
Market participant's perspective on the practical implications of design options

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EDFT Carbon activity

- EDFT CO2 position are a combination of asset optimisation, hedging products to industrial customers and proprietary trading activity
- Traded around 70 Mt in 2005, 50 Mt in first 2006 OTC and on the various exchanges (ECX, Nordpool Exchange, Powernext carbon)
- Structured products with end-users in order to manage their CO2/power price risk
- Participant on the first traded EUA option deal with Statkraft
- Portfolio of over 40 Mt of credit at various stages of development
- CDM registry account opened in April 2006 with credits from 7 projects
- EDFT Carbon is the unit within EDFT in charge of its CDM / structured products activity

Design options : a market participant perspective

- Compatibility of caps / safety valves / intensity targets with the market functioning
- Other design option issues for market participant
- CDM / JI, the most effective mechanism to avoid unsustainable carbon prices ?

Caps on prices – the case study of a EU member states imposing caps on EUA

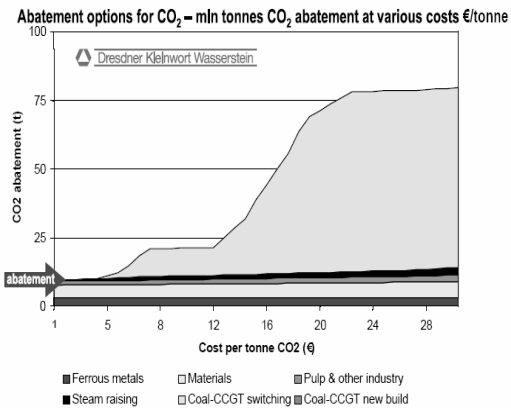
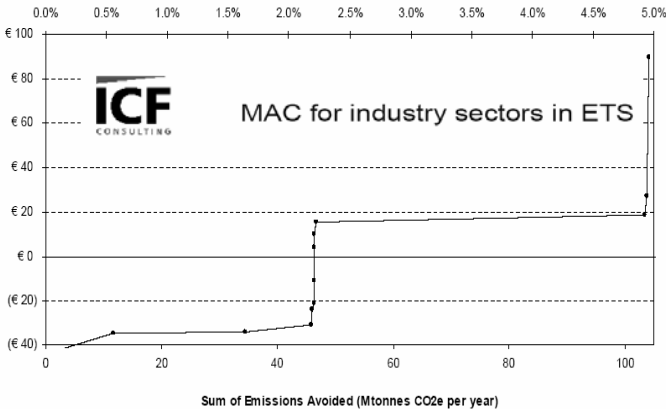
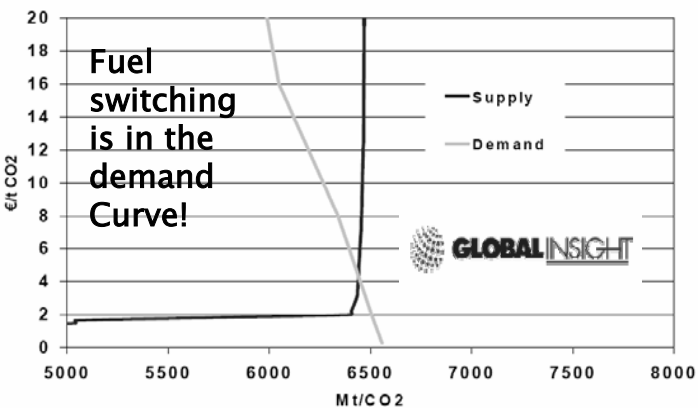
- In view of the market volatility, some proposals have been formulated to impose a cap on EUA prices
- **What would be necessary for such cap to be consistent with the Kyoto protocol ?**
 - The compliance buyer would have to pay a penalty equal to the cap to the member state
 - The member state in order to comply with the Kyoto Protocol would have to buy AAU / CER / ERU
- **However such proposal would pause several practical issue :**
 - How to avoid competition distortion between industries across Europe ?
 - How to avoid export of power towards adjacent countries and the indirect corresponding subsidies ?
 - How to prevent sale of credit from such member states industry to another uncapped member states without undermining the functioning of the market ?
 - How to fund such policy in a costly and effective manner ?

Safety valve trigger – the case study of North-Eastern States

- Several “safety valves mechanism” incorporated in the scheme
- Extension of compliance period by 1 year if price above 10 \$
- If prices are above 7\$ increase of offset limit from 3.5 % to 5 % of reported emission and use of other States Offsets
- If prices above 10 \$, offsets limits are increased to 10 %, Credits from international scheme could be used
 - Extension of compliance period would not be compatible with a Kyoto framework
 - Link with EU ETS / CDM would be only unilateral
 - Prices would be at a discount to EUA

Intensity target : can they be compatible with vertical abatement cost curve ?

