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Presentation of Probable Allocation Rules 2021-2030 – The ENVI Package brings unpleasant news for operators

System operators should prepare themselves for some unexpected developments with regards to the allocation rules for the EU-ETS of the coming trading period.

The regulation package having been compiled by the parliament's ENVI environment committee exceeds more than clearly the commission's proposals. It sends a clear signal for an almost drastic shortage of certificates and includes bad news for many operators.

For the first time Emissionshändler.com® points out which rules and modifications the next trading period will bring up and in which partial periods 2021-2025 and 2026-2030 request the fulfilment of which conditions and connections in order to achieve a free allocation. Furthermore the Emission News 01-2017 explain what kind of price signals may be the result of such kind of political news and in how far a system operator is supposed to make his purchase decisions of the calendar year 2017 dependent from them.

Almost ignored by the public, the environment committee of European Parliament (ENVI = Environment, Public Health, and Food Safety) has finally decided on 15.12.2016 about more than 700 change requests having been presented before. The change requests relate to the EU commission's proposal how to manage the EU-ETS after 2020. Emissionshändler.com® analysed for its readers

the proposal about the allocation of emission rights. The _____ and deals with the rules of allocation of emission rights after 2020 as well as with more cost effective reductions of emissions rights in the EU aspired in this context.

The “ENVI-Coup” - The successful way (until now) how to deal with free allocation shortages after 2020

Tough negotiations between the correspondents of all fractions took place for weeks before an agreement was reached. Subjects of the negotiations were how to achieve for example a CL status, which conditions had to be fulfilled for a free allocation, which NACE Codes were supposed to take profit, etc.

Only shortly before the decisive committee meeting the 65 ENVI members agreed upon 17 new compromise motions. Due to these compromises most of the requests having been presented by individual parliamentarians became invalid. Afterwards more than 112 remaining individual requests were negotiated.

_____ rejected. The total package of 62 requests found acceptance on _____ with a fairly large majority of 53 against 5 votes by 7 abstentions. Then the package was presented to the Parliament's plenum for a concluding consultation. Debate is planned for _____ and the related voting is set on the agenda of _____



Despite the big majority in the ENVI which usually is supposed to be followed by an approval of the suggestion bundle also by the plenum, the possibility that industry-orientated deputies may present change request can be assumed. It is not entirely excluded that the change request may find acceptance. According to the rules of procedure, change requests can only be presented to the plenum. The requests can be submitted by fractions, the industry committee, or by 40 delegates maximum which, by the way, is expected in this case.

A consequence of this change package of the ENVI would not only be a distinctive aggravation and modification of the commission's proposal but also a left-hand overhaul of resolution proposals submitted by the Englishman Ian Duncan. Originally these proposals had a proper compromising character and were classified as safe.

The following chapter includes especially important aspects being explained by Emissionshändler.com®. The ENVI package's line being now supposed to be treated – if it is relevant for German system operators.

The report includes the following subjects in particular:

- **The significant shortage of emission rights in total**
- **The significant reduction of free allocations of emission rights**
- **Other innovations especially for ETS systems with emissions.**

The significant shortage of emission rights in total

As far as the theme shortage of emission rights is concerned, 5 essential points can be listed from the ENVI package which may cause worry lines on the system operator's forehead. This especially because these items do have a high potential to increase the EUA price.

- 1) Already the EU commission supposed to shorten until 2020 the annual emission rights' budgets with a bigger linear reduction factor than before. 1.74% per year were suggested. ENVI increased this factor to

per year. A reduction factor of 1.74% was applied so far in the running period 2013-2020.

