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David Bebbler

Treaty hot air chills the carbon traders

Uncertainty about the next response to global warming has hit the carbon credits market. By **Dominic Rushe** in New York

THE Manhattan offices of Eco Securities were eerily empty last Thursday morning. Over the rows of unoccupied desks, two men could be seen peering out of the 19th-floor windows — a sight that might have aroused concern considering the company has been in the headlines recently for its plunging share price.

In his corner office, Bruce Usher, the London-listed firm's chief executive, was quick to explain nothing untoward was about to happen. The staff members were looking for a hawk that had taken to perching on the floor above. The rest of his crew were off for the day to take part in Green Week — an annual eco-awareness jamboree — and were gathering up bottles for recycling.

Usually, Eco Securities staff are employed at the vanguard of another solution to the global ecological crisis. The company is the largest trader of carbon credits, a system established under the Kyoto protocol, the international agreement to tackle global warming, which aims to encourage free-market solutions to the problem.

Global warming is by definition a global problem, and Kyoto established the Clean Development Mechanism (CDM), a market for tradable credits that western companies can buy to meet their pollution requirements. These are then used to finance green schemes in the developing world.

The world is making ever more hot air. Trade in green-

house gases, worth about €40 billion (£31 billion) last year, is expected to increase to €63 billion next year, according to Point Carbon, a market analyst. Most trading is done in London.

But while the principle of the CDM has taken off, policing the market has proved tricky and time-consuming for the market's under-resourced watchdog, the United Nations. Meanwhile, Eco Securities and the rest of the industry have been hit by an ever-shifting maze of international legislation and byzantine discussions on the next stage of the world's response to global warming. Eco Securities' shares have fallen 70% this year.

"There's a lot of misunderstanding about what is happening and it's very frustrating," said Usher.

Despite this, he stressed that the CDM works, and calculates that by 2012 the scheme will have reduced emissions of carbon dioxide by between one and two billion tonnes.

"The problem is that we are emitting 20 billion tonnes of carbon dioxide a year. So in the next five years we are going to emit another 100 billion tonnes. CDM works but it's just not enough," he said.

Most of Usher's problems now centre on the approval of schemes. The UN appoints local inspectors, companies known as designated operation entities, to sign off on the creditworthiness of green schemes.

But the auditors are so over-

loaded with schemes that Usher said: "You literally cannot book their time. We are having to book designated operation entities a year in advance.

"They are all over capacity. There are about 2,000 projects — we have 400 — and there are only a few of these companies. They simply don't have the ability to deal with all these projects quickly," he said.

This would not be a big problem if Eco Securities was not facing such tight deadlines. The credits, like the Kyoto protocol itself, expire in 2012.

At present, those credits are valued to 2012 because nobody knows what will happen after Kyoto expires. Credits are given only once a project is registered, so a one-year delay is a 20% reduction in the value of that credit.

"That is the biggest challenge we face," said Usher.

Guy Turner, analyst at New Carbon Finance, said that, in the long run, vigorous scrutiny from the UN was a good thing. "It used to be a bit of a black art getting a project through," he said. "Now it's much clearer what has to be done. The concerns are about the time it is taking, but the actual rejection rate is very low. The last thing the UN wants is for this scheme to fail."

Usher said: "The system needs to be adopted not for a few thousand projects but ultimately for millions of projects. There is a will to do that and there are ways to do that.

"There is huge learning going on here. It's very frustrating when the criticism of the market is so negative.

"We all know that this [global warming] is something that is going to be around for the rest of our lifetimes and our children's lifetimes. There is no way we are



Hot future: carbon credits expire with the Kyoto treaty in 2012

going to come up with a perfect system in five years. But you have to build on what you have."

But even if the approval process is sorted out, real questions surround what happens after the Kyoto protocol expires.

Negotiations to replace the treaty began in Bali last December and are expected to culminate late next year. It is a tight timetable and the key nations are divided. If the talks fail, the market's future may be curtailed.

The world's governments meet again in Poznan, Poland, in December. America and Australia had been among the biggest countries to hold out against the treaty, but Australia has now signed up, and in America all three presidential candidates are far greener than George Bush.

If America finally signs up to

the idea of carbon credits, companies such as Eco Securities could suddenly find their fortunes rising sharply.

America already has a domestic trading system for sulphur dioxide (the main component of acid rain) and analysts said it could be used as a model for a carbon-credit market.

But the uncertainty over the CDM looks set to continue even after Poznan, said Turner. Ultimately, governments may even decide that the CDM is not the best way of curbing the world's carbon problems, he said.

"The carbon-credit market's problem is that it affects the whole world and is therefore subject to the very different political and economic needs of all those different countries. It's not for the faint-hearted."