EU ETS on the edge

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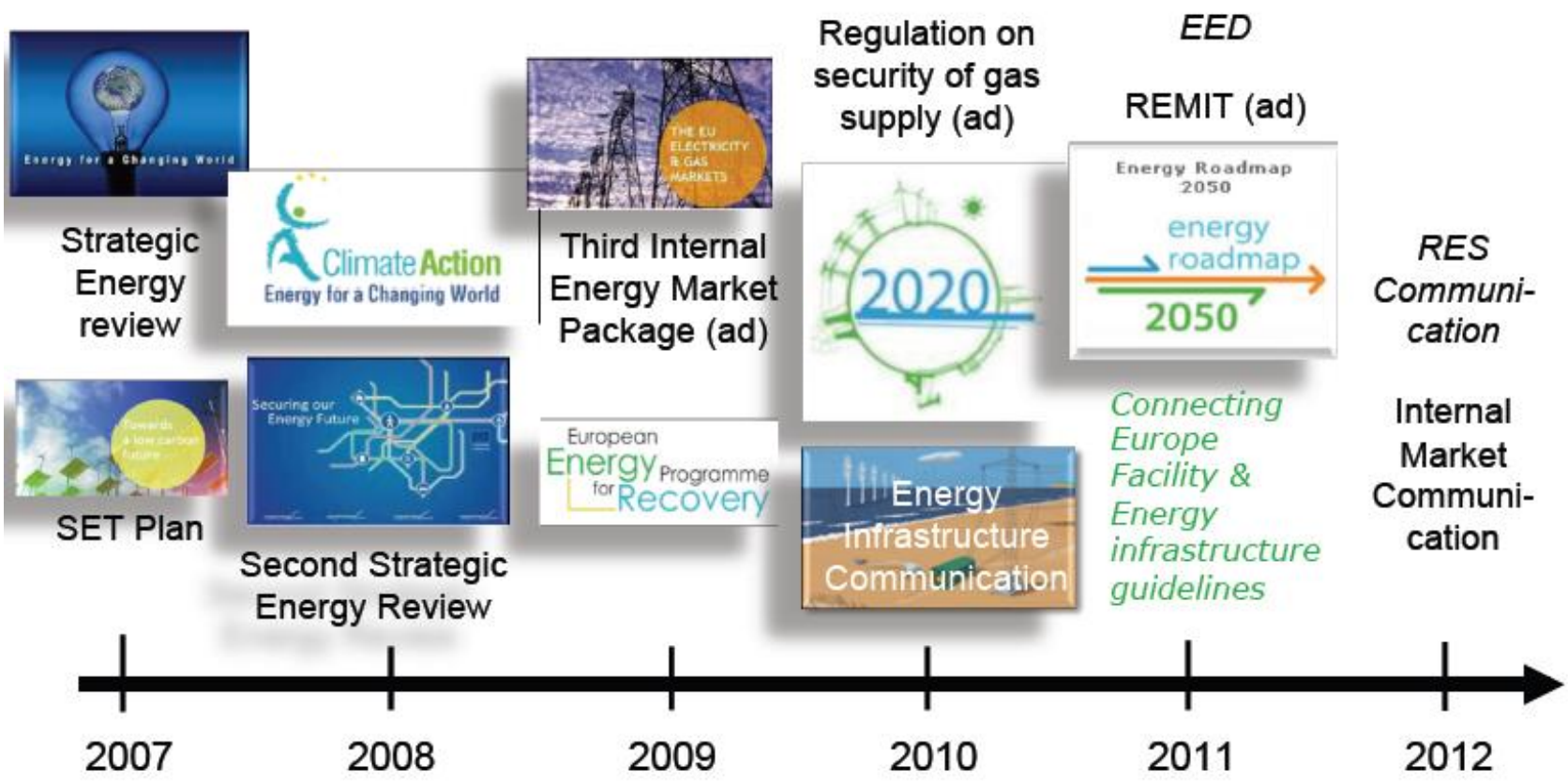
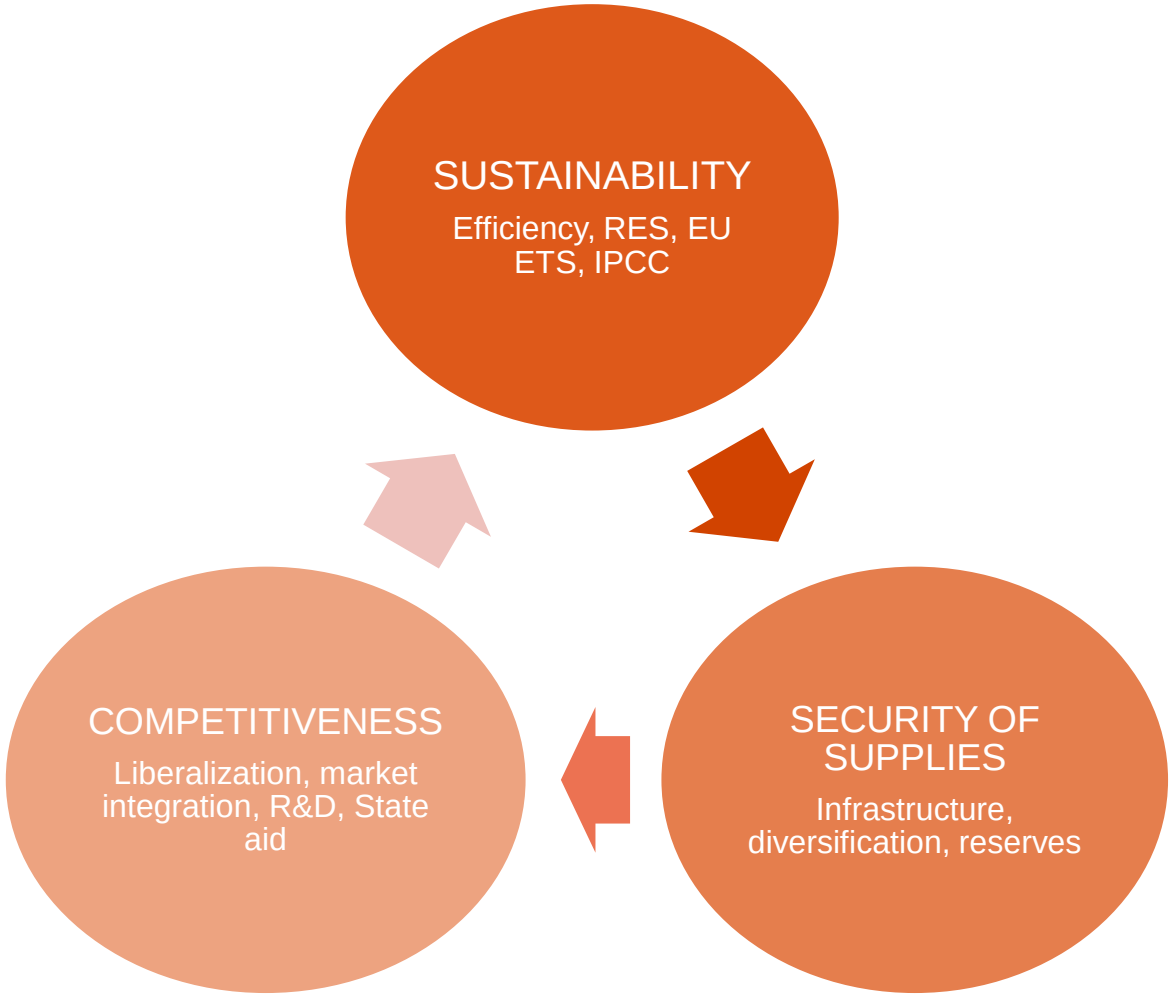
… As The Time Passes By In The Field Of Energy



