

Commission must cut through a Gordian knot

In January, several cyber-attacks were carried out against the emission allowance registries of five EU Member States, resulting in the theft of at least 3.1 million allowances – the number still needs to be defined exactly. These attacks are the latest in a series of frauds that have targeted the EU ETS over the past 18 months, including the theft of allowances, VAT fraud, and phishing. The urgent measures taken by the European Commission on January 19th involved the provisional suspension of transactions on the registries of the 27 Member States.

In the short term, these incidents have a greater impact on the way the allowance trading systems operate than on the environmental compliance procedures of the parties involved. In fact, the amount of stolen allowances, which represents around 0.15% of the allowances granted every year, is still minimal, so the impact on compliance by industrial companies will be limited. Nonetheless, the suspension of transactions on the spot market froze 20% of transaction volumes. Most transactions that take place are for futures contracts that do not involve immediate delivery.

Despite the interruption of spot transactions, the stolen allowances have not “disappeared” from the market: they have been sold on to other market participants. What are the consequences? In the absence of a coordinated EU legal framework, the domestic laws of each Member State apply. For example, in France an operator may be charged with harbouring stolen goods if they sell a stolen allowance in another country, although they will not be prosecuted in Germany.

Although the Commission allowed the registries of five Member States (France, Germany, the Netherlands, Slovakia and the United Kingdom) to reopen on February 4th, and Portugal on the 11th, and although the spot market is returning to life, this incident raises the longer term issue of the EU ETS’ governance. Two examples are illustrative:

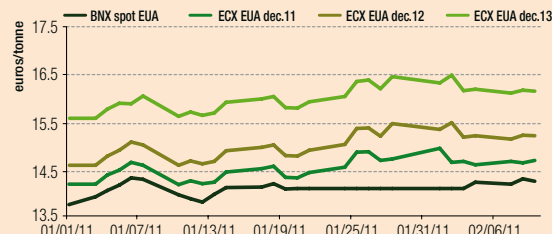
- 1) Half the Member States did not implement the latest version of the registry security standards that was approved by the Commission in April 2010, but who is responsible for assuring the security of registries? The Commission is responsible for managing systematic risks to the market. But it currently only defines the minimum security requirements for the registries, while each Member State is responsible for the implementation of community measures. The Commission and the Member States are currently involved in discussions aimed at amending the Registry Regulation and ensuring a higher level of security in the future. However, the Commission seems reluctant to accept the role of coordinator that some are proposing.
- 2) Although it is the market regulator, the Commission has no legal mandate that would enable it to draw up a full list of the stolen allowances and disclose it to market participants. This measure would nonetheless enable the hunt for the stolen allowances to be speeded up and participants’ trust to be rebuilt quickly. As things stand, market participants have to glean information from various sources without being certain that the information gathered is genuine.

The Commission’s next task is to ensure the complete security of the 27 registries before they are gradually reopened in time for the compliance. It will then need to work on introducing one centralised EU registry from 2013 onwards. This registry is now an essential factor for the security of the EU ETS. The registry may be placed under the stewardship of an independent institution in order to ensure its security and good management. Until then, all efforts are needed to restore the confidence of market participants, on whom the sound functioning of the EU ETS depends.

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Chart of the Month:

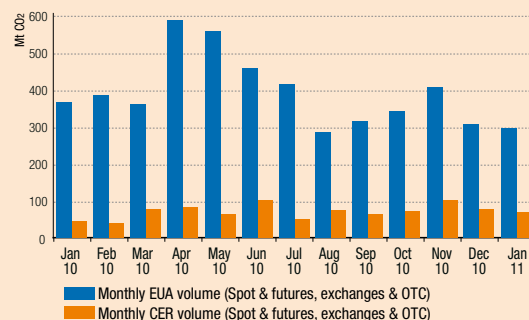
The impact of the registry shutdown on allowance futures prices.



