The New York Times



June 14, 2010

# CDM Critics Demand Investigation of Suspect Offsets

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UNITED NATIONS -- A broad coalition of activists are charging that as much as a third of all Kyoto Protocol carbon offset credits ever sold to banks and governments could be illegitimate because they were generated by firms manipulating the marketplace.

Companies, the activists allege, are deliberately generating greenhouse gas pollution in order to snag millions of dollars worth of carbon credits when they then mitigate the emissions. Many chemical manufacturers also seem to be tweaking their systems to generate as much emissions as possible, only reverting to normal pollution levels once they've hit their maximum annual offset credit allowance.

The coalition of European and U.S. activists is now pushing for a radical change to the Clean Development Mechanism, the U.N.-run international greenhouse gas offsetting scheme. Having been rebuffed back in 2007 the group launched a more formal request for review yesterday.

They charge that since 2005 a small number of firms have deliberately produced excess greenhouse gas pollution for the sole purpose of destroying it, thus earning them valuable carbon offset credits called Certified Emissions Reductions (CERs). The CERs can be worth millions of dollars as they are sold to the carbon markets, primarily to firms regulated under the European Union's Emissions Trading Scheme.

"Sometimes they produce gas just to burn it and get some CDM money, and it's not at all an honest way of behaving," said Chaim Nissim, an engineer with Noe21, a Geneva-based climate change advocacy organization that has researched carbon offsetting projects at industrial gas companies.

"It's fake," Nissim said.

CDM officials say they are investigating the allegations

"A request for revision of the methodology used in these projects is now with the Executive Board's Methodologies Panel," said spokesman David Abbass. "The Board is aware of such allegations but has yet to consider them. Certainly, it's clear that without the CDM there would be no incentive to destroy the by-product HFC-23 gas."

Market demands not making a dent

About 19 chemical gas manufacturers are at the center of the controversy. Most are located in China and India but others are based in South Korea, Argentina and Mexico. They produce the refrigerant HCFC-22, a hydrochlorofluorocarbon promoted by the Montreal Protocol as a replacement to more destructive ozone layer-eating substances.

Manufacturing HCFC-22 creates the chemical byproduct HFC-23, a potent greenhouse gas normally vented into the atmosphere. The companies in question are earning huge quantities of CERs for destroying this HFC-23 gas, CDM records show.

Lambert Schneider, a German CDM expert who helped design the system at its conception, has joined the chorus of critics. He says data shows most of the firms now design their businesses around earning these CDM credits. HCFC-22 production has at least doubled since the CDM began, and the output of heat-trapping HFC-23 has spiked as well.

Experts are not sure what is happening to this excess of HCFC-22, which is itself a greenhouse gas, though much weaker than HFC-23. Companies could be stockpiling it as they wait for prices to rise, but some fear they're venting much of it into the air.

Schneider noted the case of one company seeking the renewal of the crediting period that, prior to obtaining CDM credits, produced between 3,000 and 4,000 tons of the substance. Now, it's 7,000 tons. "So they more or less doubled production," he said.

The clearest sign, Schneider says, is that HCFC-22 production has been rising steadily despite historically experiencing more volatility in supply and demand. The new trend changed little even during the steep global economic recession of late 2008-2009. Schneider says many of these firms now make more money from selling CERs than from sales of their primary product, HCFC-22 gas, prices for which have fallen sharply as production now exceeds demand.

"What I found most astonishing is that many of the plants produced exactly the amount where they are eligible to get credits for," said Schneider. "Let's say they are allotted 400,000 tons per year for which they can get credits, and so they produce 400,005 tons every year, and in the past production varied quite a lot depending on market demand."

## A 'real attack' against CDM

Of the 19 facilities, 11 are located in China, while 5 are in India. These countries also host the largest plants, with two in China generating around 10 million CERs each per year. The groups pushing for reform fear that the heavily politicized CDM will come under Indian and Chinese pressure to maintain the status quo, even though the alleged cheating threatens to discredit the entire system.

"It's a real attack against the CDM," said Eva Filzmoser, head of the Bonn, Germany-based group CDM Watch. "There's a lot of money that's in there, and of course who wants to forget about it if you can have it?"

Though no one's quite sure precisely how many CERs were generated by the alleged manipulation, Filzmoser says groups estimate anywhere between one-third to one-half of all CERs sold up to now originated from manufactured pollution.

According to an E&E review, the volume of credits earned by just these 19 firms is around 50 to 60 percent of the total number of CERs generated since the CDM began, or at least 246 million of the 420 million CERs issued to date. This despite the fact that the whole program now boasts more than 2,200 individual $CO_2$ emission offsetting projects registered.

Prices have fluctuated since trading began, but CERs have historically traded in a range between $10 to $14 per metric ton of CO2-equivalent emissions reductions. CERs are the most heavily traded carbon offset credit in the world, used mostly by European companies to keep their greenhouse gas emissions levels beneath a government-mandated cap.

CER developers usually sell their credits first to banks or carbon brokerages at a fixed price agreed to earlier, usually around $8 per ton, meaning the 19 firms at the heart of the CDM probably generated in total around $2 billion in CER sales to date.

Treaty talks lend added uncertainty

The CDM executive board is swamped with a tight reform agenda as governments and companies pressure it to speed up its review process. Groups say they are unsure how their concerns will be received.

Schneider, Filzmoser and others say warning signs first appeared in 2007 but were dealt with by only a minor tightening of the rules. They argue the only answer is to slash the amount of CERs alloted to the 19 firms by more than 90 percent. That, they say, will remove the economic incentive to artificially create excess pollution.

At least 14 of the companies are expected to ask for 7 more years of CER earnings, experts said.

With countries still unable to negotiate a second commitment period to the Kyoto Protocol, the future of the entire CDM is in limbo. No one could say what it meant for the carbon market as a whole if it is indeed determined that one third of the whole volume of CERs don't represent any actually abated or avoided greenhouse gas emissions.

Abbass at CDM headquarters in Bonn stresses that the Executive Board has adopted rules to prevent abuse of the offsetting system.

"It's important to note that there are safeguards in the existing methodology designed to prevent perverse incentives," he said. "Specifically, no new plants can qualify to earn credits and the amounts that can qualify are pegged to historic production levels. The question now is whether the safeguards need to be adjusted or added to."