Since 1995 Energy Has Been Driven By The Principles Of…



Our Challenge Today

How to deal with the carbon regulation represented by the EU ETS system?

- **Fix it?**
  - But how and are we ready to agree on the steps needed?
    Maybe…
- **Replace?**
  - But do we have better solution at our disposal?
    Probably not…
- **Abolish?**
  - Can we do it and can we afford it?
    No, not now…

Question Of a Tool: Direct Vs. Indirect Pros And Cons*

Command-and-control:

- static regulation usually taking the form a kind of restrictions;
- no flexibility, no option to optimize (e.g. incumbents vs. new entrants);
- no account of the diversity in abatement costs for individual installations;
- huge information asymmetry on the side of the regulator.

Market-based:

- if set properly (demand over supply), there are incentives to change the behaviour of the installations;
- trading enables to mitigate at the lowest costs of abatement;
- price of carbon created through a market leverages the investment into low carbon solutions;
- carbon trading is not only a regulation but also business opportunity.

* First introduced in the Green Paper on GHG emissions trading eithin the European Union in 2000 and further elaborated by the European Climate Change Programme

Question Of A Tool: EU ETS System Chosen

For those reasons the EU decided more than a decade ago for a „bubble“ sharing of the Kyoto commitments:

- demanding EU wide abatement tool;
- creating one carbon market;
- covering all major sectors and emitters;
- providing flexibility and mutual benefits to all the engaged;
- minimising distortions of competition that would otherwise occur because of a number of national approaches.