The suspension of spot transactions on the EU ETS resulted in spot market transactions being carried over to the futures market. The price of futures on the Dec 2011 ECX contract registered an increase of €0.60 per tCO₂ between January 19th and 31st. Despite the rise in electricity prices in Germany, the price of coal and oil, the contract price ECX dec.11 dropped by 3% on February 3rd following the reopening of the spot market transaction. Source : CDC Climat Research

Monthly volumes:

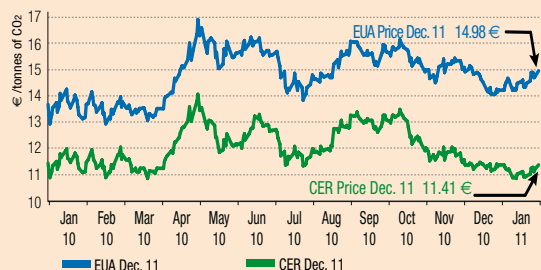
EUA Trading volumes stabilised at 300 mt over one month.



Source : ECX, LEBA, NordPool, PointCarbon

Carbon prices:

5% increase in the value of the EUA Dec 2011 contract, while CER contracts were relatively stable.



Source: ECX

EUA – CER price spreads:

25% increase and a record price of €3.62 per tonne reached on January 25th.



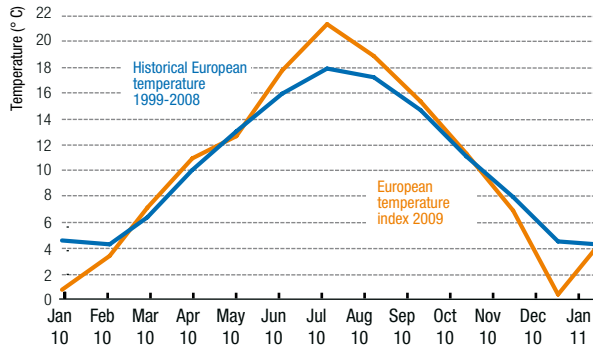
Source: ECX, LEBA, NordPool, PointCarbon

Temperatures (°C)

- Average of BlueNext Weather indices* – France, Germany, UK and Spain – weighted by the allowances allocated to each country.

	December	January
Monthly average (°C) - 2010	0.4	4.0
Monthly average (°C) - 2000-2009	4.5	4.3
Monthly minimum – 2010	-4.0	-1.3
Monthly maximum – 2010	5.5	10.5

Source: CDC Climat Research, based on data provided by Météo-France and BlueNext



Our European Temperature Index recorded an abnormal drop of 0.3°C in January, with very variable temperatures ranging from -1.3°C to 10.5°C. In fact, January 2011 saw a return to the seasonal average, which had not been seen since January 2005. We recorded very diverse abnormalities in temperature for different European countries: -4.2°C in the United Kingdom and -2.8°C in France, while Spain returned to the seasonal average. This index experienced three extremely abnormal periods in 2010. The winter of 2009-10, where our January Index was 3.8°C below the ten-year average, was extremely cold, although the summer was hot, despite an abnormal 3.4°C fall in temperatures in July, while the weather in December, where the Index was 4.0°C below the ten-year average, was extremely cold. Rainfall in Oslo was abnormally low, registering a 21 mm shortfall compared with the ten-year average and contributing to a record low in dam water levels in the Nordic Region, which are 25% below the ten-year average.

* The BlueNext Weather indices are defined on the basis of average temperatures, weighted by the population of the representative regions making up each country.

Precipitation (mm)

- Average of precipitation indices for Lyon, Oslo, Turin**, Vienna and Madrid, weighted by the hydroelectric share in each country's electric power mix.

