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How to develop carbon credits and make money

By **Lara Wozniak** | 7 May 2009

South Pole is a carbon asset manager that helps companies develop projects that create credits to trade on carbon trading markets. We talk to Renat Heuberger, a managing partner at South Pole, about the industry.

How aware are Asian companies about the carbon trading market?
The world of carbon is dividing into two parts -- those with Kyoto targets and those without Kyoto targets. The countries that have Kyoto protocol targets at the moment are mainly OECD (Organisation for Economic Co-operation and Development) countries, and in Asia (ex-Australia), Japan is the only country that has such targets. As a result, only Japan has so far been acting as a buyer.

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In other Asian countries, however, there are many companies that are active on the selling side of the carbon trading market. These include Korea, Thailand, Indonesia, Malaysia and of course China and India. The way they participate is by, for example, introducing CO2 reduction measures for their companies, whereby the resulting certificates are then sold. So the level of participation in carbon trading really depends on what country you come from. So Asia is aware of the market.

You help companies that are investing in projects that potentially qualify for emission reduction credits. How does that work?
South Pole is a carbon development and carbon trading company. We have offices staffed with technology experts all around the world. When we're talking about selling to the carbon market (so I'm talking now about the countries outside of Japan) what these experts do is approach companies and identify what they could do to reduce emissions. Of course, we have a lot of experience in what works and what doesn't. This is very important, because you need to take measures that reduce at least 50,000 tonnes of CO2 per year to make it worthwhile. If it's lower than that, it gets tricky, it's not really worth the effort so much to participate in carbon trading. So we are quite aware of what industries work for carbon trading and we approach companies in those industries and propose emission reduction measures.

We also have technology partners, for instance providers of bio-gas engines, generation equipment or boilers -- technology that is directly or indirectly used for reducing emissions -- and we introduce these technology providers to the companies.

So basically we come through the door and say: 'Ok guys, we see an opportunity for emission reductions, and guess what, we have a solution. We can help you reduce the emissions and you can even make money from it.'

How long does this whole process take?
There are two parallel steps. The first part, which is to get the technology in place and start reducing the emissions, can take from six months up to several years. How long this takes is often linked to the question of how fast you can get your financing act together. In parallel, the process to register the project (so it is accepted as a clean development mechanism, or CDM, project) normally takes another year.

Just to be clear to our readers. Under the Kyoto Protocol, developed countries with quantitative emission limits can invest in carbon projects in developing countries to assist their sustainable development. Those projects are known as CDM projects. And those CDM projects produce tradable carbon credits called certified emission reductions or CERs. But there are also voluntary emission credits, or VERs, which are also called carbon offsets. In this case, a purchaser -- typically a commercial firm -- buys an emissions allowance to offset the carbon produced. This happens mainly for reputational purposes, and to contribute voluntarily in the fight against climate change. There is no formal market for VERs.

So, my question for you is, do you normally do projects that are CDMs, that will produce certified CERs? You don't usually do VERs, do you?
We do both. Our focus is obviously on CERs because the market is much bigger, but the voluntary market is growing. The good thing is it doesn't stop in 2012. On the voluntary market you can transact emission reductions for as long as you want. While on the compliance market, things may change once the political circumstances change.

We are the only carbon credit development company in the world which has an office in Taiwan. Taiwan doesn't qualify for CDMs because its legal status with the United Nations is not clear due to its dispute with China and it is not under the Kyoto Protocol. So we are generating VERs in Taiwan, which is quite an interesting model as well.

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Do you tell a company "I think you should produce CERs" or do they usually tell you what they would prefer to do?
It depends. There are certain industries, for instance the starch or the ethanol industry in Thailand, which are already aware that they can produce CERs by covering their waste-water lagoons and producing bio-gas. The starch industry is quite busy in Thailand and these companies are more or less aware of carbon trading and basically it comes down to what company they are comfortable doing business with to produce their CERs.

For other industries, it's all quite new. There are sectors, such as the transport industry, or producers of energy efficient appliances, which only recently became aware that there is this possibility. So in these cases, it's typically us going to them and saying: "You have this potential, why don't you do this...?"

Ok, so once a project has CDM status and you've produced CERs, how are they then traded?
For CDMs, it's like trading crude oil. The volume may be a bit smaller, but it's the same mechanics. It mostly happens in Europe, because most of the buyers are in Europe. But every day you can check the current spot price. And so you develop your project, and you sell it at a good moment -- when you believe the price is not going to move against you. It's very classic trading techniques.

The difference is that when you trade crude oil, someone actually has the product. You have the one gallon of oil. With carbon trading, you don't have a product. You just have a couple of bytes on a server at the United Nations. It's an abstract commodity, if you will. But it can be traded.

Aside from it being abstract, the market is also slightly different because it is exposed to political decisions. If the political winds move in a way that makes them say, no one wants these products anymore, obviously the price will fall. But if the political winds blow in another way, and politicians say we've not done enough to prevent global warming and we need to reduce emissions even more, the pricing will go up. So my point is, this market is not only driven by fundamentals but also by political decisions, and that makes it unique from other commodity markets. That's the CER market.

I think, however, it's also important to note once again the difference between CERs and VERs because the VERs don't have this 2012 deadline, which is when the Kyoto Protocol expires. They can sell indefinitely. The voluntary market is like selling any product. For this, you go out and talk to banks and airlines, anyone who can be interested in voluntarily offsetting and making a contribution to prevent global warming and promote sustainable development in the developing world.

