

Global Carbon Credits Die as Smart Money Embraces India's RECs

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Vibhav Nuwal, founder of REConnect Energy Solution Pvt. Ltd., stands for a photograph in Gurgoan, India, Feb. 28, 2011. Photographer: Namas Bhojani/Bloomberg Markets via Bloomberg

Vibhav Nuwal was once an enthusiastic supporter of the global carbon market. The 32-year-old Indian-born banker started in September 2009 developing carbon credits to target investors in Europe and Japan for Mumbai-based private-equity fund Managing Emissions. Less than a year later, he quit his job, convinced that the [United Nations'](#) failure to broker a global agreement to reduce greenhouse-gas emissions meant the carbon credit market was effectively dead.

Now, Nuwal has set up a business helping companies that earn incentives from renewable-energy projects under a new Indian government program. Nuwal says that in the absence of a global consensus, investors are more likely to channel funds into incentive programs in local markets such as India, where they can make three times as much as they do selling credits under the global, UN-sponsored plan, Bloomberg Markets reports in its May issue.

“There is a base being built for a really strong local economy around this,” says Nuwal, a former JPMorgan Chase & Co. investment banker. “Carbon is getting more and more difficult. A significant amount of the business that is done in the carbon space should shift.”

Nuwal's decision is one more sign that the consensus eventually reached 14 years ago by 193 nations and the European Union in Kyoto, Japan, may have cracked beyond repair. [The plan](#), which introduced greenhouse-gas restrictions to support the development of a global carbon market, is breaking down as the U.S. and [China](#) grapple over how, when and to what extent they can reduce pollution.

'Plan B'

With the two biggest economies blocking progress on emissions, global temperatures last year matched the record highs of 2005 while droughts and flooding wrecked harvests from Karachi to Rio de Janeiro. Today, the price of carbon languishes at less than half the level Deutsche Bank AG says is needed to meet the UN's aims for controlling global warming. Officials and investors say local initiatives like Nuwal's may offer the best chance of both slowing emissions and making money from the process.

"People are moving on to Plan B," says John O. Niles, director of San Diego-based Tropical Forest Group, a nonprofit lobbying organization. "That means taking what we can get wherever we can get it."

The latest casualties of the death of the Kyoto plan may be the companies and executives who bet their careers and their capital that credits to release carbon into the environment would become a globally traded commodity to rival the \$21 trillion market in crude oil. So far, the carbon market is a comparative blip on the landscape. Banks and brokers traded 93 billion euros (\$128 billion) of carbon credits last year, according to Bloomberg New Energy Finance.

'Not Enough Investment'

"All the people I've seen who went into carbon trading have failed and moved out," says Jason Kennedy, chief executive officer of London-based headhunter Kennedy Associates. "There's not enough volume, not enough pay and not enough investment."

Even some pilot programs are being shut down.

IntercontinentalExchange Inc. closed its voluntary carbon-trading platform on the Chicago Climate Exchange on Jan. 31, while JPMorgan Chase shut down carbon credit origination at several offices and fired staff after acquiring EcoSecurities Group Plc, the biggest offset developer. The Geneva-based International Emissions Trading Association

says its membership has declined about 16 percent since the international divisions emerged at the 2009 annual climate summit held in Copenhagen.

High Hopes

There was little anticipation of such a failure in December 1997, when UN members, after 11 days of talks in Kyoto --[Japan](#)'s former imperial capital -- agreed to reduce emissions in rich countries by 5 percent from 1990 levels. Those nations, listed in Annex I of the Framework Convention on [Climate Change](#), pledged to reduce emissions of the six key greenhouse gases that scientists say are largely responsible for changes in the Earth's atmosphere: carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride.

Developing countries, including China, didn't face carbon limits and could sell credits to Western nations if they reduced their own emissions.

"Addressing global warming is a long-term challenge, and the Kyoto agreement is a vital turning point," then-Vice President [Al Gore](#) said in [Washington](#) following the conclusion of the summit.

Carbon Market Dream

Yet the U.S., then the world's biggest polluter, turned away from the deal. President [Bill Clinton](#), who pushed for carbon trading to be included in the treaty, never submitted it for ratification, judging that he couldn't muster the 67 votes required to get the treaty approved by the Senate. Clinton's successor, [George W. Bush](#), supported the carbon-trading concept during the 2000 campaign and then reversed his position a year later, after taking office.