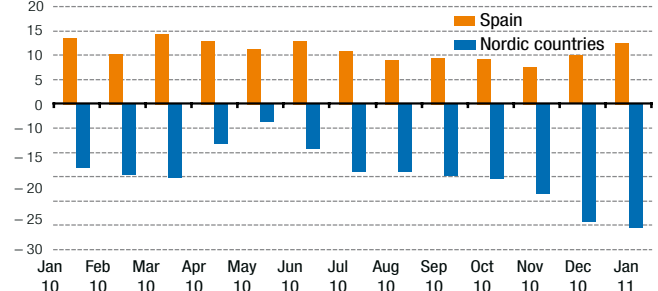
	December	January
Monthly precipitation – 2010	36.3	37.4
Monthly precipitation - 2000-2009**	53.5	38.1
Cumulative over 12 months	750.6	753.2
Cumulative over 12 months 2000-2009**	768.9	753.8

Source: CDC Climat Research based on data provided by Météo-France

** Precipitation for Turin Bric della Croce, a new observation point for Turin, was not available prior to 2006.

Reservoir Content for Electricity Production

- Spread between the monthly rate of reservoir levels (%) and the ten-year average rate (%).



Source: CDC Climat Research based on data from Nord Pool and Spanish Ministry of environment.

Production Indices

EU27 (base year 2005)	Nov. 10	Change over last month (%)	Change over 12-month average (%)
Indust. prod. (excl. construction)	100.3	1.5%	3.5%
EU ETS sectors production*	94.8	1.6%	1.5%
Electricity, gas and heating	98.4	0.7%	0.0%
Cement	72.2	1.2%	1.7%
Metallurgy	95.4	3.7%	8.8%
Oil refinery	95.0	7.3%	4.2%
Paper and cardboard	99.5	1.9%	1.5%
Glass	92.2	1.9%	3.6%
Ceramics	86.4	-2.5%	0.8%
Metal ore	104.9	6.2%	4.6%

* Index weighted by EU ETS sectors' weight in average total allocation over 2005-2007.

Source: Eurostat

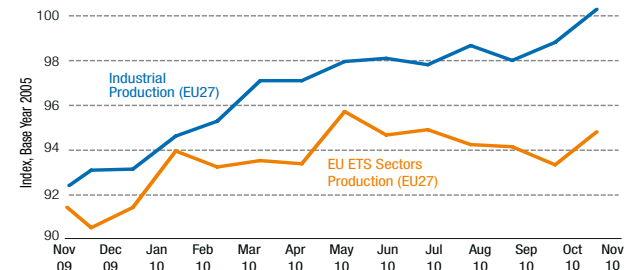
Opinion of Business Leaders

EU 27	Nov. 10	Dec. 10	Jan. 10
Industrial Sentiment Indicator	0.6	4.4	5.0

Source: European Commission

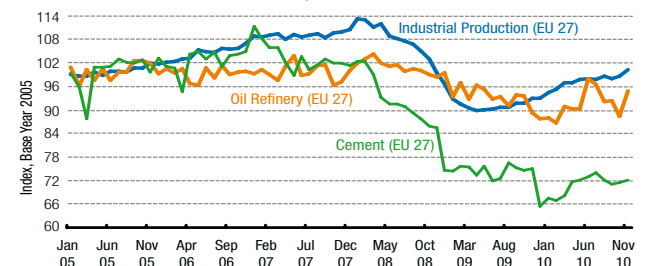
Our EU ETS production index, which had been declining since May, saw an upturn in November and returned to its pre-crisis level, rising by 1.6% to 100.3 over the month. In contrast, output from the other sectors expanded at a more sustained rate over the past 12 months, rising by 3.5% compared to the 1.5% rate registered by the EU ETS-constrained sectors. The major EU ETS sectors all registered an increase over the month, including combustion installations (+0.7%), cement (+1.2%), steel (+3.7%) and oil refining (+7.3%). The position of these sectors, in other words the difference between allowances awarded and allowances and international credits returned, was very diverse in 2009, with the short sector, which was an overall buyer of allowances and included combustion (around 100 million allowances short) on one side, and the other industrial sectors on the other. Those other sectors had a significant long position, and were therefore sellers of allowances, like the steel sector (+89.2 mtCO₂), cement producers (+61.8 mtCO₂) and oil refiners (+11 mtCO₂).

