FROM A TINY RIPPLE

The carbon market as we know it grew from several, separate initiatives around the world – which the 1997 Kyoto Protocol helped coalesce, and inspired further efforts. In an extract from IETA's forthcoming oral history, Katie Kouchakji looks at what was built with just a small amount of policy direction

For many observers, the carbon market truly began to take off in 2005, with the entry into force of the Kyoto Protocol and the start of the EU Emissions Trading System (ETS). In reality, work on market mechanisms to tackle rising GHG emissions had been ongoing since the late 1980s and really took hold after the Kyoto Protocol was agreed in 1997 – despite the rules for its flexible mechanisms not being agreed until 2001.

"The process to negotiate market mechanisms started with the mandate from COP 1 in Berlin," recalls Frank Joshua, who helped set up the flexible mechanisms when he was at the UN Conference on Trade and Development, referring to the first Conference of the Parties to the UNFCCC in 1995.

"The US had, at that point, signalled they were interested in discussing flexible mechanisms … leading up to the Kyoto conference in 1997, were a series of proposals, including one from Brazil on something called the Clean Development Fund that, at some point, became the Clean Development Mechanism [CDM]."

The road between the Kyoto Protocol being agreed and the rules for its flexible mechanisms being finalised in Marrakech in 2001 was long, as a result of lingering ill feeling after the end of the negotiations in Japan, says Joshua – which had overrun by two days.

"It was mainly the provisions on emissions trading [that held up the Kyoto talks], which had been objected to by many delegations," says Joshua. "The US insisted that they must be in and, at one point, the US delegation had threatened to walk out."

He adds: "The meeting eventually got around to fixing the question of emissions trading by deleting the paragraph on emissions trading and reinserting a paragraph at the back of the document, which is now Article 17 … which authorised emissions trading."

Dirk Forrister, now president of IETA, was negotiating for the US in 1997 in his capacity as Chairman of the White House Climate Change Task Force under President Clinton.

"The biggest challenge was trying to get global agreement on the use of markets," he says. "It was such a new thing – we had done it in the US on acid rain trading, but it was not a tool that had been used in a lot of other places, and it was one of the last things to be negotiated. It really went down to the wire."

GROWTH OF THE CDM

"The Kyoto Protocol was the first international piece of law that tried to articulate an idea of carbon rights and the trading of these carbon rights, and creating a market," says Martijn Wilder, head of Baker & McKenzie's global climate change practice, which was started following the Kyoto agreement. "Our vision was that the Kyoto Protocol, the CDM and international emissions trading really set a framework for really interactive private sector engagement in climate change."

The first CDM projects were quick off the mark, building off of previous experiences with government initiatives to reduce emissions. EcoSecurities was one such firm that translated its experiences into this emerging market and, by 2005, it had built up the largest private sector portfolio of CDM investments.

"Over time, we started recognising that the next stage of the market was going to emerge – there was going to be a real market, as opposed to companies trying to figure out a project," says Marc Stuart, one of the co-founders of EcoSecurities, of the early years.

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Stuart and his business partner, Pedro Moura Costa, built the first certification system for third-party verification firm SGS in 1997, and it was this that prompted the establishment of EcoSecurities. The first project that they used this new system for was to certify the national GHG reductions of Costa Rica – before emissions accounting became standard under the Kyoto Protocol.

This work led Stuart and Moura Costa to other projects with governments and public sector institutions, before they looked to acquire their own carbon assets – often at a discount. But it paid off, and Moura Costa notes that by the time the Kyoto Protocol entered into force, the firm had the largest private sector portfolio.

"We got involved in something like 700 projects, developed and registered about 450, and about 54 technologies," he says, with the pair moving away from their initial projects in forestry as these projects were largely shut out of the Kyoto Protocol.

CARBON FUNDS: STIMULATING THE MARKET

The World Bank was also a significant player in the early years, with Ken Newcombe heading up its carbon finance unit. Its Prototype Carbon Fund (PCF) aimed to stimulate the market and show what could be done – in a similar fashion to how its current Pilot Auction Facility is showing a new model of finance for CDM projects. However, Newcombe says the greatest challenge was the fact that he worked for the Bank.

"It was both an opportunity and very difficult – some people call it being an 'intrapreneur', being an entrepreneur on the inside of a big institution," he says. "It was like making love in the time of cholera – it was, at the same time, really exciting and dangerous because you had a major proposal for change which was poorly understood and, in some quarters, unwelcome."

Newcombe says the road to the PCF began at the Rio Earth Summit in 1992, and culminated eight years later with the Fund's first close in April 2000, having raised $135 million (which rose to $180 million in later fundraising rounds) from both private sector firms and sovereigns. One of these investors included Gaz de France (GDF), now known as Engie.

Christine Faure-Fedigan, who is now the firm's director of corporate climate policy, recalls that, in 2000, it was a bit of a gamble to invest in the PCF as the firm was not yet then subject to carbon emission regulations.

"Carbon markets didn't exist, crediting projects didn't exist, we didn't know if we were going to have obligations, we didn't know anything about regulations," she says. "It was like a jump into the unknown." What swayed the decision was a sense by the board that, as GDF transformed from a gas supply company into a power generator, it would be subject to constraints in the future.

The PCF was an opportunity to "get us a better understanding of how putting a price on carbon would give us opportunities to develop new services and new products for our big consumers", says Faure-Fedigan. "Also we knew that there was going to be the possibility to use those credits against our possible future obligations."

Private sector funds followed suit, most notably Natsource's Greenhouse Gas Credit Aggregation Pool which, in 2005, raised €455 million ($498 million) at its first close – the largest in a private sector fund at the time.

"The hardest part was to get it launched," remembers Jack Cogen, then president of Natsource. "When the carbon markets first began… we had very little capital, and it was very hard for large industries to take us very seriously. We had to convince them that our intellectual property and staff was more than sufficient to make up for the capital and they should give us the money – which ultimately they did. We ended up raising about $1.2 billion at our height."

PREPARING FOR LIFE AFTER PARIS

Despite the difficulties of recent years and the near-collapse of the CDM, the private sector is keenly watching Paris for any ripple of policy that could spawn the next wave of market activity. As the past has shown, it doesn't take much to spark the innovations that the future needs – and this time, there are solid examples to draw from and build on.

"A lot of the early lessons that were learnt will be brought across," says Baker & McKenzie's Wilder – including on market

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– KEN NEWCOMBE

linkage, CDM evolution, use of offsets and market design. "We've got a very solid base to work off."

"I think we'll build on the base of experience and exciting tools and existing markets," says Forrister. "We're seeing carbon markets take grounding in a lot of new places, and I think that's very healthy."

But, he adds, "It's frustrating to see the erosion of the market because the policy side, frankly, hasn't kept up with the business side … it will surprise you how creative and engaged the business community can be behind such a programme.

"We need to be taking the issue much more seriously and using this tool to its full potential. Right now, it feels like we're still revving the engines and getting ready to do something dramatic with it, but we haven't let it show its full colours yet."

Katie Kouchakji *is a freelance journalist who has covered the carbon market and climate policy since 2005. Formerly editor of Carbon Finance until 2013, Katie has also worked at Argus Media. She has worked as IETA's communications advisor since 2014 and is preparing an oral history of the carbon market for IETA, to be released in 2016. Katie has a degree in English Language and Linguistics from Durham University.*

(left) Participants on a site visit in Chile to one of the PCF's projects (right) Tombstone marking the total amount raised by Natsource's Greenhouse Gas Credit Aggregation Pool in 2005 – the world's largest private sector manager of carbon emissions assets at the time.