must not exceed the [redacted] % points maximum of the EUA quantities being held ready for auction by the member states (57% of the total quantity). If this limit turns out to be insufficient, the allocations shall indeed be shortened by means

of a necessary ESK factor but only for sectors with a trading intensity of lower than [redacted] % or an emission intensity of lower than [redacted] kg CO₂-äq/EURO gross value added).

Free allocation for district heat facilities

After the ENVI package passed through the EU Parliament [redacted]

and turned to an EP package, the rules for district heat facilities are clear.

The allocation amounts to 30% of the EUA quantity which would be calculated in accordance with the allocation rules for [redacted] facilities which means

$$\text{free allocation} = \text{heat benchmarks} \times \text{annual production quantity} \times 30\%$$

The determination of the heat benchmark and the production quantity as well as their adjustments require the same rules as applied for the [redacted]

The relevant voting in the EU Parliament for the special regulation of the district heat sector was decided without counting of votes i.e. with a large majority.

Originally the (main) reporters of the EU Parliament's environment as well as industry committee planned no more free allocations of EUA after 2021 generally for non CL-ETS facilities (which also includes the [redacted])

This was a completely logical decision because why should facilities obtain a free allocation while they bear no CL risk at all and can include the EUA costs into the price structure of their products without any problem?

Several parliamentarians from Eastern European states, however, argued with the fear of probable social consequences on poorer social classes. They voted for an exception of the [redacted] which found acceptance although this is an exception in clear [redacted] to the rule.

Other innovations of the coming trading period for facilities with low emissions

The other innovations explained in the following chapters were all decided by members of the European Parliament either "en bloc" or without the counting of votes, i.e. with a large majority. That is why it can be [redacted] as almost sure that the final law will later cover these rules.



Extension and restriction of withdrawal options for small emitters

Due to the new rules of the EP package the previous option of the member states to exclude small emitters from the ETS means more action possibilities on one hand but more restrictions on the other hand.

- An **extension** is the **increase** of the threshold value amounting from 25,000 t CO₂-äq/a to **30,000** t CO₂-äq/a. In case of burning activities the previous restriction of the rated thermal input of less than 35 MFWL shall be annulled without replacement while the threshold value will have to be undercut unalterably in each of **three** years before the exclusion.
- But an **intensification** respectively restriction follows directly afterwards by the fact that exclusively ETS facilities are concerned by this rule. These are facilities which are run by small and medium-sized enterprises (KMU) in accordance with the commission's recommendation 2003/361/EG dated 6.5.2003.

KMU are defined in this recommendation as enterprises which occupy less than **50** employees and which either achieve an annual turnover of not more than **10** million Euro or whose balance sheet total amounts to **10** million Euro maximum. Moreover the ETS system operators concerned will not only have to consult the member states but these will have to approve to the exclusion, too. Furthermore and unchanged, however, these facilities will have to experience “measures” by the respective member states. By means of these measures an “equivalent contribution to emissions reduction” is supposed to be achieved. The member states are at the same time obliged to inform the commission “how it can be achieved that these measures will not lead to higher following costs for these facilities”. As due to these “measures” the facilities probably concerned would not have any advantage by exclusion, this option was almost never applied – at least in Germany.

According to the opinion of Emissionshändler.com® this fact will not change so far although the member states are now in the position that they not only “**introduce**” simplified measures for the monitoring, reporting, and testing of facilities but on request of the system operator even “must allow” them. This, by the way, even for facilities which emit less than **30,000** t CO₂-äq/a (referred on

the years 2008-2010!). Because what are these simplifications good for as long as annual tests and verifications are still necessary in order to find out if this threshold value is still observed anyway.

Special withdrawal options for smallest emitters without “comparable measures”

Completely new is the rule of the withdrawal option for smallest emitters being proposed by ENVI and confirmed by the EP. Those ETS facilities are concerned by this rule which have not only on the average but in each of the previous past three years emitted less than **10,000** t CO₂-äq and inform the competent national authority about it. Because these facilities will not have to accept any more “equivalent measures” prescribed by the member state. But on the other hand the member states will have to consult the system operators and can (but must not) exclude the facility from the ETS. And of course a monitoring is prescribed, too, in order to confirm that the threshold is observed after the exclusion. Otherwise the facility will immediately go back into the EU-ETS.

For some few ETS facilities this option could **be used as a last resort**. The condition that the system operator has to be a **small business** is **not** applied to this rule.

Infobox

The external authorised representative and the CO₂-Know-how

An external consultant and representative as Emissionshändler.com® can assist companies with the relief of his authorised representative and may advise in all essential technical and administrative tasks regarding the account.

Here Emissionshändler.com® can be used as external third authorised representative upon request taking over all activities, such as account management and monitoring the changes in legislation and pointing out the annual duties and deadlines.

Insofar Emissionshändler.com® is also a knowledge carrier and a "CO₂-Know-how-Backup" for the management of the company as well as a practical guide for the previous account representative.

An application and more information are available on request.

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Modified calculation of the 20 MW_{FWL} threshold

The present EP package will change the annex I of the directive in so far as the calculation of the total rated thermal input of an installation will be a slightly different one as far as probably existing spare modules are concerned.

They will be included into an addition for a rated thermal input in the future as long as these

- **“reserve and replacement units serve exclusively for the production of electricity for the consumption on-site and in case of a power failure”.**

Some installations whose threshold lies slightly above the 20 MW_{FWL} limit may indeed succeed in leaving the emissions trading zone.

Simplified MRV for small entities

The commission is invited to fix for the MRV regulation also simplified monitoring, reporting, and test procedures for “small entities”, this in accordance with the prescriptions of the EP package (in the frame of an adjustment to be applied for other reasons until 31.12.2018). More details about the way of simplification is not yet known at present.

Probably unintentionally the “small entities” does not bear the identity as defined in the above-mentioned withdrawal option. In fact the emission threshold amounts to 10 t CO₂-äq./a and the option that the installation must be run by a KMU is applied. But the emission threshold is calculated here as an average of the verified emissions within the period preceding the running one. If this average value is not available or is no longer applicable due to modifications of the installation limits or operating conditions, the annual emissions awaited within the following 5 years will build the basis for a calculation.

It remains to be seen if the simplifications achieved by these methods will be more than homeopathic.

Outlook on other important aspects of the ENVI package for plant operators

At the middle of March, the following **Emission News 03-2017** will continue to report on the present EP-package, about last correction of the package, about new additional reporting obligations, about Better accesses to auctions,

especially for small and medium enterprises, and payment obligation on EUA for emissions with CCU technology.

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Kind emission regards



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