Total Production and Production by EU ETS Sectors



Note: Data reflect a new classification of economic activities that was implemented in May 2010.

Sectoral Focus: Oil refinery and cement



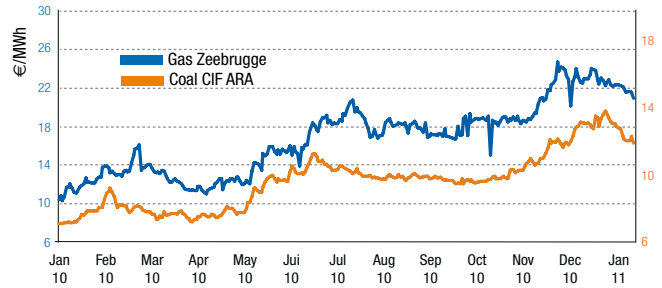
Source: Eurostat

Energy Prices

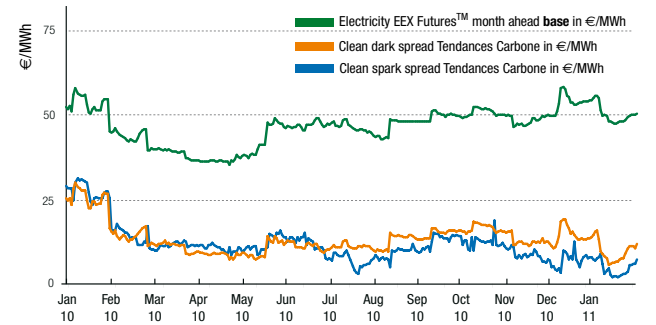
	December 10	January 11	
Average closing price			
Brent, in \$/barrel	92.4 \$/bbl	96.8 \$/bbl	
Natural gas Zeebrugge month ahead	6.79 €/MMBTU	6.55 €/MMBTU	
Amsterdam coal CIF ARA month ahead	91.41 €/t	93.68 €/t	
EEX Futures™ month ahead	Base	54.07 €/MWh	49.30 €/MWh
	Peak	69.06 €/MWh	64.29 €/MWh
BlueNext spot price	14.22 €/t	23.92 €/t	
Clean spark spread	6.86 €/MWh	3.86 €/MWh	
Clean dark spread	13.94 €/MWh	8.46 €/MWh	
CO2 switch price coal/gas	28.44 €/t	23.92 €/t	

Source: Reuters, BlueNext, EEX, CDC Climat Research

Primary energy prices



Price of electricity and price difference between electricity and primary energy prices



The price of Brent Crude continued to rise, breaking through the psychological USD 100 per barrel barrier on December 31st, a level last seen on September 26th 2008. This rise was closely linked to political instability in Egypt, which could jeopardise oil shipments from the Middle East. In addition, the risk of cyclones in Australia contributed to the increase in the price of coal over the month; the price of CIF ARA coal increased by 4.6% compared with the previous month. During the month, the coal price fluctuated in a range of between USD 118 to 131 per tonne. The price of Zeebrugge gas continued to fall during January, closing at 52.3 pence per therm on January 31st. The EEX baseload electricity price for the front month delivery contract registered an overall 8.8% fall compared with December over the month. However, the price followed the rising trend in fossil fuels and closed at €50.13 per MWh on January 31st. Coal and gas power stations' profit margins fell by 40% and 50% respectively over the month, reducing the CO₂ switching price by 15% to €23.90 per tonne, which encouraged electricity generators to use coal power stations to produce electricity.