- 2) More decisions for “adjustments” which means aggravations of this factor are now possible until 2024. In fact the commission is invited to report about it until mid 2024 (6 months after the end of the UN climate conferences' consulting services about the level of realization of the Paris Agreement at the end of 2018) and until mid 2024 (first survey of the states' self-commitment for the reduction of greenhouse gases until the end of 2023). Probable aggravations of the factor may result from these reports and, as a consequence, request the presentation of legislative proposals.
- 3) Furthermore the ENVI package includes the decision that 1.1 billion emission rights (EUA) have to be deleted from the market stability research (MSR) until 1.1. 2021 instead of being left at the system's disposal in the course of the fourth obliging period (2021-2020) as originally planned.
- 4) Instead of selling by auction, member states will furthermore be entitled already from the beginning of 2021 to delete directly EUA being neither used for the free allocation nor being transmitted to the MSR. This means of course for the member states a possible renouncement of auction proceeds which will only be balanced to a small extent by the price increases induced. This is, by the way, in conformity with a proposal of the DEHSt who proposed this for the first time in 2011. This is the result of a study of the DEHSt.
- 5) Furthermore the member states are obliged to report to the commission every 5 years about closures of electricity generating capacities caused by national measures. The commission will then charge these closures with the corresponding EUA quantities and report to the states. Then the member states will have the option

Germany would allow, for example, to delete directly 1.1 billion EUAs. The present EU law would not allow such a procedure.

If and to what extent the above-mentioned items will influence the EUA quantities being really left at the disposal of EU-ETS by the options mentioned above and will influence the present price for the EUA. The price volatility may be the consequence of such



... ("Boarder Adjustment Scheme").

This ... the CL risk, ... the current windfall profits of billions, a regulation that has long been proposed by the Federal Association for Emission Trading and Climate Protection (bvek). Industrialists have, however, hitherto ... these regulations, so that this ... was finally agreed upon as ... Thus a ... of the ENVI package was only possible at all.

In any case, it can be assumed that there will still be ... in order to prevent ... in the EU Parliament.

According to the Info-Service ... the product areas of cement, lime, brick and tiles would be affected by the ... In Germany this would currently be approx. 250 ETS plants with 2015 emissions of approx. 30 million t CO₂-äq. and an allocation amount of some 28 million EUAs.

The CL sectors / subsectors with a trade intensity > 10%

ETS plants of the CL sectors / subsectors with a trade intensity of 10% or more will initially receive ... allocation of emission allowances.

The allocation is calculated as follows:

- **Free allocation = product benchmarks x**

The calculation of the allocation or the determination of the two factors is carried out separately for two sub-periods of the next trading period covering a total period of 2021-2030. Since, according to the ENVI package, the coming trading period will also have different rules in two equal-sized 5-year periods, one should also define them in the "1st Subperiod / subperiod "and the" 2nd subperiod / subperiod "of the fourth trading period. In any case, the free allocation will be calculated separately for each of the sub-periods 2021 - 2015 and 2026 - 2030 at ... time

... as a factor for the free allocation quantity

The Commission's proposal specifies unchanged, that the determination of the ... is not set out in detail in the EU Directive itself, but only in the context of the new

Commission's allocation order. The directive merely stipulates that this should be based on the ... data of the five calendar years preceding the application.

Infobox

What to expect for Aviation ETS after 2016

In Montreal last October at ICAO's 39 triannual assembly, Member States were able to adopt a resolution to start CORSIA, a global market based mechanism to reduce CO₂ emissions from aviation. CORSIA is the abbreviation for Carbon Offsetting & Reduction Scheme for International Aviation and will be implemented in accordance with the ICAO resolution by most member states from 2021 onwards.

In its first phase (2021-2026), 65 countries will participate on a voluntary basis, with all EU Member States joining from the start. In its second phase (2027-2035) CORSIA participation is mandatory; except for those exempted (countries with small aviation activities). The exact definition of small aviation activities still leaves room for interpretation.

Now the EU Commission has reported back to the EU Parliament on the outcome of the ICAO assembly and the details of the CORSIA proposal. The issue to address is, that there is a timing gap between aviation EU ETS today and the start of CORSIA in 2021 so that the EC will have to create a follow up legislation to aviation ETS, which ends in 2016.

Rumour has it that the European Union favours ICAO's CORSIA proposal and will propose extending an exemption on foreign flights from its carbon market until 2020. This will mean that only Intra EU flights will have to be reported

The European Commission, the EU's regulatory arm, will probably present ... sparing carriers, that includes US and Chinese carriers, which are mandated like before to report and offset emissions from flights within Europe. This implies that the current exemption to report Full Scope emissions, which began in 2012, would expire this year unless renewed will continue.

