Regulation by the EU Commission

AUCTIONING OF EMISSION ALLOWANCES

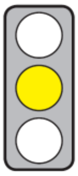
Status: 06 September 2010

Centrum für Europäische Politik

MAIN ISSUES

Objective of the Regulation: The Regulation regulates the auctioning of greenhouse gas emission allowances pursuant to the Emission Trading Directive 2003/87/EC.

Parties affected: Power supply companies, energy-intensive industries.



Pro: In principle, the early publication of auctioning calendars, the rules of procedure for auctions and the joint monitoring of auctions leads to a transparent auctioning process.

Contra: (1) The Commission is too late in submitting its draft.

(2) The Regulation does not ensure that by 2013 enough allowances will be available on time for the period from 2013 onwards.

(3) Excluding "too low" auctioning prices only serves the Member States' profit.

CONTENT

Title

Draft Commission Regulation of 14 July 2010 [without number] **on the** timing, **administration** and other aspects **of auctioning of greenhouse gas emission allowances** pursuant to Directive 2003/87/EC of the European Parliament and the Council establishing a scheme for greenhouse gas emission allowances trading within the Community

Brief Summary

Articles quoted refer to the Draft Regulation, unless otherwise provided for.

- **Background and targets**
  - The EU Emission Trading System (ETS) stipulates that since 2005 certain stationary installations (e.g. for power and heat supply, for metal production and processing, for paper production and for the chemical industry) and, as of 2012, air traffic may emit greenhouse gases only if the operators possess the corresponding allowances (Art. 12 (2a) and (3) in conjunction with Annex I ETS Directive 2003/87/EC; see CEP Analysis, p. 12 et seq., in German only).
  - As of 2012 Member States must auction all allowances for aviation and, as of 2013, for stationary installations which are not allocated free of charge (Art. 3d (1–3) and Art. 10 (1) ETS Directive).
  - The Commission must define in particular the procedure and the timeframe for the auctioning in the form of a regulation (Art. 3d (3) and Art. 10 (4) ETS Directive). The aim of this regulation is to ensure an "open, transparent, harmonised and non-discriminatory" auctioning procedure (Art. 10 (4) ETS Directive) so that
    - the timing and sequencing of auctions as well as the volumes of allowances are "predictable";
    - the small and medium sized enterprises (SMEs) covered by the EU Emission Trading System have "full, fair and equitable" access to auctions;
    - all participants have access to the same information at the same time;
    - participants do not undermine the operation of the auction; and
    - auction organisation and participation is cost-efficient and unnecessary administrative costs are avoided.
- **Scope and "auctioned products"**
  - The Regulation applies to the auctioning (Art. 2) of
    - allowances for aviation for the trading period from 2012 onwards and
    - allowances for stationary installations for the trading period from 2013 onwards.
  - Shares of the allowance volumes scheduled for 2013 and 2014 will already be auctioned from 2011 onwards in "early" auctions (Recital 19 and 20, Art. 10 (1) and Annex I).
  - Member States must offer allowances for sale by means of standardised electronic contracts that are traded on an auction platform (Art. 4 (1)).
  - "Auctioned products" are:
    - "2-day spots", meaning the auctioned allowances must be delivered on the second working day after the auction at the latest (Art. 4 (3), Art. 3 lit. c; Art. 38 (2) lit. a Regulation (EC) No. 1287/2006), and
    - "5-day futures", meaning the auctioned allowances must be delivered on the fifth working day after the auction at the latest (Art. 4 (3), Art. 3 lit. d; Art. 38 (3) Regulation (EC) No. 1287/2006).

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- **Auctioneer**
  - In order to auction their allowances Member States must appoint a public or private entity as their "auctioneer" (Art. 3 (1) lit. t, Art. 22 et seq.).
  - Several Member States may appoint the same auctioneer (Art. 22 (1)).

- **Auction platforms and auction calendar**
  - In order to auction their allowances Member States must
    - together with the Commission establish an EU-wide joint auction platform (Art. 26) or
    - establish their own Member State auction platforms ("opt out", Art. 30).
  - Auction platforms must notably (Art. 27 (1), Art. 31 (1) and (3)):
    - provide access to auctions on the internet;
    - conduct auctions;
    - manage the auction calendar;
    - provide a "clearing or settlement system" serving to
      - transfer auction proceeds to the auctioneer (Art. 44 and 45) and deliver the auctioned allowances to the successful bidders (Art. 46–48);
      - manage the "collaterals" (Art. 3 (1) lit. ll) which, prior to the opening of the auction, must be given by the bidders for payment obligations (Art. 49) and by the auctioneer for delivery obligations (Art. 50).
  - The auction platforms determine an "auction calendar" for each calendar year in advance, and this must contain "all relevant information" regarding auction dates, bidding windows, auction volumes, auction products and payment and delivery dates of allowances (Art. 8–14, Art. 32).