Availability of Kyoto credits and allocation of allowances in the EU ETS

CDM / JI credits	As of January 2011	As of February 2011	Change
Number of projects in the pipeline: CDM - JI	6,977 - 414	7,106 - 421	+129 / +7
Of which : - number of projects registered: CDM - JI	2,703 - 206	2,786 - 211	+83 / +5
- number of projects with CER - ERU issued	844 - 90	942 - 202	+98 / +112
Cumulative volume of CER - ERU issued (Mt)	496 - 25	546 - 28	+50 / +3
CER/ERU available 2008-2012 UNEP Risoe estimate	953 - 225	960 - 229	+7 / +4
CER available until April 2013 CDC Climat Research estimate	1,125	1,100	-25

European Union allowances	Jan. - Dec. 2010	January 2011	Phase II til Sept. 2010
Allowances auctioned/sold (Mt)	85.62	7.88	209.49
Total revenues of the allowances auctioned/sold (M€)	1,200	111.63	3,100

Source: CDC Climat Research, UNEP-Risoe CDM Pipeline and European Commission

Estonia submitted a new NAP to the European Commission in January 2011, which aims to set the country's emission cap at 14.3 mtCO₂ between 2008 and 2012. Hungary announced the sale of 2.5 million tonnes of Phase II CO₂ exclusively through an auction process during the first half of 2011; the second half is expected to be sold in 2012 the European Parliament has asked the Environment Commission to draw up an own-initiative report addressing the possibility of going beyond 20% and the carbon leakage risk, in response to the European Commission's announcement in May 2010 regarding moving from a 20% reduction target to a 30% target. In addition, on January 21st 2011, Member States approved the ruling proposed by the Commission in November 2010 to prevent the return of HFC-23 and N₂O credits from CDM and JI projects as of May 1st 2013. In order to include maritime transport in the emission reduction targets, the EU announced on February 3rd that it may take unilateral measures in the absence of an international agreement between now and the end of 2011, but that it favours a multilateral approach that is supportive of the International Maritime Organisation until then.

Dashboard

European Union Emissions Trading Scheme

		Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11
Spot Market BlueNext	Phase II Average closing price in €	12.98	12.87	12.87	14.25	15.30	15.32	14.22	14.63	15.31	15.26	14.76	14.22	14.13
	Total monthly volume in kt	30,949	30,129	40,500	44,527	24,671	23,344	13,769	10,414	12,928	11,816	18,875	8,001	1,603
Futures Market ECX	Dec. 2010 (*Dec. 2011) Average closing price in €	13.70	13.04	13.05	14.41	15.50	15.48	14.34	14.71	15.39	15.30	14.79	14.62	*14.54
	Dec. 2012 Average closing price in €	15.48	14.13	14.16	15.59	16.55	16.42	15.20	15.55	16.17	16.09	15.57	15.06	14.98
	Total monthly volume in kt	320,398	337,559	295,072	508,756	515,409	400,298	385,045	255,262	284,029	302,357	370,865	278,825	278,390
Total European market volume in kt (PointCarbon)		367,578	385,878	362,044	592,305	559,106	462,248	428,657	286,110	316,286	346,213	420,122	312,596	300,537

Source: BlueNext, ECX, Point Carbon

International Kyoto Credit Market

		Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11
Spot Market - BlueNext	Average Closing Price in €	11.68	11.64	11.74	12.91	13.16	12.98	12.17	12.77	13.75	13.38	12.27	11.27	11.38
	Total monthly volume in kt	2,860	4,210	6,901	4,308	2,455	4,750	3,038	4,343	2,786	1,682	3,688	5,145	4,633
Futures Market - ECX	Average Closing Price in €	11.51	11.47	11.52	12.73	13.10	12.98	12.12	12.69	13.72	13.38	12.22	11.37	10.99
	Total monthly volume in kt	42,244	35,857	71,310	80,425	64,493	86,516	50,822	69,284	62,448	67,133	105,238	70,069	71,183

Source: Reuters, LEBA, NordPool, Nymex, ECX

Weather

Temperatures (°C)	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11
Germany - difference monthly and decennial average	-4.4	-2.4	0.1	-0.1	-2.9	0.0	2.7	-0.9	-1.5	-1.3	-0.5	-5.2	-4.2
Spain - difference monthly and decennial average	-0.5	-0.7	-1.2	0.7	-0.7	-1.2	1.1	0.6	0.2	1.4	-0.8	-0.3	0.0
France - difference monthly and decennial average	-2.8	-1.5	-0.8	0.4	-2.0	-0.2	1.5	0.6	-0.8	1.6	-0.7	-3.2	-2.8
UK - difference monthly and decennial average	-3.5	-2.4	-0.4	0.2	-1.1	0.8	1.2	-1.1	-0.6	1.0	-2.1	-4.9	-4.8

