

Opening comments

- ETS and project based mechanism are (carbon) market mechanisms
- They generate assets (allowances and emission reductions) for trade and transfer
- If we are to achieve a climate related target, the ultimate goal of an ETS must be to trigger investment of low carbon technologies

ETS with free allocation



- □ This is what we have experienced to date
- □ Whether or not there is over-allocation, this approach triggers a buy low / sell high business model.
- □ Having received allowances for free, emitters can easily see the opportunity to invest in abatement activities to free up allowances to sell
- □ This is a well understood business model and its easy to build and close a bankable finance proposition because it is backed by assets (allowances)
- □ This model leads to lots of trading and transfer, economic efficiency, lower costs of compliance; lots of derivatives for hedging etc.

ETS with auctioning



- When an ETS moves to full auctioning, the situation changes significantly
- Capped entities no longer receive allowances for free but instead they need to buy them
- Instead of buy low / sell high, the business strategy changes to buy as few as necessary
- Some firms may opt to speculate but this will not be the norm
- □ As a result, the ETS becomes much more about pricing emissions (an EPS?); capped entities will treat emissions as a production cost and seek to minimise consumption – like any other raw material
- □ There is no particular reason why capped entities should chose to trade emission allowances – they don't trade and transfer electricity or coal or iron ore in order to reduce costs

Consequences for linking and flexibility



- □ Linking ETS brings some clear benefits (but should not to be confused with merging or an ETS under a bubble like we have in EU ETS)
- □ Potential common prices; efficiency; liquidity
- □ With free allocation it brings flexibility noting that the greater the over-allocation the greater the scope for flexibility (think AAUs / hot air)
- □ With auctioning, it may not bring flexibility

Project based mechanisms and flexibility



- □ The CDM and JI were designed as flexibility mechanisms alongside IET
- □ The KP provided free allocations of AAUs
- Without free allocation, good quality project based mechanisms remain the only true and reliable source of environmentally credible flexibility
- □ Parties, and the EU in particular, are at risk of relying on a flexibility mechanism that won't work, whilst the one which can work is being ignored
- □ Whilst working to improve the design of the CDM, we also need to ensure that ETS (EPS) recognize the CDM's key role as the only true source of flexibility for capped entities

PROJECT DEVELOPER FORUM

Thank you for your attention!