So the CER market has this political element, which makes it different, while the VER market doesn't have such a political element, but much more of a reputational element.

In December, world leaders are coming together in Copenhagen to try to reach a decision on how to, if at all, continue the Kyoto Protocol. Do you think there will be an agreement in Copenhagen in December?
In 2012, the Kyoto Protocol expires. Unfortunately, the world has yet to agree what will happen after that. This is unfortunate right now, because, as I mentioned, it takes about two years to take a project to market, and we've only got three years left to go with the Kyoto Protocol. So now, if you were to start a project, you're only talking about one, maybe two, years of trading under Kyoto -- but a typical CDM project could generate up to 21 years worth of credits. One or two years versus 21 years is obviously a big difference. So of course we hope that a resolution is reached in December in Copenhagen that calls for countries to extend their commitment beyond 2012.

At the moment we are hopeful that this will happen because of the new administration in the US. What challenges the whole thing is the financial crisis, which is changing the focus for politicians. Their priority is fighting the financial crisis rather than focusing on the Kyoto Protocol. So the climate issue goes on the back burner. But there are positive signs from the US and Europe. European leaders, for example, have said that if other countries participate they would aim for 30% less emissions by 2020.

Now, what would happen if it doesn't go through? The reality is this market won't collapse. The good news is it would not go away just because there is no agreement. What would happen is there would be regional markets. For example, in Australia, the new government has embarked on an emissions trading scheme that is likely to launch in 2010 or 2011. Once it's online, it will include commitments that go way beyond 2012.

The Europeans have also committed that even if there is no agreement they would continue carbon trading. Of course, the big unknown is the price. No one knows what the price would be in those schemes.

The good thing about the Kyoto market is that there's one set of rules that applies to everybody. But if nothing is passed in Copenhagen, what could emerge is that we have a series of domestic schemes -- one plan in Australia, another in Europe, another in Canada -- with everyone having different rules. And that complicates matters. So once you start developing projects you would have to do it according to the rules of the country in which you were going to sell the credits. This would be more complicated, but it could work.

What type of products does South Pole specialise in?
We specialise in renewable energy and energy efficiency. And we of course specialise in the highest quality products -- Gold Standard credits -- you could say that we dominate that market, as we think it adds far more value. What qualifies as Gold Standard? Mainly energy efficiency and renewable energy. So we have a lot of wind power, hydropower, thermal-power, solar power, bio-gas -- these types of projects. There's a lot of potential in Asia. For example, countries like Thailand and Malaysia have a lot of potential for bio-gas power. And wherever there are mountains -- there is potential for hydropower, so Vietnam, Indonesia and China are good countries. So there's room to grow.

Tell us a little more about the Gold Standard carbon credit that South Pole created.
The point of these projects is to reduce emissions as the main aim is to protect the planet against global warming. But, you get there in different ways. You may have a project where you have a landfill site and you burn the landfill gas. That is good for reducing emissions, but that's it. There's no other benefit in doing this. The "only" benefit is to prevent climate change.

Now, there is a group of NGOs, such as WWF and the like, who said: 'If we do this carbon trading mechanism, we should actually distinguish between the projects that only reduce climate gases and those that reduce climate gases and provide additional benefit to their host country." We agreed, and contributed to make the Gold Standard happen.

The Gold Standard is given to projects that reduce carbon gases but also have social benefits. Some examples would be employment generation, or other positive impacts on air pollution, or a project that also reduces water pollution, and so on. The focus of the Gold Standard is projects that have a community element -- so the money doesn't just go to the industry but to the community as well. A very good example

is rural electrification, which brings clean energy to people in the countryside.

What do you say to people when they are sceptical about CO2 emissions, arguing that it's not necessary, or whatever their criticism may be? Do you hear criticisms? Or by the time they come to you, are they already convinced that they need to do something?
Well there are two types of critics. Both of them are clearly wrong, I would say. The first type of critic is still sceptical about climate change and the question of whether the problem is man-made. If you've got hundreds of scientists agreeing to the fact that the fast worsening of climate change is man-made, it's amazing there are still people questioning this. There's just an overwhelming amount of evidence, and it's just very, very hard to find convincing evidence to the contrary. But there will always be people who will say crazy things.

But even if there wasn't the issue of climate change, it still makes sense to reduce CO2 emissions, because when you do that you typically save fuel. And the fuel we use -- such as crude oil -- is going to run out at some point. So there's anyway value to reducing our use of it.

The second set of critics say that carbon trading is not a good thing -- they argue it's not sound. This is clearly wrong too. Because nations have set up a very extensive set of compliance rules -- that's why it takes more than one year to complete a project -- and the process is extremely conservative, in the way we prove and calculate and certify it by an independent entity.

Plus there are lots of economic arguments for carbon trading. Money incentivises people to reduce emissions. If a European company finds it difficult to reduce their emissions any further, it makes sense that they finance a measure in Asia where it can be less expensive to reduce emissions. That's what climate trading is all about. It leads to a good allocation of resources so that we can protect the planet in the most efficient manner.

Finally, another important point for Asia (and also the rest of the world) is that most of the Asian companies, who participate in carbon trading, actually end up making money doing it (and I'm not talking about trading here, I'm talking about the process). Because what is an emission? It's waste, it's inefficiency. And it does intuitively make sense to reduce your inefficiencies.

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