Source: BlueNext

Precipitations (mm)	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11
Vienna - difference monthly and decennial precipitation	-2.2	-12.4	-38.8	47.3	55.8	3.5	36.7	96.0	16.6	16.9	-11.2	-3.4	-8.4
Madrid - difference monthly and decennial precipitation	15.5	64.1	16.7	-5.0	-24.1	12.6	7.0	-6.8	-2.2	-41.0	-25.5	19.0	-3.7
Lyon - difference monthly and decennial precipitation	15.3	31.0	8.0	-36.9	54.0	31.8	-30.8	-33.0	27.5	-31.0	-1.8	-18.0	-6.6
Oslo - difference monthly and decennial precipitation	-64.0	-16.6	-3.7	-22.3	-26.7	17.3	19.5	-5.3	8.8	-20.5	-83.0	-44.4	-21.1
Turin - difference monthly and decennial precipitation	5.5	47.2	20.1	-68.0	40.2	110.6	-24.8	27.9	-86.2	79.4	101.2	14.8	-34.6
Hydraulic Reservoirs – Spread between the monthly rate of reservoir capacity and the decennial average rate													
Spain	13.5	10.3	14.5	12.9	11.2	12.9	10.9	9.1	9.4	9.2	7.6	9.9	12.5
Nordic countries	-13.1	-14.6	-15.1	-8.3	-3.6	-9.1	-14.1	-14	-12.6	-15.4	-18.5	-24.3	-25.4

Source: Météo-France, NordPool, www.mamr.es

Economic activity

	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11
Total industry production index (excluding construction and seasonally adjusted), base year 2000 = 100													
Europe 27	94.51	94.19	95.98	96.41	97.56	97.69	97.63	98.68	97.97	98.79	100.27	-	-

Source: Eurostat

Energy prices

	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sept-10	Oct-10	Nov-10	Dec-10	Jan-11	
Brent crude oil, 1 st maturity, in \$/baril	77.01	74.79	79.93	85.84	77.00	75.66	75.36	77.14	78.42	83.50	86.15	92.40	96.80	
Natural gas Zeebrugge, 1 st maturity date, in €/MMBTU	4.05	3.85	3.41	3.71	4.45	5.26	5.45	5.32	5.05	5.43	5.71	6.79	6.55	
Coal CIF ARA, 1 st maturity date, in €/tonne	60.18	55.50	54.36	59.37	71.20	77.00	72.86	71.78	70.36	70.48	77.86	91.41	93.68	
EEX FuturesTM month ahead, in €/MWh	Base	49.78	39.22	37.97	37.97	46.62	47.26	44.43	47.83	49.77	50.73	48.03	54.07	49.30
	Peak	63.64	48.09	46.14	46.97	57.95	60.32	55.80	58.83	61.74	61.69	58.17	69.06	64.29
Difference in prices of electricity and of natural gas, corrected for the price of CO ₂ : Clean Spark spread in €/MWh	19.94	14.14	12.34	9.57	13.27	9.13	5.75	9.34	12.82	11.55	7.27	6.86	3.86	
Difference in prices of electricity and of coal, corrected for the price of CO ₂ : Clean Dark spread in €/MWh	20.20	13.93	10.27	7.56	11.67	10.52	9.91	13.30	15.07	16.05	11.49	13.94	8.46	
CO ₂ switch price coal/gas in €/tonne	13.39	13.80	9.02	9.69	11.85	17.81	23.13	22.15	19.69	24.35	23.30	28.44	23.92	

Source: Reuters, EEX, CDC Climat Research