It is to be noticed expect that the issuance of free allowances for 2017, which should be handed out on 28 February 2017, will probably be postponed, due to the above mentioned final decision by the EC. Therefore aircraft operators could face a shortage of certificates to cover their emissions of 2016 because

... Airlines are advised to turn to the emissions market in due time to assure sufficient stock on necessary emission certificates.

- Since the Member States are required to submit to the Commission the list of their ETS installations which are to receive a free allocation of EUAs for the first subperiod by 30 September ... and for the second subperiod by 30.9. ... it can be



assumed the **2019 and 2020** refers to the years from **2019 and 2020** respectively.

- The ENVI package now also stipulates that the **2019 and 2020** used - **probably from the 2019 and 2020** - is adjusted not only by a reduction in the actual **2019 and 2020** but also by a reduction to less than 50%, but already by a reduction By 10% (calculated from the rolling average of the last two verified **2019 and 2020** for **2019 and 2020**).
- The amount of the adjustment is the respective calculated percentage. However, an adjustment is also made in the case of an increase in actual **2019 and 2020** by a correspondingly calculated amount of at least 10% with regards to the respective percentage. The **2019 and 2020** volume for the calculation of the allocation therefore remains the basic **2019 and 2020** only as long as the actual **2019 and 2020** changes by less than +/- 10% compared to the basic **2019 and 2020**. However, as soon as an adjustment is made, the quantity to be applied would have to be recalculated for each year. This could possibly already be applied on the basis of actual verified production in 2019 and 2020 for 2021.

In any case, it is clear that the reduced EUAs allocation amount will be put into the new plant reserve and the more allocated EUAs will be taken from it.

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

At the end of February, the following Emission letter 02-2017 will continue to report on the present ENVI package, how the product benchmarks will be calculated, how they will affect the free allocations, when and why they will be adjusted in the next trading period and how (If any) the uniform, cross-sectoral correction factor will be calculated.

Furthermore, we are informing about electricity compensation, allocations for district heating plants, extensions / restrictions for small-scale mines, as well as the modification of the 20 MFWL threshold for plants and also impose additional notification obligations for plant operators.

Price-Outlook 2017 - Additional factors and relevant periods of price influence

If the question arises which factors may influence the emission rights' price in 2017 y – beside the

existing oversupply – it would be advisable to distinguish first of all between short-term and medium-term periods while taking into account a long-term development, too.

The experience shows that short-term and medium-term price movements will be accompanied by a **2017** in 2017 – as in the years before, by the way – which may be typical for the emissions trading in the meantime.

Price developments in the preliminary stage of corrections or redefinitions of the EU-ETS

Preliminary stages of EU-ETS' decisions being made by the EU parliament's environment or economic committee, by the parliament itself, and by the EU Council, entail permanently new information resulting from prior formation of opinions and discussion which take place for years and months and which are spread over the market.

In this context, related intelligence and reviews of market observers are published, for example, which lead market observers to report about addition or reduction of free emissions' certificates, auctions' shortenings and increases and about auctions' shifting or about a minimum price for CO2. Further typical and, above all, price sensitive, topics are the **2017** Carbon Leakage, or the inclusion/exclusion of air traffic, cause distinctive price movements on the occasion of discussions taking place preliminarily to decisions

- **which, however, use to fall back almost every time to the discussion's beginning as long as**

But if a political decision regarding the EU-ETS has been made finally – as there are for example about a number of emissions certificates having been withdrawn from the system

this decision may in fact entail a long-term price development upwards or downwards.

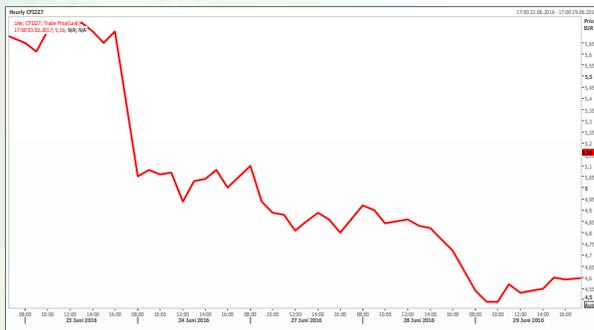
Price development as a result of decisive world political developments

If we look back on world political events and developments of the past having been able to influence the price of emission rights in the EU-ETS, we will find examples which caused to a

