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Carbon Trading Heating Up

With California on track to implement Cap-Trade Laws, the market gets active

By Katy Burne and Cassandra Sweet

After a series of false starts, the market for trading carbon-emission credits is showing new signs of life in California.

Trading volumes for these carbon credits—which allow holders to emit as many greenhouse-gas emissions as they want, provided they acquire enough of them—are at a nine-month high. Prices are up 1% since the start of this year, even as prices on carbon allowances elsewhere in the world are plumbing lows.

While federal efforts to regulate carbon-dioxide pollution collapsed in 2010—and other carbon markets have run into trouble—California is now on track to implement its own laws capping heat-trapping gases that scientists believe contribute to climate change. As the Jan. 1, 2013, start date for the new rules approaches and as opponents of the rules run out of time to mount new legal challenges, operators of power plants, oil refineries and other facilities are wading in to purchase credits.

The spurt of activity has been a score for a small group of traders and other investors who had wagered that California officials would prevail in a lawsuit and a referendum that sought to block the cap on carbon-dioxide emissions. They say they see more opportunity to stock up on credits, ahead of an expected spike in demand next year.

"What's changed is we are really at a phase now where [California is] in implementation mode," said Greg Arnold, president at CE2 Carbon Capital, a fund backed by private-equity firm Energy Capital Partners that owns carbon contracts, expecting prices to rise.

California's cap on statewide emissions drops every year, likely raising demand for allowances.

It is mostly power producers and other companies that will need credits in the market today. But that could change as volume picks up, traders say, as investors come in to speculate on the direction of prices.

"Once we get going, the hedge funds will be there," said Randall Lack, founder of Element Markets in Houston, an asset manager that helps clients hedge in carbon markets.

A state appeals court in June upheld California's cap-and-trade program and

dismissed a lawsuit filed by some community groups that had argued the program wouldn't reduce emissions.

Trading picked up in carbon credits, or allowances, soon after. More than 1,000 contracts traded on the IntercontinentalExchange in August, up from 246 in May, the month before the lawsuit was dismissed. Prices for contracts promising the delivery of 1,000 California carbon allowances in December 2013 hit an 11-month high of \$20.10 a metric ton on July 24 on the ICE.

But the market turned again in August, after regulators said they would reconsider the way they plan to enforce a ban on shuffling out-of-state energy purchases to claim an emissions reduction. Any changes made to the rules might affect the number of credits California power producers need to buy. Credits settled at \$15.65 a ton on Friday.

Some still think the carbon market is too risky. "We are supposed to be getting off the starting blocks soon, but California has made it clear if there are any issues, possible further delays are not off the table," said Francisco Padua, manager of environmental commodities at brokerage firm Amerex Brokers LLC.

The cap-and-trade program is proceeding on schedule and



California's cap on carbon emissions will drop each year, likely raising demand for allowances, for which trading volume has hit a nine-month high. Shown, a Chevron oil refinery in Richmond, Calif.

there are no proposed rule changes pending, said Air Resources Board spokesman Dave Clegern.

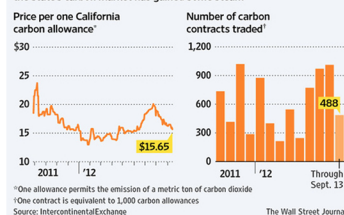
Prices are likely to stabilize between \$14 and \$18 a ton as long as cap-and-trade looks set to begin in January, said Chris Schaffer, a Houston-based trader for Vitol, one of the world's biggest energy-trading firms. Prices could rise after that, as the program expands to encompass new areas, including fuel sales in 2015, he said.

Power producers such as Constellation, a unit of Exelon Corp. EXC -0.20% and NRG Energy Inc. NRG +1.91% are trading as well.

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Getting Warmer

As the Jan. 1 start date to California's new pollution law nears, the state's carbon market has gained some steam



One allowance permits the emission of a metric ton of carbon dioxide. One contract is equivalent to 1,000 carbon allowances. Source: IntercontinentalExchange

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