

## ViewPoint: Carbon Market Europe's new look

Point Carbon is pleased to launch this first issue of Carbon Market Europe (CME) in a new and extended format. The number of pages has been doubled – from two to four – in the hope that CME will continue to be a useful tool for everyone keeping an eye on the European carbon markets.

We have kept pure market information, including prices and comments from brokers and traders, on the first page, to ensure easy access. On page two we have introduced a guest column, where we will invite various market actors and observers to contribute their thoughts. Rolf de Vos at Ecofys is the first one out with the article "The Silent Majority". Anyone interested in contributing to this column should contact the editor. Page two is also where we keep you updated on the latest news.

Two additional features are introduced on pages three and four. In each issue we will present one of the sectors covered by the EU ETS, bringing background information and comments, identifying main players and challenges presented by the EU ETS. This feature is being kicked off in this issue by a special on the German electricity industry.

Last, but not least, each issue will take a closer look at the allocation process in one of the EU Member States participating in the EU ETS. Today's country focus is on Ireland.

We hope that you will enjoy the new look of Carbon Market Europe. If you have any suggestions on further improvement, do not hesitate to contact us.

Stian Reklef  
Editor, Point Carbon  
[sr@pointcarbon.com](mailto:sr@pointcarbon.com)

Carbon Market Europe is a weekly round-up of events in the EU emissions trading market – the **EU ETS** – presenting current carbon prices, news and commentary. The publication is intended for anyone with an interest in this market: company officials, traders, analysts, risk managers, government representatives, financiers, consultants, legal advisers, researchers and other observers and stakeholders.

Carbon Market Europe is available for free. To subscribe, fill out the registration form available at [www.pointcarbon.com](http://www.pointcarbon.com).

From our web page you can also subscribe to our other free news services; the daily Carbon Market News, covering the global carbon markets, and the monthly CDM Monitor.

Any comments on the content of Carbon Market Europe will be gratefully appreciated, along with suggestions on how to improve the publication or subjects that should be covered in future issues. Please contact:

Stian Reklef, editor  
[sr@pointcarbon.com](mailto:sr@pointcarbon.com)  
Tel: +47 92 447 147

## European carbon prices

	Bids		Offers		Close
	Volume	Price	Volume	Price	Price
EU 2005	10,000 t	€10.20	10,000 t	€13.30	-
EU 2006	-	-	-	-	-
EU 2007	-	-	-	-	-
UK 2002/3	2,000 t	£1.75	5,000	£2.30	-

Quoted prices are for allowances per tCO<sub>2</sub>. EU 2005: A bid for 5,000 t was reported at as high as €10.50. In larger volumes, a 10,000 t bid was also reported at €10. A bid for 50,000 t was reported at €9.50/t. The offerer expects to be able to deliver in the first quarter of 2006. EU 2006: Nothing firm is in the market, only indicative with a somewhat wider bid-offer spread than 2005. EU 2007: Nothing is in the market. UK: The bidder wants immediate delivery.

## Market comment

Three small volume deals (500-5000EUAs) representing test transactions conducted for education purposes took place in September, each with at least one Scandinavian counterparty. Neither prices nor exact volumes were disclosed, reported **Andrew Ertel** at brokers Evolution Markets. - The bid side for EU Allowances (EUAs) remained strong throughout September. The offer side on EUAs remains thin as companies await guidance on allocation. Our bid-offer spread widened as active market players waited to see real volume on the offer side, he commented.

- Although this month's transactions were reported to close around €13, Evolution Markets does not believe this is an indicative mid-market price (the price at which a higher volume, e.g. more than 50,000 per year, would close today). We believe mid-market remains in the area of €10.

Ertel was pleased with the level of activity conducted in the market, announcing that to date Evolution Markets has recorded a total of 11 transactions of EUAs in the entire EU GHG market.

## In this issue

### The Market

ViewPoint – European carbon prices – Market comment (**Page 1**)

### In the news

Russian Kyoto delay not to affect the EU ETS – Guest commentary: Rolf de Vos, Ecofys – News in brief (**Page 2**)

### Corporate

The German electricity sector's emissions trading challenges at a glance – Nuclear phase-out to gain electricity sector (**Page 3**)

### Country focus

The going gets tough for Ireland – Allocation should reflect liquidity uncertainty: ESB (**Page 4**)

## Point Carbon

Point Carbon is the leading global provider of independent carbon price forecasts and analysis of greenhouse gas emissions trading markets.

## Guest commentary

Rolf de Vos, Ecofys

## The silent majority

Less than 15 months before the establishment of a European emissions trading market there remains a lot to be done. The national allocation plans are the well-known challenges over the next few months.