The dream of a global carbon market was already showing cracks in 2002, by the time the then-15 nations of the EU ratified the [Kyoto Protocol](#). With the U.S. on the sidelines, [London](#) became the carbon-trading capital when EU allowances were introduced in 2005 at about 15 euros. The securities, which allow polluters to emit the equivalent of 1 ton of carbon dioxide, doubled within a year as the booming economy and the run-up in [oil prices](#) spurred companies to cover their liabilities.

Obama's Promise

Barack Obama's election in 2008 revived hopes for a real global carbon market after he pledged to make climate change a priority for the U.S. As a candidate, Obama supported cap and trade -- a system in which companies can buy and sell a gradually declining number of emission permits. The plan would allow cleaner organizations to profit by selling their credits to more polluting enterprises. Yet in office, Obama focused his legislative efforts on passing changes to the health-care system.

"After all these years, what we can say is there is a strong cultural resistance in the U.S. to a move to cap carbon," says [Emmanuel Fages](#), a Paris-based analyst at Orbeo, a carbon-trading joint venture between Societe Generale SA and Rhodia SA. "Whatever the excuses, whatever the context, they just don't manage to pass any constraining carbon cap into law. They cannot."

When Obama arrived at the climate change summit held in Copenhagen in December 2009, carbon traders were optimistic about securing a global deal. Almost two-thirds of respondents expected an agreement at the meeting, according to a 2009 survey of 3,319 market participants conducted from Jan. 20 to Feb. 15, 2009, by Oslo-based Point Carbon.

China, U.S.

Instead, Obama clashed with Chinese Premier Wen Jiabao over energy financing, pollution-reduction goals and the verification of emission cuts.

"Ten years ago, you would have said by 2010 carbon will be a global commodity just like all the other commodities, fungible across different regimes," says Jon Anda, vice chairman of UBS AG's securities unit in Stamford, Connecticut, who runs the firm's environmental business. "We didn't get any of that."

Today, carbon trading remains a backwater of the global commodities market, and it's not even included in the benchmark Dow Jones UBS Commodity Index. Without demand from institutional investors spurred by global limits on emissions, the price of carbon has languished compared with the fossil fuels that policy makers are aiming to marginalize.

Investors trade two main families of carbon emissions: EU permits, which allow companies to vent gases in [Europe](#), and UN credits that represent avoided emissions in

developing countries. The price of UN carbon credits fell 6.9 percent from the beginning of the Copenhagen climate talks in December 2009 to March 21.

Japan Earthquake

That compares with a 66 percent gain in northern European steam coal over the same period and a 50 percent rise in Brent crude. EU carbon futures for December delivery traded at 15.77 euros in London on March 10, about where they started six years ago, before the earthquake in Japan. The carbon futures price rose to 16.85 euros on March 21, after the quake and subsequent tsunami triggered a radiation leak at a nuclear plant north of [Tokyo](#) and spurred Germany to review its atomic energy program.

While carbon trading is stalled, the world remains on course for potentially catastrophic climate shifts. If governments manage to limit emissions in line with existing rules, average global temperatures will likely rise about 4 degrees Celsius by 2100, according to [the Climate Scoreboard](#), a model built by a team led by John Sterman of Massachusetts Institute of Technology.

Environmental Danger

That would melt the Siberian permafrost and flood an extra 150 million people a year, mainly in Asia, while corn and wheat yields would fall 40 percent at low latitudes, according to the [Met Office](#), Britain's weather tracking organization.

[India's](#) renewable-energy-trading program offers investors a way to engage with the problem while multiplying the returns they would make on carbon. Under the plan, power distributors have to source up to 14 percent of their energy from renewable sources or buy Renewable Energy Certificates, known as RECs, from wind farm and solar park operators to cover the shortfall. If they don't, state energy regulators will purchase the certificates and bill the companies.

India, which the Paris-based International Energy Agency says will be the world's third-biggest power consumer by 2035 behind China and the U.S., has imposed a minimum price of 1.5 rupees (\$0.03) per kilowatt-hour for the RECs to guarantee a certain return for investors. That's almost three times what developers earn from UN credits, Nuwal says. He expects companies to be able to register, earn and sell RECs in about five months compared with delays of as much as three years in the UN program.

‘Big Gulp’

Nuwal, along with his Bangalore-based partner, Vishal Pandya, planned to set up a business to steer companies and investors through the process. Before they could start, he had to get the plan past his wife, who had just given birth to their first child, a son named Parth.

