



## Are You Ready For The Expansion Of The EU Emissions Trading Scheme?

*Global Energy Advisory Launches New Carbon Advisory Service to Support Industry in the Expansion of the EU Emissions Trading Scheme.*

On 6th April 2009 the European Council adopted a climate-energy legislative package containing widespread measures to fight climate change and promote renewable energy. This ambitious package is designed to achieve the EU's overall environmental target of a 20% reduction in greenhouse gases and a 20% share of renewable energy in the EU's total energy consumption by 2020. It also includes a proposal to improve and expand the EU Emissions Trading Scheme (EU ETS). The EU ETS is currently the world's largest carbon market and preferred mechanism for fighting climate change. However, as the renewable targets come under more strain, so will the compliance under the EU ETS. Is your firm ready for the expansion of the EU ETS?

Very soon, the EU ETS is set to expand across new economic sectors and greenhouse gases. With regard to sectors, aviation, petrochemicals, ammonia, and aluminium are to be included. Regarding gases, nitrous oxides from acid production and PFCs from aluminium smelting will join. The last major sector classed as a big emitter, transport (land and shipping), is not included in these proposals because the EC hasn't yet decided if its inclusion is the best way of achieving emissions reductions, but at best, this is likely only to be a stay of execution rather than exclusion.

What does this mean? From 2013 onwards, and in some cases much earlier, a number of companies will find themselves confronted by a new set of legislation to bring about emissions reductions that will have a direct impact on their businesses. The legislation regarding the EU ETS will be **in addition to** any parallel legislation regarding energy efficiency, etc., so for the first time, many companies will see an explicit price of carbon showing up in their input and/or output costs and prices.

Companies in these new sectors, or those doing business with them, should start preparing an impact analysis on their business resulting from this new legislation and, if necessary, commence preparations. If a company does get drawn in to the EU ETS, there are a number of important issues for it to consider:

**Carbon prices** – what level are they likely to be? We have seen a wide range of estimates, from €zero/t to €50+/t, but we do know that the EU ETS will reduce supply over time to flush out abatement. Historically, prices have been volatile and have sent out contradictory signals. Companies need to put their own price tag on carbon for budgeting and financial planning purposes,

especially in preparation for the initial auction of allowances. Through our unique GEM (Global Energy@Market) service we have access to real time carbon market price data and can therefore comprehensively support clients in their carbon purchasing and offset investment decisions.

**Compliance** – entry in to the EU ETS entails some very onerous reporting and audit requirements and penalties for non-compliance are severe. This means that the underlying business processes and IT systems may need to be enhanced to meet the needs of the EU ETS as well as support the business needs of the organisation. With our comprehensive experience and latest understanding of market and legislative developments we can best advise and support processes and systems.



**Trading and risk management strategy** – the EU ETS is a traded market, which aims to find the marginal cost of emissions abatement in the most cost-effective way. This process is very different from the procurement one that companies may be more accustomed to, and could be a real culture shock. While a traditional procurement strategy could be followed for managing the emissions position, it is unlikely to give optimal results: Global Energy Advisory provides comprehensive decision making support for the EU ETS.

**Auction** – Unlike previous phases, emissions allowances are not going to be given away – there will be an initial auction process, in which companies have to bid for their allocation of allowances.



Would your firm know how to bid for these allowances? Does your firm have a view of the cost/price of carbon in the company's' value chain?

**Credit risk** – through the EU ETS, companies may be trading with many new counterparties for which they have no credit history. Credit risk mitigation will become essential and Global Energy Advisory can advise on systems and risk mitigation tools.

**Integrated emissions reduction strategy** – a company may already be following an emissions reduction strategy, domestically and/or internationally, by virtue of previous legislation or voluntary participation. This could include involvement in Kyoto projects in other parts of the world, generating carbon “credits”. Participation in the EU ETS will mean being in a market which sets an explicit price for carbon, so it will become important, possibly essential, to benchmark current reductions strategy against the market. Through GEM and our realtime price feeds, we can keep our clients fully aware of carbon price developments and future volatility levels.

**Impact on input and output costs** – even if a company is not a direct participant in the EU ETS, it may be trading with companies who are, so could see adverse financial ramifications. What are these likely to be and what can be done about them? Full cost pass-through to end customers may not be the panacea to these questions

The expansion of the EU ETS is a near certainty – only the debate over the inclusion of land transport remains, and that too will no doubt be included in the EC's plans at some point in the future. There is no doubt that a widespread, explicit price for carbon will have an impact on economic activity by virtue of it being an additional cost.

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The key point is that emissions trading does not need to be a *threat* – with good preparation; most companies should be able to turn climate change legislation in to a financial opportunity. The principal aim of the scheme is to discover the marginal cost of abatement – for companies able to do this at less than market prices, it should prove to be a highly profitable activity.

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*Carbon, like all commodities supported by Global Energy Advisory, has its own characteristics. For example, implied at the money volatility front month for oil is currently 70% while for carbon (Dec 09) it's currently 55%. These vol levels demonstrate carbon has the potential to be a very tricky commodity and needs to be traded with the support of experienced people and accurate data. Our carbon advisory support service has all the key elements to fully advise clients in this important area.*

#### Global Energy Advisory

Global Energy Advisory comprises seasoned experts in the global



energy market: entry criteria are a minimum of 20 years' experience in related disciplines. We draw on our team of senior advisors and consultants to complement and enhance our modelling scenarios, providing unrivalled clarity in an uncertain energy future.

#### Enterprise Wide Risk and System Development



Our solutions company – Global Energy Solutions – works closely with Microgen plc, one of the City's leading business software companies, to offer clients a clean, efficient and fast track IT delivery. Microgen's Aptitude business process management and business rules framework enables us to advise on best practice price risk management, as well as fast, comprehensive and controlled deployment of company-wide risk systems.

#### Global Energy Finance

Global Energy Finance is a Global Energy Advisory working relationship



with Orban Corp. The company has a proprietary finance structure evolved from a Supply Chain Finance (SCF) solution the concept of which was initially developed by Citibank and SAP. This solution combines trade financing provided by a financial institution, a third-party, or internal funds; and a technology solution that unites the buyer, supplier and the trade financing source electronically. In short this is a payment platform that serves as a gateway to the financial markets with global financing capability.