But there is another challenge, which up till now often has been neglected. At present only a small part of all participating companies (over 10,000 or maybe even 15,000 installations in the enlarged EU) are well informed about the upcoming carbon constrained world. This top 20% - at the most - will probably dominate at least 80% of all emissions trading, enough to make the market liquid. But the majority of all participating companies is not fully aware of the changes that will influence their business from 1 January 2005.

For these companies, the most important feature of the EU scheme is not the trading market itself. They will delegate that part to their (financial) advisors, brokers and consultants. Nevertheless their corporate emissions will be capped, which in the end will affect their balance sheets and their business. Thus these smaller companies also have to install a proper carbon management and monitoring system, in order to account for their carbon emissions.

Naturally, this is the companies' own responsibility, but one should realize that this large number of companies makes up the backbone of a properly functioning EU emissions reduction policy. The European Commission and all the national governments must focus on raising the sense of urgency at these companies in time, with the help of consultants, financial advisors and lawyers to point out the opportunities and pitfalls. This will be a hell of a job.

**Rolf de Vos**  
Editor  
Ecofys  
[www.ecofys.com](http://www.ecofys.com)

## Russian Kyoto delay not to affect the EU ETS

The long awaited climate change conference in Moscow was arranged this week, but anyone who had been hoping for Russia to take the opportunity to announce that it would ratify the Kyoto Protocol were left wanting. Prime Minister Vladimir Putin said instead that the country is still weighing the pros and cons, and that when a decision is made at some unspecified time in the future, Russian national interests will weigh heavy. Not a tactically clever move, according to **Michael Grubb** at Imperial College London.

- Putin wants western governments to assure more clean investment under Kyoto - but it is western companies that control that, not western governments. And companies listening to Putin's speech will conclude that Russia is still not ready. Those companies seeking secure, low-cost investments that will guarantee emission credits can and will go elsewhere - and already are going, to countries that have already ratified Kyoto and are putting in place the institutions to attract clean investment and to verify the resulting emission reduction credits, he told Point Carbon.

- Such investments are already being announced for some of the more advanced countries in central Europe. The greatest irony is that whilst Putin's announcement is sufficient to keep Kyoto

on track, it is Russia that will lose out from the continued delay - and pleading for more investment guarantees is not going to change that, Grubb argued.

He does not think that a further postponement of Kyoto entering into force will have an impact on the EU emissions trading scheme.

- An increasing number of countries are saying that they will abide by the terms of Kyoto even if Russia were to back away. The EU ETS will go ahead as scheduled. But the Kremlin's demand for investment guarantees betrays a worrying lack of understanding of the Treaty - a classical disconnect between old-style international politicking and the realities of the market in carbon emission reductions that is established under Kyoto, he noted.

He compares the current situation in Russia with the one in the US, where as the federal government is unable or unwilling to move forward, the regions are taking matters into their own hands.

- I can envisage a scenario where Russian regions develop their own emissions trading schemes, which may lead to bilateral deals with EU companies being proposed to the EU Commission for approval. It would be interesting to see how the EC would handle such a challenge, Michael Grubb said.

## News in brief

Friday last week brokers GT Energy announced another trade in the EU market. The counterparties were Scandinavian and German. The volume traded was reported to be low, while **Moe Moe Oo** at GT Energy stated that "the price continues to push upwards due to shortage of supply".

Denmark, Finland, Germany, Iceland, Lithuania, Norway and Sweden have signed the **BASREC** Regional Testing Ground Agreement for Flexible Mechanisms of the Kyoto Protocol. Estonia, Latvia, Poland and Russia are expected to sign later. The agreement is expected to generate some JI projects.

**The Netherlands** has signed Memorandums of Interest with three Russian regions - Omsk, Vologda and Kostroma - on greenhouse gas reducing projects eligible under the Kyoto Protocol. Realisation of the projects will depend on Russian ratification of Kyoto.

German investment bank **UBS Warburg** forecasted that power wholesale prices across Europe could increase by 63% following the introduction of the EU emissions trading scheme. (Platts)

**Norway** signalled this week that it may have to buy more credits from JI and CDM projects than expected in order to reach its Kyoto target. Under Kyoto Norway can not increase GHG emissions by more than 1% from 1990 to 2008-2012, but new data suggest a 27% increase. (Dagsavisen)

**Ruhrgas** announced plans to invest in a gas pipeline overhaul programme in Russia, expected to reduce CO<sub>2</sub> emissions by 5 Mt annually until 2007. The company hopes to get the emissions reductions approved as JI credits. At the climate change conference in Moscow, other EU companies also expressed an interest to invest in projects in Russia. (ENDS Environment Daily)

## The German electricity sector's emissions trading challenges at a glance

### Total German CO<sub>2</sub> emissions

1990: 1014.4 Mt  
2001: 870.8 Mt  
Change 1990-2001: -14.2%

### CO<sub>2</sub> emissions from the electricity sector

1990: 289 Mt  
2001: 274 Mt  
Change 1990-2001: -5.2%

### The EU ETS

Electricity installations covered:  
Approximately 900.

