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Fair Trade Carbon - CantorCO2e's new online auction

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Next month, CantorCO2e will auction 260,000 Certified Emission Reductions (CERs) generated from three biomass plants owned by the forestry firm Arauco in Chile.

It is the first CER auction the firm will conduct using its new electronic internet-accessed platform.

Though CantorCO2e has conducted online trading of greenhouse gasses since 2000, the new system will uniquely allow buyers from across the industry to secure CERs with a binding contract completed at the close of auction.

In addition, CantorCO2e is promising full transparency of sourced CERs, meaning firms will know the exact specifications of the credits they are purchasing.

Quality & Quantity

Call it organic or Fair Trade carbon, because not all emission reductions are certified equally.

Legally, a CER is a CER. In practice, a CER generated from a renewable power project - say a wind farm - may have perceived value greater than one generated by "low-hanging fruit" like HFC 23, a powerful greenhouse gas created by refrigerant-producing factories.

HFC 23 has been a controversial and cheap source of CERs. The practice of destroying the greenhouse gas for carbon credits is often criticised by environmentalists claiming it as a wasteful use of the Kyoto Protocol's Clean Development Mechanism (CDM).

If buyers, either leery of environmentalists or perhaps savvy on PR, are willing to pay more for CERs not generated from the destruction of HFC 23, then an auction that offers such a product is likely to secure a higher price for the producers of such credits than an auction with mixed or unspecified CERs.

John Deacon, a partner with the law firm Hunton & Williams, explains:

"The source of credits has become a very real issue for a number of buyers in the carbon market with certain purchasers philosophically opposed to credits emanating from some of the more controversial methodologies.

"We should remember also that a primary objective of Kyoto was technology transfer and clearly this has had very limited success to date. Identifying the source of credits, as is proposed in the Cantor auction, will give the purchaser the right to match the credit with its own objectives. This must be good for the market and good for using the CDM to achieve the objectives of the Kyoto Protocol."

CantorCO2e is moving ahead on the premise that current carbon exchanges are not a viable source of CERs. These

exchanges operate on the basis of delivering to buyers unspecified CERs. By contrast, buyers through the CantorCO2e auction will not only know the type of CERs that they are buying, but also the identity of the company selling the units and the geographic origin of the CERs. CantorCO2e says such transparency is an enormous benefit to buyers.

CantorCO2e's new system will cater to all kinds of CERs. It is designed to hold multiple auctions simultaneously. For example, one auction may offer HFC 23 credits while another offers CERs generated by a wind farm. Buyers would be able to bid on either or both, according to appetite.

Branding or labelling CERs and holding separate auctions has the potential to suite all types of buyers - from financials looking to take advantage of carbon markets to compliance buyers who just want to meet their quota as cheaply as possible.

CantorCO2e is also promising to deliver quantity.

By aggregating credits into one auction and with no direct contact between buyer and seller, the firm is promising to deliver large volumes of issued and pre-delivered CERs from developers that may each only generate a small number of credits.

It also offers buyers wider exposure to multiple projects, thereby spreading the risk.

How it works

Buyers become registered users with CantorCO2e, pay a deposit and participate in the auction - anonymously bidding on either part or all of the units being sold.

"The CantorCO2e auction service has been designed to allow CER buyers, big and small, to participate in the auction on a level playing field with each other," said James Emanuel, commercial director at CantorCO2e.

"Additionally, many of the barriers to trading CERs that currently exist in the market, such as the requirement for buyers to become project participants in order to take delivery of the CERs, are eliminated when using the CantorCO2e auction."

Once the auction is complete, bidders are immediately notified of the results. Successful or not, they are told the clearing price of the winning bid or bids.

Contracts become binding immediately at the close of auction with a payment and delivery cycle within 10 days.

CantorCO2e claims this is the fastest way to transact CERs. It also alleviates some of the cost issues that plague small developers with CantorCO2e acting as match principle in the process.

Previously, project developers unable to generate large volumes of CERs were at a disadvantage. Most auctions matched buyers and sellers on price and led to one-on-one negotiations. This process could take two or three months, and if the market changed, one party or the other might be tempted to look for a way out of the contract.

Pricing

CantorCO2e's new electronic internet-accessed auction platform uses a uniform pricing algorithm similar to those used by governments to sell bonds.

Each seller involved in an auction sets a floor price. CantorCO2e will subjectively set a reserve price on the day of the auction - taking into account market conditions at the time.

If the reserve price is less than a seller's floor price, the seller will not participate in that auction. Therefore, buyers should note that the number of credits up for auction may change on the day of the auction.

At the close of the auction, the algorithm software looks at the best bid (highest price), and determines whether it can unload the total volume capable of being sold at this price. If not, the software looks at the next best bid and determines

the same - taking into account the volumes from the higher price. Once a price that clears the volume of CERs has been identified, all successful buyers, including those who bid higher, are allocated the credits at the clearing price.

If buyers place a bid that turns out to be above the final price, they would have had the option while making their bid to accept more credits at the same price.

For example, if a bidder placed for 16,000 CERs at US$18 - a transaction value of US$288,000 - and the final price was US$15.50; that buyer would have had the option to take more credits - roughly 18,580 - for the same US$288,000.

The system has been designed for CERs, but CantorCO2e said it is not restricted to that market. In future, it could be adjusted to include other emission trading products such as voluntary Verified Emission Reductions (VERs).

Arauco Auction - 2 October 2008

Latin America's largest forestry company, Arauco will be the first developer to test the new system.

On 2 October, the Chilean firm - owned by Empresas Copec and part of the Angelini Group - will auction 260,000 CERs generated from three biomass power plants fuelled by wood waste from pine plantations (view results - IJ News 3 October 2008).

Arauco produces power for its own consumption and sells the rest into the Chilean grid. The company's CERs are only generated from the excess power on the premise that the company is not taking power from the grid, but contributing a sustainable source.

Chile's power mix is dominated by reservoir and run-of-river hydro and fossil fuels. The country has struggled to replace the cheap natural gas it purchased from Argentina in the 1990s, burning expensive diesel fuel oil in combined cycles instead. Renewable power, excluding hydroelectricity, makes up less than 2 per cent of the mix.

Last year, Arauco sold 480,000 CERs from the same project to Tokyo Electric Power Company (IJ News 25 June 2007).

This year's auction promises to be the first in a serious. CantorCO2e has suggested it would hold auctions once a month to begin with.

The Arauco Auction has already received roughly 120 expressions of interest. Interested firms are said to include banks, energy utilities and hedge funds - primarily from Europe, but with a few US and Japanese companies as well.

The CERs will be delivered to successful buyers via the Swiss national emission registry.

Conclusion

In 1992, the company that is now known as CantorCO2e launched what it claims was the world's first environmental brokerage.

Ten years ago in 1998, the broker completed a series of trades between US and Canadian companies speculating on the future of the carbon market - the first such contracts related to the Kyoto Protocol, which was signed only a year earlier. Two years later in 2000, it launched CO2e.com, which allowed greenhouse gasses to be traded online for the first time.

As the market has evolved, so has CantorCO2e.

The firm's depth of experience in this market and ability to innovate make the new online auction platform a promising development. As CantorCO2e seeks to decrease the inherent risks associated with CER purchases, it is helping to set higher standards for a market trying to move forward.

CantorCO2e is not alone. In both the private and public sector, there is a movement that builds with each passing day to not only establish strong carbon markets, but link them and create a true global network adhering to the principles of the Kyoto Protocol.

If climate change is the driving force behind the carbon markets, then clearly this is what is needed to build cleaner economies. What CantorCO2e looks to achieve is not just good business. It's good business for the world we live in.