



Meeting Notes- CEPS Carbon Market Forum

Task Force: EU ETS

3rd meeting of the Task Force, September 10, 2012

Brussels, Belgium

This meeting of the Task Force reviewed and discussed the documentation put out by the EC on July 25, 2012 and the input that the Carbon Market Forum (CMF) Task Force (TF) on EU ETS could make in response to the consultative process that the EC had started. The meeting was attended by representatives from business, civil society and different levels of government in, and outside, the EU.

On July 25th the EC released a number of documents including:

- A proposal to amend the EU ETS Directive and clarify the prerogative of the EC to make changes to the auctioning profile within a trading period through the Climate Change Committee,
- An amendment to the Auctioning Regulation that does not include number
- A Staff Working Document (SWD) that outlines, in some detail, the rationale behind back loading as well as at least three different options on how to implement such action. It showed by calculations using three different figures, the potential impact of back loading.

The TF meeting was divided in a number of sections

- By way of introduction a preliminary discussion of the results of the CEPS TF on “EU ETS Pricing”
- A presentation and discussions of clarifications on the documents released
- A session entitled “Under what conditions is back-loading effective?” which was intended to address the conditions under which back loading could be effective if, any. Are there any specific external circumstances that need to prevail in order for back loading to provide an attractive alternative? Are there any specific circumstances/design features needed for back loading to succeed?
- A discussion of the three back loading alternatives provided in the EC documents of July 25, 2012 as well as any other alternative scenarios.

In the course of the discussions a number of points were made which are outlined below. The meeting was held under Chatham House Rules.

- The SWD referred to an end of Phase 3 surplus of around 1.4 billion tons. That number is now expected to rise to 2 billion tons by the end of 2020.

- Substantial amount of supply will come to the market in 2012-2013 through a number of channels
 - Early auctioning
 - National NER that will likely be auctioned
 - NER 300, 200 million in 2012, another 100 million in early 2013
 - Some CERs (industrial gases) will come in large quantities as their usefulness comes to and end in April 2013
- The issue was raised that, given the potential time delay in implementing all the proposed changes, as it would be important to consider carefully whether this back loading would be done on a 12 month period or on a calendar year. This remains unclear but the reactions seem to be that it would be very unlikely not to be on calendar year basis.
- It was remarked that 1.4 billion was the equivalent of a 30% reduction, but that this was not about structural changes, but redressing temporary market imbalances.
- The EC proposal was questioned and the wording found to be very broad, allowing market intervention in unclear circumstances, without clear guidelines. “Orderly” market functioning does not provide any definition. The result was compared with a mandate or function of a “carbon bank” without the clear guidelines that such an institution ought to have (e.g. Fed or ECB).
- Some participants spoke of very broad conditions for the proper functioning of the carbon market as the cornerstone of EU climate change policy, including alignment of climate and energy policy in the EU, creation of a EU wide energy infrastructure, setting a 2030 target that would help calibrate the market, the development of a consistent EU external climate change policy. The reality is that the EU ETS is an ex ante system that is now behaving as an ex post system but in an erratic way.
- There was outright opposition by some stakeholder to any ex-post changes such as back loading. Price is, in this light, seen as secondary, with the environmental outcome to be fulfilled as the objective. If there are any issues to be resolved they are of a long-term nature, structural, not short term and price driven. Others were sceptical to what extent the Commission’s proposed changes to the Directive allow the Commission to become a Carbon Bank. Others held that the backloading does not constitute an intervention but simply addresses temporary imbalances in the market. This was similar to early auctions, which were also meant to address such imbalances.
- Some viewed the alignment of each phase as an important factor. Since this is a regulatory driven market, calibrated through economic forecast, which by definition is not accurate. Consequently, flexibility must be inserted in the instrument to make it viable and credible. What is known right now is that there is a 1.2 billion surplus in 2012, and that is what should be addressed.
- Concerns were expressed regarding volatility that would be introduced in the market by back loading. Volatility, with any back loading was also very real. What was seen as important was the

“nature” of the volatility, triggered by the lack of liquidity in the market or by objective factors due to changes in the supply demand balance. Lower prices will lead in some views to the exit of many liquidity players, resulting in a much less liquid market that would be prone strong fluctuations

- A series of “conditions” were outline that need to be met in order for back loading to “make sense, including the existence of a clear roadmap on structural reforms; return allowances as late as possible but not in a single year (2019-20); higher volume back loaded in 2013, lower volumes in subsequent years (as better supplied).
- How do you measure success with back loading – what is the objective? Is it price or market functioning, what is the measure? The “market” cares about 2013-5, 2020 is not on the radar, there is no price for 2020. There is a “sweet spot”, if one takes out too much we risk reducing liquidity.
- The carbon market was seem as functioning well, with the exception of supply which was seen as totally inelastic. There is a theory of market functioning and the political reality of maintaining the relevance and existence of the ETS.
- Power sector is short, industrials are long. EUAs are treated as a cash reserve almost, to be sold at a pre-agreed price. Intermediaries are needed in a market driven by auctioning or else industry and power will have to tie up large amounts of capital if intermediaries are not in the market due to low prices and the resulting low margins.
- The market trades to a large degree on sentiment with a 400 million back loading seen as bearish, and a 1 billion as bullish.
- Whatever the number of back loading that will emerge, it will be wrong. Three things need to be linked: political procedure to get a short term fix, how this will lead to market reform, and how this will fit in the long-term perspective.

CEPS will produce a draft paper that will be very much responding to the consultation and be focused, but bold. This paper will be the subject of a conference call with TF members, and will then be finalized. CEPS will try and submit around October 3rd to ensure that the process moves ahead smoothly.

At the end of the meeting it appeared that the following four questions should be addressed by the CEPS Task Force on EU ETS with respect to back loading:

- Is back loading a good idea?
- Is there a need for following up the back loading with structural measures?
- What should the number be? If this cannot be addressed, what are the considerations for deciding upon that number?
- What price expectations are linked to the number? On what basis are they construed?



The next meeting of the Task Force on New Market Mechanism will be scheduled for October 22, 2012 in Berlin (after the meeting if it was scheduled on October 22nd) in cooperation with the Government of Germany. It is expected that at that time we will cover the following main issues

1. Cost of non EU ETS study
2. Back loading
3. Structural changes

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These Meeting Notes represent the discussions in the meeting as captured by the Rapporteurs, and do not attempt to portray any consensus among the members of the Task Force.