The Rise And Fall Of The EU ETS

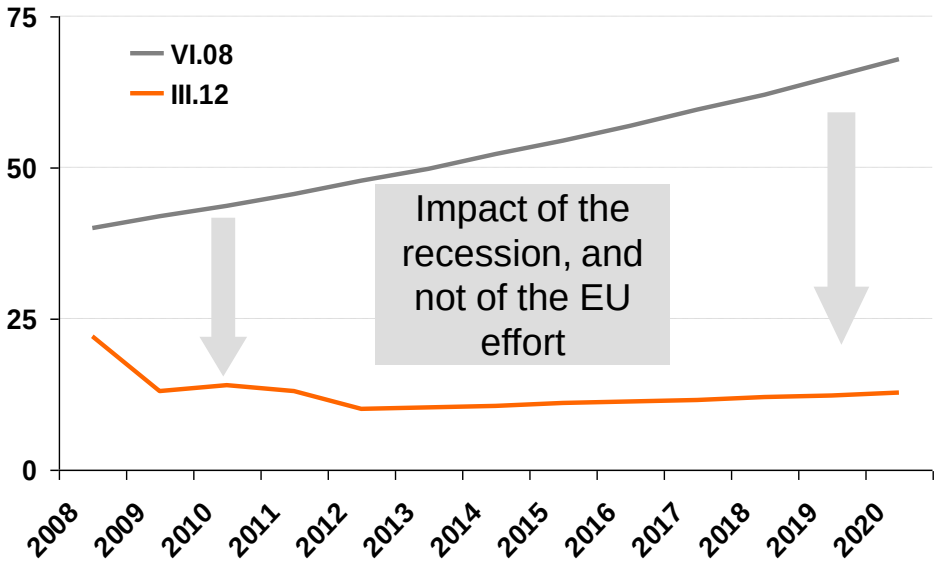
Based on the Directive 2003/87/EC the Community-wide trading system with the allowances was established and came into force in 2005.

- Pilot period served as a practical exercise both for the regulator as well as the operators.
- Due to the over supply the market witnessed a slump in carbon price, first in 2006 and namely in 2007.
- For the second period several improvements were incorporated, e.g. stricter NAPs.
- Though, owing to the crisis the price went down in the latter half of 2008 with a slight recovery in 2009 and further decrease in 2012.
- Now, we are entering a critical third phase, with the auctioning as a default method of the allocation.
- Since the beginning the market is under a huge pressure as another drop in carbon price took place.

The oversuplly seems to be a major drawback…..
Have we learnt enough to fix it?

Fall Of the EUAs Price

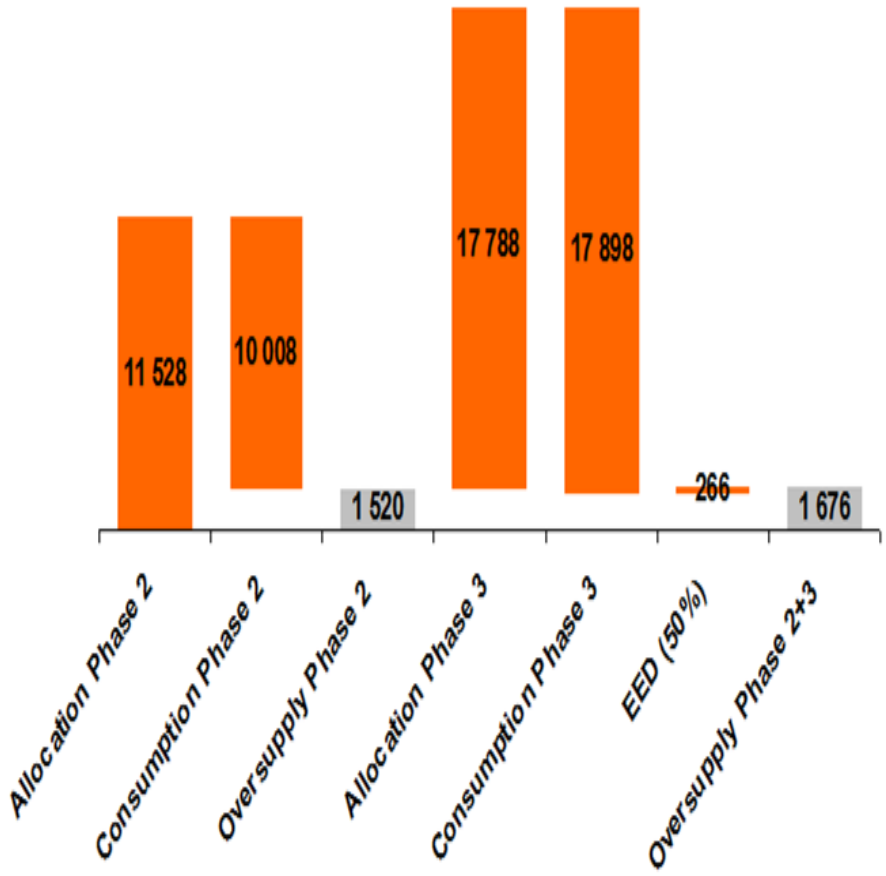
EUA price estimates 2008 and 2012
EUR/t



- The recession has caused a significant oversupply of allowances in the Phase 2.
- Fatal price collapse, however avoided banking to the Phase 3
- A return to the earlier price levels possible by strengthening of EU emission targets to 25-30% from the current 20% savings