### Main actors

Electricity production market share  
2002: RWE (32%), E.ON (30%),  
Vattenfall (12%), EnBW (7%)

### Voluntary commitments

The German Electricity Association (VDEW) and four other sub-industry association of the energy sector signed an agreement with the government in June 2001. The overall target is to reduce CO<sub>2</sub> emissions by 45 Mt by 2010, using 1998 as reference year. Of this, 30 Mt applies to electricity. Around half of the reductions should be delivered through CHP, but only if the government introduces a law supporting CHP. The rest is to be covered by other measures in the energy sector (renewable energy, refurbishment of existing capacity etc.). There are no targets concerning the average emission intensity of electricity production. The expected increase in CO<sub>2</sub> emissions through the nuclear phase-out will not be accounted for, meaning that the net reductions will be less than 45 Mt.

### Current climate policy related regulations

- The eco-tax on electricity consumption;
- A renewable energy law (EEG) with differentiated feed-in tariffs across technologies;
- A CHP law with differentiated feed-in tariffs for old or new capacity.

Sources: VDEW, ZEW, EEA.

## Nuclear phase-out to benefit German electricity sector

The German electricity sector has announced as much worry as anyone concerning the EU emissions trading Directive. Early in the ETS process concerns were voiced on rather general terms, in opposition to regulation of the sector's greenhouse gas emissions, which was seen as unnecessary as the sector had taken on voluntary targets.

That has changed, and the sector's main concerns in relation to the Directive are very specific indeed. Four of the major German power companies, RWE, E.ON, Vattenfall Europe and EnBW, have taken part in negotiations with the Ministry of Environment, discussing an emissions reduction framework (a reduction of 45 million tonnes of CO<sub>2</sub> (MtCO<sub>2</sub>), of which approximately 30 MtCO<sub>2</sub> applies to the electricity sector) that the German allocation plan should be based on. Given that the electricity companies get their way on the subject of phase-out of the country's nuclear industry. **Michael Weltin** at E.ON explained:

- The self-obligation agreement includes the commitment of the German government not to take into account the emissions resulting from the phase-out of nuclear energy in Germany. This means that supplementary emissions resulting from the nuclear phase-out have to be compensated to the electricity sector by generating these certificates among the other CO<sub>2</sub>-emitting sectors, including households and transport, or generated from JI and CDM.

- With these key points taken into account, a solid basis for the allocation has been set, although we would prefer to cut emissions equally among all CO<sub>2</sub>-relevant sectors, Weltin told Point Carbon.

### New entrants

Another concern for actors in the electricity sector in Germany is the treatment of new entrants. Weltin argued:

- There is a risk that, instead of using the ETS as a market mechanism to stimulate investment in less CO<sub>2</sub>-intensive technologies, inefficient allocation criteria will be chosen. This risk concerns how to deal with new installations.

- In Germany there is a discussion on providing new plants with emissions rights at no charge and according to need. An allocation to new installations that is based on need and free of charge gives the wrong signals. Although there is no doubt that if the existing broad German generation mix, consisting of coal, lignite, gas, nuclear, etc. is to be maintained, allocation mechanisms must provide an incentive to reduce emissions, meaning that the climate effect of new CO<sub>2</sub>-intensive installations must be taken into account.

### Nuclear phase-out allowances to save the day?

The electricity companies' desire to be allocated emissions allowances that are likely to arise from the phase-out of the nuclear industry could well bring profit to the sector.

**Marcus Stronzik** at Zentrum für Europäische Wirtschaftsforschung (ZEW) told Point Carbon:

- If the electricity sector is allocated the allowances from the nuclear phase-out, it seems that the sector in general could be on the sell-side of the market. However, it is too early to say how many of these allowances electricity companies will get.

He doubts whether the EU ETS will have any influence on wholesale power prices, at least in the first phase of the scheme. – Companies will be given the allowances for free, and some of them will have to go into the market and buy the extra ones they need. As I expect carbon prices to be quite low at least in the first phase, I don't think emissions trading will affect prices much. There are other factors far more important to price-setting, Stronzik said.

Stronzik is being contradicted on this by **Christian Güthert** at EnBW. - Emissions trading will cause production costs to grow, which means that electricity prices will rise again. They have already increased as a result of the renewable energy legislation. It is correct that the electricity sector may be allocated allowances from the nuclear phase-out, but due to the political risks of the issue there is no certainty on which basis this will happen, he argued.

- As only a small part of German electricity is based on fossil fuels, we lack real reduction options, meaning that we will have to trade actively, Christian Güthert said.

