

## **Independent Observer's Report on the conduct of the EU ETS Carbon Emissions Allowances Auction on 10 September 2009**

### **Role of the Independent Observer**

The Independent Observer is David Steeds, a senior partner of Evolve Business Consultancy, who was appointed by HM Treasury through an open competition. His role under Regulation 12 of the Community Emissions Trading Scheme (Allocation of Allowances for Payment) Regulations and Scheme 2008 is to oversee an auction and to provide a report to HM Treasury on the conduct of an auction as soon as reasonably practicable after the auction has taken place. HM Treasury and the Independent Observer take the view that his role is essentially to monitor the conduct of the auctions to provide assurance that the published procedures have been followed and that all Primary Participants have been treated fairly and equally in accordance with the Regulations and the Scheme.

Primary Participants are parties who are approved to bid both on their own account and on behalf of other parties (who are known as Indirect Bidders). Primary Participants must have an office in an EEA state, have the ability to meet their financial commitments, the ability to participate effectively in an auction on behalf of others and systems to prevent the disclosure of confidential information.

### **Before the Auction**

The administrative arrangements for the auction were unchanged from previous auctions with DMO responsible for the conduct of the auction. New secondary legislation, the Community Emissions Trading Scheme (Auctioning of allowances) Scheme 2009, came into force on 23 April in time for the previous two auctions. The main change from the earlier Scheme is that Primary Participants are now allowed to earn 5 euro cents on each allowance allocated to an indirect bidder for whom they act. This change was introduced to incentivise Primary Participants to encourage indirect bidders to take part in the auctions. The number of Indirect Bidders who submitted bids in the three auctions since the new Scheme was introduced has risen considerably compared to earlier auctions and the number continues to increase.

The Independent Observer noted that the auction procedures were broadly the same as for previous auctions. They are based on DMO's procedures for gilt auctions using Bloomberg's Auction System which have a long history and are widely accepted by all the market participants. He is satisfied that the adopted procedures are appropriate for the EU ETS auctions.

Seven Primary Participants had been approved before the auction by DECC on advice from the DMO and their contact details were published on the DMO website. All 7 took part in this auction; in the previous auction there were six Primary Participants. The Independent Observer welcomed the approval of another Primary Participant.

The proportion of units allocated to Indirect Bidders increased compared to the fourth auctions on 9 July 2009, although it remained below the levels of the previous two auctions.

% allocation	10 Sept 2009	9 July 2009	4 June 2009	24 March 2009	19 Nov 2008
Indirect Bidders	46%	39%	58%	60%	24%
Primary Participants	54%	61%	42%	40%	76%

## The Auction

The Independent Observer was present at and observed the auction at the DMO's offices on 10 September 2009 from 8am to 10am. Figures in brackets below are the comparative figures from the fourth auction on 9 July 2009.

There were 31 (21) successful bids for 4.2 million (4.2 million) EUAs (EU carbon allowances) at or above the clearing price of €15.05 (€13.38). The average size of successful bids decreased from 200,000 allowances to 135,500 allowances. This is principally because in the previous auction there were a small number of large successful bids from Primary Participants acting on their own account.

The total number of allowances for which bids were received was 21,780,000 (21,873,000) so the bid cover ratio was 5.19 (5.21). Each allowance covers the emission of one tonne of carbon. The clearing price is the lowest bid price, above a Reserve Price set by HM Treasury, at which all allowances for sale would be allocated. The Reserve Price is not disclosed.

The scaling ratio applied to bids at the clearing price (where there are not enough allowances being auctioned to meet all the bids made at the clearing price) was 3.3%.

The total proceeds from the auction were €63,207,592 or £55.7 million @ £0.8811 (€56,191,451 or £48.5 million @ £0.8638) before discounts to Primary Participants in respect of successful indirect bidder allocations. It was noted that since the last auction the supply of carbon allowances in the UK has been made subject to a zero-rate of VAT.

Although the amount of trading on the spot market is rising, the ECX ICE futures market remains the most liquid secondary market in carbon trading. The prices of secondary trades (DEC-09 contract) on this market at the time of the auction are shown below together with the futures prices adjusted to spot prices by discounting using the nearest Euribor interest rate. The BlueNext spot prices are shown alongside.

	ECX ICE Dec 09 Futures	Adjusted to spot price	BlueNext spot EUA contract
Before the start of the auction (08:00am)	€15.17	€15.10	€15.14
Approximate weighted average of trades during auction bidding window	€15.15	€15.08	€15.11
After the end of the auction (10:00am)	€15.13	€15.06	€15.10
Auction clearing price as a discount to weighted average of trades during auction		0.2%	0.4%

A small discount to the secondary market is to be expected and the discount at the last three auctions has been very small compared to the first two auctions. By stimulating competition, the increased number of bidders may have contributed to a narrowing of the discount in the more recent auctions.

No telephone bids were received, although the facility to make bids by telephone was available to bidders.

## **Conclusions**

Based on his observation of the conduct of the auction, it is the Independent Observer's view that:

- The auction was conducted in a fair and transparent manner in accordance with the published procedures;
- The auction results were consistent with the published procedures and the bids received;
- Sensitive information was treated appropriately by the auction administrator;
- There were no indications of hardware or software problems, communications issues, security breaches, or other problems with the auction platform;
- All the information that he requested had been provided to him.

In summary, the Independent Observer confirms that the results of his monitoring of the fifth EU ETS auction to be held in the UK raise no material concerns about the conduct of the auction in terms of either the process or its results.



David Steeds

**Evolve Business Consultancy**

The Independent Observer of EU ETS Carbon Emissions Allowances Auctions  
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