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California sees “uptick” in early-action buying

Published: 08 Nov 2010 01:59 PM PST Last updated: 08 Nov 2010 02:16 PM PST

Last week’s Proposition 23 defeat and new California ETS rules have awoken the US offset market.

Over the past few days, market participants have observed more transactions of carbon credits issued by the Climate Action Reserve (CAR), a North American offset registry.

They’ve seen a wave of offset buying after state air regulator, the California Air Resources Board (Carb), released its draft market design rules on 29 October.

Since the release of those market blueprints, there has been a 30-40 per cent increase in prices for Carb-endorsed offsets issued by CAR, said Patrick Pfeiffer, an environmental markets broker at CantorCO2e.

“Pre-compliance is bringing more people into the market,” he said.

Pfeiffer added that around a month ago, CAR credits, known as climate reserve tonnes (CRTs), had seen $3.75 bids and $4.50 offers.

Market signals

The release of Carb’s rules, coupled with the defeat of a referendum to halt California’s climate law, has sent clear signals that a western carbon market will begin as planned in 2012.

“It is fair to say that we are seeing an uptick in activity. I’m not sure how sustained it will be, but there is some added strength post-election,” said John Battaglia, San Francisco-based associate carbon markets broker at Evolution Markets.

Emitters who will be obligated to cut their greenhouse gas emissions to 1990 levels by 2020 are already starting to buy offsets to comply with the state law.

The main activity in the past two weeks has been for offset credits deemed “Carb-compliant” or potentially compliant, added Cantor’s Pfeiffer.

So far, Carb has specified four CAR project protocols that can generate credits that emitters can use for compliance with California’s carbon cap:

• Livestock protocol versions 1.0 through 3.0,
• Urban forestry protocol versions 1.0 through 1.1
• Ozone depleting substances protocol version 1.0
• Forestry protocol version 2.1

Price divergence

Olga Chistyakova, an analyst at Point Carbon who tracks US voluntary and pre-compliance offsets, has said within the past few days, a $3 spread has emerged between California-compliant CRTs and CRTs from CAR’s seven other project types.

She said offers for California-compliant, early-action CRTs have surpassed $10/tonne.

She noted, however, that this price divergence was not a new trend.

“The same thing happened when federal regulations came out,” she said, noting that voluntary carbon prices diverged when federal cap-and-trade bills came out with specific information on what project types would be allowed.

Market activity for the near term is likely to focus solely around those four CAR protocols, observers have said.

“What we'll see now is a reallocation of capital and project development activity around projects identified in Carb draft regulations,” said Jean-Philippe Brisson, head of law firm Linklaters’ climate change and environmental law practice and CAR senior advisor.

Sustained activity

Even after the post-election buzz quiets down, many believe that market activity will be sustained but modest in the coming months.

“It would make sense to see some uptick in pre-compliance behaviour, as on balance the election does mean cap and trade is more likely to go ahead now,” said Trevor Sikorski, a commodities research analyst at Barclays Capital.

He warned, however, that the market may still be a bit cautious as they wait for the Carb draft rules to be finalised by board members in mid-December, and as they digest the potential impact on the state of Proposition 26.

The little-known ballot initiative passed last Tuesday while much of the state's attention was focused on the defeat of Proposition 23, the ballot initiative that explicitly called for a suspension of the state's climate law.

Proposition 26 will require two-thirds of legislators to approve fee increases, a difficult political hurdle given the makeup of the state legislature.

Some lawyers have warned that the proposition could threaten Carb’s future ability to collect the roughly $30 million a year in administrative fees it uses to oversee its cap-and-trade programme.

“Such activity should be sustained, albeit at reasonably low levels, until the draft rules pass through to the next legislative stage and the implications of Prop 26 are better understood,” Sikorski added.

Supply worries

In the meantime, the market is expected to be in short supply in the near term, with Carb limiting offset use to the four CAR types.

Cantor’s Pfeiffer said stakeholders in California have until 15 December to issue comments on the Carb market rules and propose changes to its offset limits.

“We’d all like to see increased project types under Carb,” he said, adding the supply of offsets will be short at the start of the proposed emissions trading programme.

He added that some utilities plan in 10-20 year cycles and would like to start hedging future carbon costs early, when offset prices will be lower.

“They need to start thinking about it now,” he said.

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