Source: banks, analysts

Expected Oversupply



Demand and supply in the second and the third phase of the EU ETS:

- Because of the ongoing recession, banking and supply of international credits, the oversupply is expected.
- The estimates range from 400 up to 2200 million of tonnes of CO2.
- However, possible banking to Phase 4 and linking carbon markets prevent the price forecast go down to zero.

High Time To Act

At the close of the second trading period, the Commission proposes two-bullet solution:

- Instant, but temporary withdrawal of 900 million of allowances;
- structural, long term measure change in the system enabling to achieve 2050 targets.

Options on the table:

- retirement of some allowances in phase 3;
- revision of the reduction factor;
- EU reduction target up to 30% in 2020;
- discretionary price management mechanism;
- extended scope of the EU ETS;
- limited access to international credits.

Preferred Options For CEZ Group

First best option is retirement of allowances as it is

- feasible,
- timely responding,
- consistent with nature of the legislation,
- corresponding to the theory.

But a working number of allowances must be set aside.

Second best is revision of reduction factor as it is

- similar to the set aside measure in terms of strengths
- and diminishes the discrepancy between 2020 and 2050 targets.

However, it is less efficient and definitely harder to negotiate.

Less Preferred But Still Useful Options For The CEZ Group

Increased reduction target to 30% in 2020 is time demanding as it is preconditioned by:

- progress achieved internationally;
- effort sharing decision.

Discretionary price management mechanism enables to rebalancing the demand and supply. But it means higher:

- role of the regulator
- risk of information asymmetry
- administrative costs.

Last but not least it changes the nature of the system.

Remaining Options Are Even Not Worth Considering….

Extension of the EU ETS is not a welcomed option as it is extremely difficult to:

- negotiate,
- set,
- operate,
- monitor,
- verify and report.

Limited access to international credits

- does not affect the current trading period;
- its existence after 2020 is uncertain and arguable.

Optimal Solution Proposed By CEZ Group
…And Hopefuly To Be Supported By Others

A combination of ambitious set-aside and shock absorbing measure based on flexible cap and trade system guaranteed by carbon intensity targets under the current EU ETS:

- supply can respond to the economic cycle;
- there is a stable improvement of the technology while maintaining the overall emission cap and
- the system such as including the overall cap, industrial benchmarks, auctioning rules, etc. would remain the same.

Recent Development To Be The Last Wake-Up Call…. (I)

(EC): Connie Hedegaard urged Member States and MEPs to *"**act responsibly and support the backloading**". **"This is not the time to put backloading on the backburner,"** she said, warning **that failure to approve the plan could see the ETS replaced with an ineffective patchwork of 27 different climate policy tools – one for each member state – that could affect productivity and trade across the EU**.*

Recent Development To Be The Last Wake-Up Call…. (II)

Some other companies such as Alpine Energie , Alstom, Areva, Danish Energy Association, Doosan Energy Systems, Dong Energy, EDF, EnBW, E.On, European Renewable Energy Research Centres Agency, First Solar, GDF Suez, General Electric, Shell, Statoil and Unilever expressed their worries about:

- ***First: what's next after the EU ETS collapses? What is the substitute?***
- ***Second: with such a low carbon price, what is the value of the free allowances given to ETS installations? Members States expected additional revenues from the sale of those to finance investment in low carbon, they will need to find the money elsewhere.***
- ***Third: as ETS systems are popping up in the world (Korea, China, California….), a collapse of the EU ETS will inevitably put the EU in a corner (especially in view of linkages with other systems).***

To Conclude

- **The energy sector is highly influenced by the EU targets in renewable generation, efficiency and carbon regulation**
- **The dynamic expansion of renewables continues with the negative impacts into the wholesale prices and destabilisation of regional grids**
- **The regulation of RES and efficiency destroys the free market since the prices do not promote investment into stable generation**
- **Some countries introduce capacity payments to support investments which further disrupt the market**
- **Such a development could be avoided if the ETS system were corrected and generated real price of carbon**
- **Ambitious backloading could be the first promising step, at least rebuilding the trust in carbon market**
- **However, structural, systemic change soon shall follow soon**
- **Energy sector made that clear when having answered the backloading consultation; however for the change we must speak up**
- **Otherwise we are to lose the unique option to decarbonize our economies on the market basis and get even more dependent on direct regulation**

Questions and Answers?

Thank you for your attention