- **Auctioning procedure and price formation**
  - Bidders may only bid on auction platforms.
  - The "bidding window" during which bidders may submit, modify or withdraw their bids (Art. 5, Art. 6(3)) must stay open for at least two hours (Art. 8 (1)).
  - Bidders must bid for at least 500 allowances (representing one "lot") or a multiple thereof (Art. 6 (1)) without seeing bids submitted by other bidders (Art. 5).
  - Upon the closure of the bidding window the "auction clearing price" for allowances is determined as follows (cp. CEP Chart):
    - All bids are sorted in the order of the respective price bid; where the price of several bids is the same they are sorted by random selection (Art. 7 (2)).
    - The volumes bid are added up, starting with the highest bid price (Art. 7 (2)).
    - The bid price at which the sum of the volumes bid matches or exceeds the volume of allowances auctioned forms the auction clearing price (Art. 7 (2)).
    - All bids at or above this price are allocated to the auction clearing price (Art. 5, Art. 7 (3)).
  - The auction is cancelled if
    - disrupted through the information technology system (Art. 9);
    - the total volume of bids sorted falls short of the volume of auctioned allowances (Art. 7 (5)); or
    - the auction clearing price is "significantly" under the price for allowances already allocated on the secondary market during and immediately before the bidding window (Art. 7 (6)).

- **Access to auctions**

  Direct bids may only be submitted by the following parties (Art. 15–21):
  - Operators of stationary installations or aircraft operators having an operator holding account and bidding on their own account, including affiliated undertakings;
  - business groupings of operators of stationary installations or aircraft operators bidding on their own account and acting as an agent on behalf of their members;
  - public bodies or state-owned entities of the Member States that control any of the operators of stationary installations or aircraft operators;
  - credit institutions authorised under Directive 2004/39/EC; and
  - credit institutions authorised under Directive 2006/48/EC.

- **Auction monitor**
  - All auctions on all auction platforms are monitored by an EU-wide auction monitor (Art. 24 (1)).
  - The auction monitor reports to the Commission (Art. 25)
    - monthly on the "fair and open" access, transparency and price formation of the conducted auctions and
    - on an annual basis in particular on anti-competitive behaviour or market abuse.

- **Market abuse: prohibition of insider dealing and market manipulation**
  - Any person possessing "inside information" which might have an effect on price bids (Art. 37 lit. a) must not use it for price bids (Art. 38–40).
  - No person may engage in market manipulation (Art. 41). This can include e.g. the purchase or sale of allowances before auctions are carried out so that the auction clearing price is set at an "abnormal or artificial level" (Art. 37 lit. b).

Changes Compared to the Status Quo

To date no EU-wide regulation exists regarding the auction of emission allowances.

Statement on Subsidiarity by the Commission

The Commission does not address the principle of subsidiarity.

Policy Context

The Emission Trading System (ETS Directive 2003/87/EC) will gain increasing significance for EU Climate Policy from 2013 onwards due to the Climate Package of 23 April 2009 (Directive 2009/29/EC, see CEP Analysis, p. 11 et seq., in German only). While to date each Member State sets a national cap of available allowances, from 2013 on an EU-wide total volume will be allocated ["EU Cap", Art. 9 ETS Directive; see Commission Decision C(2010) 4658 of 9 July 2010: 1.926.876.368 allowances for 2013], which by 2020 is to be gradually reduced by 21% compared to 2005. Accordingly, the allocation of allowances which during the first two ETS trading periods (2005–2007 and 2008–2012) was conducted by the Member States under the "National Allocation Plans" (NAP) will, as of the third trading period (2013–2020), be regulated at EU level. The current mainly cost-free allowance allocation will be gradually reorganised towards auctioning so that from 2013 onwards at least 50% and from 2027 on almost all allowances will be auctioned. By way of exception, energy-intensive sectors exposed to a "significant risk" of carbon leakage to non-EU countries will receive cost-free allowances also after 2013 (Art. 10a (12)).

Legislative Procedure

14 October 2010	Approving statement by the committee of national experts for climate change and submission of the Draft Regulation to the Council and the European Parliament
Open	Adoption by Commission, unless the European Parliament and the Council do not object within a period of three months following the submission.