## Upcoming reports

- Emissions impossible? Impacts on carbon prices in the EU ETS
- The size of the carbon market
- Quarterly report Q3

## Recent reports

### Carbon Market Analyst

- CDM Methodology Panel: Lessons learned
- Global market outlook for 2003 - Update
- The missing link: The role of JI and CDM in the EU ETS
- Japan, Canada and Russia: Monopolistic prices?
- National registries – how will they influence the market
- CDM: A three-year forecast
- What price for EU allowances?
- The size of the EU Market
- Global market outlook for 2003
- Lessons learned in 2002

### Carbon Market Quarterly

- Q2: EU emissions trading set to go
- Q1: First EU trade in hesitant market

To obtain these reports and/or subscribe to the Carbon Market Analyst, contact:

Henrik Sørensen  
Tel: +47 924 07 898  
Fax: +47 925 70 818  
hs@pointcarbon.com

## The going gets tough for Ireland

On Friday 3 October, the Irish Environmental Protection Agency (EPA) is holding a consultation workshop for the approximately 70 Irish installations covered by the EU emissions trading scheme (ETS). This marks the de facto start of the allocation process in Ireland, as the job done so far has mainly been identifying participants. EPA and the Department of Environment shares responsibility. The Department will bring proposals to the Government in December on determining the total quantity of allowances to allocate, while the EPA will have responsibility for determining the distribution of these allowances among the participating installations. Recently London-based ICF Consulting and Irish consultants Byrne Ó Cléirigh were appointed to assist the Department in its job.

The job will not be an easy one, as Ireland is one of the countries struggling the most to reach its Kyoto target. Under the EU burden-sharing agreement, Ireland must not increase its GHG emissions by more than 13 per cent from 1990 in the period 2008-2012. In 2001, emissions had already increased by 30 per cent. CO<sub>2</sub> emissions from energy sources rose in the same period by 46 per cent, from 29.8 million tonnes (Mt) to 43.5 Mt. While emissions data from the installations covered by the EU ETS have not been published, the national inventory suggests that approximately 23.5 Mt of current emissions will be included in the scheme. 70 or more installations owned by 35 different companies will probably have to accept that less than 23.5 Mt is allocated annually, with some sources suggesting a figure as low as 16 Mt annually.

While no decisions have been made yet on the most difficult aspects, **Conor Barry** at the Department informed that it is unlikely that Ireland will opt out any installations in the first phase. The process is currently in the hands of the two consulting agencies.

- Allocation is to be determined by a robust analysis that considers the economic efficiency, equity, and competitive implications for companies that will be in the EU ETS as well as those that may be required to make reductions subject to other policies and measures outside the EU ETS. Put another way, we are addressing the "big bubble" question. A second piece of work will recommend the installation level allocation. We are not involved in that process, which is left to the EPA, but clearly the answer to the first question feeds into that process, **Abyd Karmali** at ICF Consulting said.

ICF and Byrne Ó Cléirigh are to finish their report by late November, when the EPA takes over the technical process. The total amount of allowances to allocate is taken care of by the Ministry of Environment, while the EPA will divide it among sectors and installations. - A draft will probably be available in February, but changes may occur after that. There will be no certainty regarding the allocation plan until it has been submitted to the Commission on 31 March 2004, commented **Ken Macken** at the EPA.

## Allocation should reflect liquidity uncertainty: ESB

The biggest Irish actor in the EU ETS by far will be Electricity Supply Board (ESB), the state-owned company. The company's total CO<sub>2</sub> emissions in 2002 were 14.1 Mt, down almost 2 Mt from the year before, due to a reduced market share. 10 ESB installations are covered by the scheme, and **Owen Wilson** at ESB entertained no hopes that the company will be allocated all the CO<sub>2</sub> allowances it needs.

- There is no choice for us, we will have to buy. We are restricted from building new plants due to our dominant market share. A capacity shortfall nationally means that the option to reduce emissions by reordering plant output is not there for us, he said.

Accepting that ESB must trade in the market, Wilson had some concerns about the liquidity in the upcoming market, due to potential non-allocation of hot air in the ten accession countries.

- There will be restrictions on how generous the allocation in the accession countries can be. It is difficult to see how even a modest portion of the hot air there could be allocated. This could cause the overall liquidity to be tight or non-existent, with a shortfall of sellers in the market, Wilson argued.

- If this happens, prices will spike in the short term, but probably fall again in the second phase of the scheme. My hope is that the Irish allocation plan will be generous enough to take these uncertainties into consideration. However, I am not optimistic that it will happen, Owen Wilson said.

ESB has not yet done any ETS trades, but could do some small ones before allocation in order to gain expertise. - A problem at the moment is to identify sellers of EU allowances, he noted.