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Chicago Climate Exchange Closes Nation's First Cap-And-Trade System but Keeps Eye to the Future

By NATHANIAL GRONEWOLD of

Clarification appended.

NEW YORK -- The nation's first experiment in carbon emissions cap and trade has come to an end, but its mark on the climate change industry will be felt for some time to come.

The second commitment period for member companies of the Chicago Climate Exchange ended as of Dec. 31, 2010, and there will be no new cycle to ring in the new year.

Exchange trading in the allowances the system generated, known as Carbon Financial Instruments (CFIs), to meet emission reduction commitments ends, as well, although CFI generation will continue as a strictly voluntary greenhouse gas emissions offset system.

Meanwhile, CCX's sister institutions, the European Climate Exchange and the Chicago Climate Futures Exchange, will continue as long as there is corporate and state government interest in fighting climate change, even with the failure of cap and trade in the U.S. Congress, CCX officials insist.

And former member companies say they have no regrets about participating in the admittedly flawed system. They praise the lessons they learned ahead of the slow spread of state-driven cap-and-trade initiatives from the Northeast to California and possibly the West.

"We're glad to have had the experience," said Jennifer Orgolini, sustainability director at New Belgium Brewing Co., one of the smallest former members. "I don't regret joining it."

Though celebrated by climate activists at its launch in 2003, CCX became plagued by a flood of credits from offset project generators that collapsed the CFI market, sending exchange prices to a nickel per unit. Highlighting this collapse, many in the U.S. carbon trading community openly questioned the legitimacy of the system itself, putting founder Richard Sandor and his team on the defensive at periodic carbon market conferences held in Washington, D.C., and New York.

So when the new parent company IntercontinentalExchange announced the end of mandatory CFI trading by member companies in October, much of the media reacted with quasi obituaries for CCX itself. Coming as it did on the heels of failed climate legislation in Congress, a fiasco at international climate change negotiations in Copenhagen, Denmark, and the collapse in the price for allowances under the Regional Greenhouse Gas Initiative (RGGI), CCX's closure seemed to confirm the death of the very concept of cap and trade itself.

Calif. keeps hope alive

But California's recent moves toward mandatory emissions trading is breathing new life into the market. RGGI officials are also in talks to reform their system. And CCX officials say that although they've closed their contractually binding trading platform, they aim to leverage their relationship with some of the nation's largest companies to revitalize the voluntary carbon market, while maintaining their dominant position as the largest host of trading in a variety of environmental commodities.

"The point was to get companies familiar with allowances and trading, and how to do that and how to use offsets and exchange them on a platform. And that has all been accomplished," said Lisa Zelljadt, an analyst at the carbon market research firm Point Carbon. "So with the advent of mandatory programs like RGGI and now California ... the sort of experimental value of CCX as it was is over."

But new participants are still welcome, says Brookly McLaughlin, a CCX spokeswoman.

"They can participate through ... the offsets registry," she said. "The credits will be offset project driven" and will continue to be called CFIs, McLaughlin added.

The central problem hurting mandatory carbon markets globally has been an abundance of allowances at the start of the programs, usually in the face of weak demand.

Prices at the European Union's Emission Trading System nearly fell through the floor after political haggling led governments to overallocate allowances to influential industries. E.U. allowance prices have recovered since the first commitment period but still face downward pressure from a weak economy.

Likewise, RGGI allowances are now at their legal price floor after a shale gas boom in Pennsylvania transformed the energy mix in the 10 Northeastern member states.

Transitioning to offsets only

Carbon market experts say the CFI market suffered the same fate, but for different reasons.

Unlike in other systems, CFIs were both allowances and emissions offsets credits. Offset project developers could generate CFIs in the system even as they faced no obligation to purchase the allowances to meet reduction commitments faced by the 450 member companies.

Thus, demand for the allowances was relatively fixed, while supply was seemingly endless. CFIs once traded as high as \$7.50 per metric ton of CO₂-equivalent emissions, but as of last Friday, the exchange trading price was just 5 cents, the same price they've been at for more than a year.

"Quite frankly, the market has pretty much collapsed," said James Hugh, who handles CCX transactions for the utility PSEG. "There really isn't all that much to do there."

CCX officials say the picture is skewed because 95 percent of trades occur in so-called over-the-counter (OTC) transactions that don't show up in spot trading data. OTC market prices have held better in recent months, averaging \$3.41 as late as October last year.

In fact, the obvious preference for OTC trading is what led IntercontinentalExchange to kill the open exchange platform. Member companies were polled prior to the decision, and most reported back that they preferred that no third commitment period be offered and instead favored the new approach, a transition to just offsets, CCX officials say.

Hugh admits that PSEG will likely be left with more CFIs than it needs when the company fulfills its obligations to CCX and finishes its reporting requirements this year. Member companies were mandated to accomplish a cut of at least 6 percent of their baseline emissions reductions during the second commitment period, but were free to exceed that target.

Company says it values CCX experience

Hugh guesses several companies are in the same situation with regard to their CFIs and will simply do what PSEG plans to -- bank them in the hopes that a future cap-and-trade system will accept them.

"I would expect that people will probably continue to hold onto them if they have them immediately, because honestly, there's not much else to do with them at this point," he said. "To the extent that there's some program in the future that recognizes them, people will hold them for that."

Orgolini at New Belgium Brewing, a small craft beer maker based in Fort Collins, Colo., says she likely will have to turn in all the company's remaining CFIs when it and other companies report in over the next couple months. But she admits that, as one of the

smallest CCX members, with a light carbon footprint, her company's trading activity wasn't all that extensive.

"Our emissions were on the scale of just a handful of CFIs," she said. "For several years, we just held onto our credits. We didn't trade them, and then in later years, as our growth kind of overcame our reductions, we applied those credits."

But Orgolini insists that her firm is happy to have been a member. The chance to join the nation's only carbon trading platform back in 2003 was one her environmentally conscious firm couldn't pass up, she said.

Despite the market collapse and lax enthusiasm for continuing the system as is, CCX's new Atlanta-based managers at IntercontinentalExchange say they consider the experiment a success. CCX's creators, who have since moved on to form the advisory service Environmental Financial Products LLC, declined to comment for this report.

CCX says its 450 members achieved reductions of 700 million tons of greenhouse gas emissions over the seven-year life of the cap-and-trade program, 88 percent through direct industrial emission cuts and 12 percent through offsetting. Its final estimated average price for the CFI throughout the term comes to \$3.26 per metric ton, about comparable to other voluntary offsets credits sold in the United States.

"It has provided cost-effective and market-based flexibility for reducing greenhouse gas emissions through an exchange platform with price transparency and independently verified reductions," the company boasted in a release. "CCX facilitated investment in new businesses, technologies and innovative products and helped companies to build the skills and institutions needed to manage climate risks."

And despite its negligible impact on the larger fight against climate change, all in all, the Chicago Climate Exchange was a worthy endeavor, said Zelljadt.

"Definitely, the businesses that participated in CCX have gained some valuable experience," she said.

"They dealt with actual emissions units, emissions permits, the things you deal with in an emissions trading system. And that's very useful."

Clarification: *An earlier version carried a headline stating that CCX was closing; CCX will in fact remain open, though its cap-and-trade system has ended.*

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