Options for Influencing the Political Process

Leading Directorate General:	DG Climate Protection

Formalities

Legal competence:	Art. 192 TFEU (Environment) in conjunction with Art. 3d (3) and Art. 10 (4) ETS Directive (2003/87/EC).
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Regulatory procedure with scrutiny (Art. 5a Decision 1999/468/EC).

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Pursuant to Art. 10 (3) of the ETS Directive 2003/87/EC, the Commission should have had a regulation on the auctioning of emission allowances adopted by 30 June 2010 at the latest. In other words, **the present Draft** of 14 July 2010 **comes too late**, as now the Regulation cannot be adopted until autumn 2010 at the earliest. The Regulation is urgent because **already from 2011 onwards emission allowances are to be auctioned** for 2013 and beyond.

In particular, power producers need allowances early, as they usually conclude long-term delivery contracts and want to be sure when concluding the contract that they will have the required volume of allowances at the delivery date. Therefore, the Regulation should ensure that from 2011 on there will be enough allowances for 2013 and the following years. These volumes needed are currently not regulated in the Regulation Draft. Instead, Recital 19 only mentions that they will be listed in an Annex to the Regulation and that they will be determined "as soon as practicable following the adoption of this Regulation". **Should these allowances not be available, enterprises with long-term delivery contracts will acquire existing market allowances** from the ongoing trading period or conclude corresponding futures contracts with an intermediary, who in turn either holds allowances or speculates on the future acquisition of allowances. **As a result the prices for emission allowances will rise** temporarily.

Impact on Efficiency and Individual Freedom of Choice

In principle, the rules of procedure for an early publication of the auction calendar and for the auctioning process, as well as the EU-wide auction monitor, **lead to a transparent auctioning process**.

The rule that an auction can be cancelled if the auction clearing price is "significantly" under the price on the secondary market, however, **is wrong**. It does protect Member States from "too low" profits from auctions, but **the purpose of auctions is the efficient allocation of emission allowances and not to gain profits for Member States**. Effective tools to avoid auction manipulation are already given by the rules on auction monitoring and by the prohibition of insider dealing and market manipulation. Hence, further tools dealing with "too low" prices are not needed.

It is very likely that at least several Member States will establish their own national auction platforms. This will lead to additional costs for enterprises registering with several platforms. However, with several platforms existing, bidders are better protected against the consequences if a platform breaks down due to disruptions in the information technology system or manipulation.

Impact on Growth and Employment

In case there are not enough allowances available from 2011 on, the prices for emission allowances will rise. The same holds true should auctions be cancelled due to "too low" prices. This will have a negative impact on growth and employment.

Impact on Europe as a Business Location

The economic burden of emission allowance trading are a result of the ETS Directive 2003/87/EC. The proposed Regulation leads in principle to a transparent auctioning process. However, the mentioned issues resulting from early auctions from 2011 on and the exclusion of "too low" prices has a negative impact on Europe as a business location, since they make allowances unnecessarily more expensive.

Legal Assessment

Legislative Competence

The EU may adopt environmental measures to protect the climate (Art. 192 TFEU). The Commission is empowered to regulate the auctioning process for allowances for aviation and stationary installations (Art. 3d (3) and Art. 10 (4) ETS Directive 2003/87/EC).

Subsidiarity

Unproblematic.

Proportionality

Unproblematic.

Compatibility with EU Law

Unproblematic.

Compatibility with German Law

Due to the proposed Auctioning Regulation, the German Greenhouse Gas Emission Regulation (TEHG) must be adjusted. As of the third trading period in 2013 the adoption of a National Allocation Plan (NAP) and the law regulating the auctioning process [§ 21 Allocation Act for the Allocation Period 2008 to 2012 (ZuG 2012) in conjunction with the Emission Trading Auctioning Regulation 2012 (EHVV 2012)] will become obsolete.

Alternative Action

An auction should not be cancelled just because the auction clearing price is "significantly" under the price on the secondary market. This rule should be deleted. At least it should be added that an auction is cancelled only if there is cause for manipulation concerns.

Possible Follow-Up Action by the EU

Not foreseeable.

Conclusion

The Regulation should already have been adopted by 30 June 2010. Hence, the Commission is too late in submitting its Draft of 14 July. The proposed Regulation does not ensure that from 2011 on enough allowances can be auctioned for the period starting in 2013. An early publication of the auction calendar, the rules on the auctioning process and the joint auction monitor in principle lead to a transparent auctioning process. However, the cancellation of auctions due to the auction clearing price being "significantly" under the price on the secondary market is to be rejected, as it only serves profit making purposes of Member States.

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