“I had to take a really big gulp,” he says.

To test the market, Nuwal sent out a newsletter to about 700 potential clients about the RECs business he wanted to set up, and to avoid alerting his employers, he used his wife’s e-mail and mobile phone number for the contact.

“For the next five days, her phone didn’t stop ringing,” he says. “That’s what convinced her there was a market. She said, ‘Go and quit.’” ‘

The Nuwals’ optimism contrasted with the mood in Cancun, Mexico, where delegates gathered for the annual climate summit in November last year, with American reluctance forcing other rich nations to abandon Kyoto, when its emission limits expire next year.

Cancun Revelation

As delegates approached the meeting at the Moon Palace Resort on Nov. 29, passing signs warning of alligators lurking in the ponds of the hotel garden, Hideki Minamikawa, Japan’s wiry, bespectacled chief negotiator, settled into his desk between Jamaica and Jordan in the main meeting room. An hour into [the opening session](#), he removed the headphones that piped in the translations, adjusted his microphone and effectively declared the Kyoto treaty unworkable.

“The Kyoto Protocol can never be an effective vehicle in tackling global warming in the coming years,” Minamikawa said.

The statement sent shockwaves through the conference. “There was absolute consternation,” says [Pablo Solon](#), Bolivia’s ambassador to the UN, who witnessed Japan’s reversal.

“We had come to Cancun to discuss what a second Kyoto period would involve, not whether there was going to be one.”

The repercussions from that shift are being felt around the world as pilot emissions-trading programs falter and policy makers look for alternative approaches.

Regional Plan

In the U.S., permits in the [Regional Greenhouse Gas Initiative](#), which limits emissions across 10 Northeastern states, slumped to a record low in December after officials issued more permits than companies needed to cover their greenhouse-gas output.

Plans for a similar program in the West have been scaled back after five states failed to pass the necessary laws, leaving [California](#) to plow on alone.

Japanese climate policy is moving toward mechanisms that generate profits for companies rather than impose costs on them. The government is looking to claim credit for reducing greenhouse-gas emissions by exporting JFE Steel Corp.'s and Nippon Steel Co.'s energy-efficient technology to plants in the Philippines and India.

Chinese policy is geared toward exporting low-carbon technology to the West rather than lowering its own emissions, UBS's Anda says, even as China plans to introduce limited cap- and-trade systems in eight cities. Similar programs in Australia and [South Korea](#) remain at the planning stage.

Range of Initiatives

Meanwhile in Delhi, Nuwal's company, [REConnect Energy Solutions Pvt.](#), is already helping clients produce credits for the market that began trading in March. Nuwal and his partner project that revenue at the company will rise to \$3 million by 2013, up from a projected \$750,000 this year.

"The carbon market has metastasized into a huge range of climate finance initiatives around the world," says Marc Stuart, co-founder of EcoSecurities, the carbon credit developer bought by JPMorgan Chase in 2009. "These things don't lead to tradable securities."

Stuart now runs his own investment firm called Allotrope Ventures, which backs projects that earn a return through emission reductions without generating credits. Among his investments: an intelligent power-management system for apartment buildings and office blocks.

European officials are sticking to their plans for extending carbon trading within the EU. The Emissions Trading Scheme has been in operation since 2005 and covers 11,000 energy and manufacturing companies across 30 countries -- the 27 EU members plus Iceland, Liechtenstein and Norway.

Third Phase

Airlines will be included in the program next year, with aluminum makers and petrochemical companies included in the third phase of the program, which is scheduled to run from 2013 to 2020. In the third phase, the EU will auction most permits instead of allocating them free to polluters.

The European ETS accounted for most of the global carbon market last year, with about 80 billion euros of permits traded, according to BNEF. Without a global deal to restrain companies in the U.S. and China, that trade adds another burden onto Europe's struggling economy while emissions leak out into the atmosphere through other jurisdictions, Fernando Albertos de Benito, assistant director of development at oil company [Repsol YPF SA \(REP\)](#), said at a Jan. 19 seminar in Madrid.

The state of the market is a far cry from the urgency of the late 1990s.

"The science demands that we act," Clinton said ahead of the Kyoto summit. "We owe it to our children."

As Nuwal builds the business he hopes will help provide both a secure financial future and a more stable environment for his own child, it's local policy makers in India rather than UN diplomats who are providing the outlet for his entrepreneurial spirit.