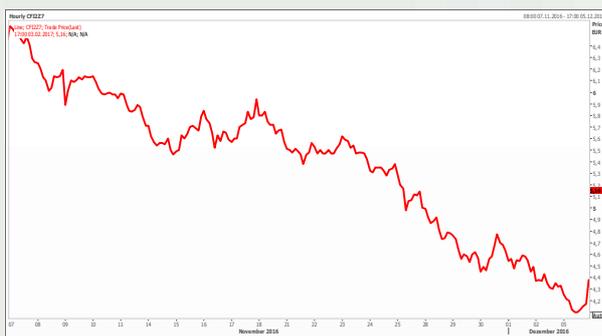


certain extent a price modification of emission rights.

1. When nuclear reactors got out of control in the Japanese town Fukushima on **11th March 2011** due to a heavy earthquake followed by a tsunami, the German government announced its atom moratorium on 14th March 2011 which lead to an increase of the price for emission rights from 22.10 Euro/t to 23.50 Euro/t. This was rather a moderate increase of 6% which could be justified by the immediate shut-down of 7 nuclear power plants as well as by a long-term withdrawal from the nuclear energy programme.
2. When 51.89% of the United Kingdom's electors voted all of a sudden for the escape from the European Union (Brexit) on **23rd June 2016**, the price for emission rights dropped from 5.73 Euro/t at that time to 4.51 Euro/t within 5 business days until 30th June 2016. This conforms to a clear markdown of more than 22%. The market imagined a scenario about British system operators throwing their collected overstocks of EUA on the market.



3. When the world recognised the shock on **8th November 2016** that the next US President would not be Hillary Clinton but Donald Trump, an immediate effect on the EUA price could not be realized at the moment. But the following days were characterized by a longer decline, starting by 6.26 Euro/t. The deepest point was reached on 7th December when the EUA only showed a worth of 4.32 Euro/t, a markdown of more than 30%.



Such world political events can consequently also take influence on the price level in the EU-ETS, while

- **they do not only have the capacity to modify the price level more or less significantly but keep on doing this constantly which means to change the price at in one or another direction.**

Price development as a result of speculation

From the view of a system operator it is interesting to recognise, however, that certain price developments do exist on the market but are not a result from political events or due to the gossip factories in the run-up to decisions for the EU-ETS. If we look upon the past years beginning from 2013, we find out that this kind of price movements can lead to a result of 35% and more within one year and that the price movements are inclined to be almost normal. It is a fact which is more than sure that speculative investors use to push the price of certificates upwards or downwards intentionally while buying or selling quantities of certificates to a scope of certainly 200-500 tons within a time period of 4-6 weeks.

The clearly recognisable intention to achieve speculative gains by using huge quantities of freely disposable certificates to push the price upwards or downwards may cause a feeling of deep insecurity on the part of the normal system operator. This above all because he only wants to buy certificates for his compliance and find the right time for such an operation. But an insider or informed watcher of the market is aware

- **that the speculations of investors lead in fact to the biggest price difference and but do not have any effects on a price level on a medium or long-term.**

Consequently a system operator can confidently whole calendar year resulting from a due to speculation.



Current and other well-known price relevant factors

If a system operator intends a forecast how the EUA price will develop in 2017 and when a normally existing purchase demand will be modified to a concrete transaction, the operator must not only observe the previously mentioned points. It is absolutely advised to consider an additional integration of

. In the present case the since January 2017 can serve as a suitable mean. The strength in volume is followed by a potential of emission rights which may, together with predicted temperatures, result in a then following price decrease.

The medium and long-term EUA price forecast for the year 2017

Basing on the fact that approximately 25% of the roundabout 1.6-2.2 billion EUA accumulated in the EU-ETS are lying in the hands of persons/institutions that could bring them on the market any time, we will, according to the opinion of Emissionshändler.com®, spend another year of high volatilities caused by gamblers.

Like in the course of the year , the price will move in the frame of . All in all the month of December 2017 if , would not cause insecurity. Owing to this fact the prices for emission rights may behave still in order to present an

If the politically characterized global economy – and this will be the case according to the opinion of Emissionshändler.com®, and the climate policy will , the CO2 prices will more likely continue to

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