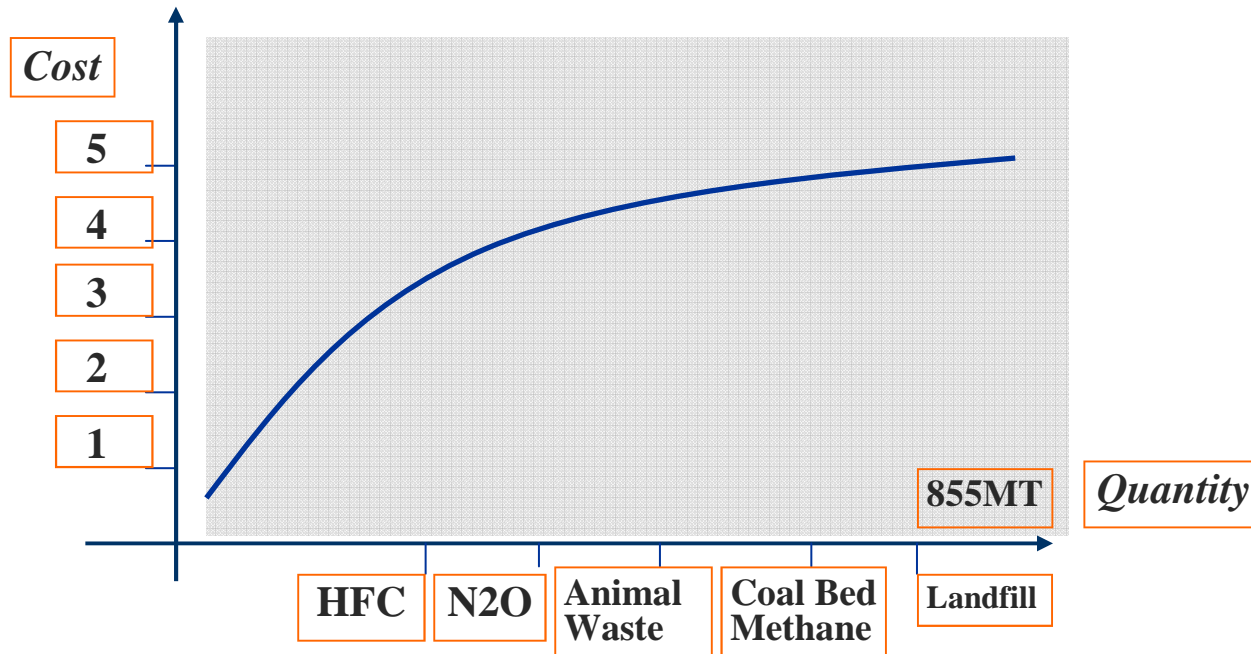
- All abatement cost models based on power generation fuel switching have a very steep abatement curve
- Phase 1 saved from sky-high prices by low industry output and demand response?
 - This would not have worked with intensity targets
- **How to reconcile intensity targets and a decreasing level of emission which ultimately are necessary to address Global Warming ?**



Plea for more transparency regardless of design

- Traders cannot provide liquidity in uncertain conditions
- ETS Phase 1
 - Data flow has to be released to the market in an orderly manner.
 - Halfway through ETS phase 1, we don't know
 - How much will be allocated in Romania and Bulgaria
 - If and when new entrant reserves will be allocated and/or auctioned
 - 10% of supply – probably very late in market
- ETS phase 2
 - Impact of aviation (if any? 2010?)
 - Midway link with other schemes (recent news: Croatia 2010?)
 - Actual government AAU procurement volumes & timing

Current caps on credit utilisation may prevent CDM to play such safety valve role



- CDM / JI project do provide the potential for low cost emission abatement and have the demonstrated potential to play the role of a safety valve in a market friendly manner
- Harmonization between countries of utilisation cap is required
- Higher cap level would benefit both the EU ETS scheme, CDM project developer effort and overall the achievability of Kyoto target without resorting to hot air

Conclusions

- **Caps, Safety valves and Intensity target can be compatible with a traded market**
- **However they do pose other very serious issues : fairness of competition, consistency of schemes and most importantly in terms their efficiency to tackle global warming**
- **Market forces can generate and have started generating a reasonably priced response to the challenge posed by global warming in the form of CDM and JI project**
- **One of the most urgent debate in term of design options is to enable this ready made solution to play its full role as it has the potential to avoid EUA price spike while enabling a true compliance with Kyoto protocol and beyond a true solution to curbing emissions**

Thank you for your attention

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