

CDM Highlights 60

June 2008

Monthly newsletter of the GTZ Climate Protection Programme (CaPP), written by Perspectives GmbH. Please send questions, comments or newsworthy items to climate@gtz.de

Editorial

Dear reader!

The CDM is reaching a “binary moment” as stated by the Economist. On the one hand, project inflow is keeping up nicely, carbon fairs have record attendances and the institutional safeguards against non-additional projects are improving steadily. On the other hand, media and politicians get more and more critical, sometimes even hysterical, and this attitude might spill over into the post-2012 negotiations. The buoyancy of the CDM market could then be shattered swiftly...

Anja Wucke, GTZ and Axel Michaelowa, Perspectives

UNFCCC, EB and its panels

- The Secretariat has assessed the financial impacts of legal cases against EB members and the costs of liability insurance. The latter would cost about 0.3 million Euros for a coverage of up to 10 million Euros. For the assessment, see <http://unfccc.int/resource/docs/2008/tp/01.pdf>
- Public comments on the Validation and Verification Manual (VVM) draft (download at http://cdm.unfccc.int/public_inputs/2008/VVM/vvm.pdf) can be submitted until June 15
- The EB made the following decisions at its 39th meeting on May 14-16:
 - The additionality tool was revised and tightened considerably. A company-internal benchmark is only acceptable if the project developer is the only company that would be able to implement the project (e.g. a retrofit of an existing plant). Company-internal documentation is not acceptable as proof for barriers. Common practice analysis is only to include projects that are “operational”
 - A detailed interpretive guidance has been given on the implementation of the investment test. It is valid immediately and will substantially reduce creative interpretations. Passing the investment test will become more difficult.
 - DOE spot checks have to contain a visit to the site of a project that is validated by the DOE in question. This will increase the costs of the spot check
 - Approval of one methodology for energy efficiency in iron smelters. The refrigerator methodologies were returned to the Meth Panel as EB members had difficulties with the benchmark concept and thought that the host country DNA might have difficulties in preventing double counting.
 - The draft guidance on uncertainty assessment of emissions reductions was sent back to the Meth Panel with the request to define a maximum degree of uncertainty.
 - The fertilizer use reduction and the waste energy efficiency improvement small-scale methodologies were approved while the methane recover from non-coal mining methodology was sent back to the SSC WG
 - The widening of applicability criteria for the waste heat recovery methodology ACM 12 was not agreed by the EB and the methodology sent back to the Meth Panel. Moreover, the EB asked the SSC WG to keep existing facilities within the applicability conditions of small-scale methodology II.C. This is important as otherwise the use of this methodology would have been severely curtailed.
 - The other methodological recommendations made by the Meth Panel (see last issue) were endorsed by the EB
 - New members of the Meth Panel are Ludovic Lacrosse (expert in biomass energy with long experience in South East Asia and consultant at Grontmij International AB) and Dinesh Aggarwal (consultant with Mitsubishi UFJ Securities). Christoph Sutter from South Pole left the Meth Panel; he had been one of the key supporters of a high-integrity CDM approach.

- DNAs can only change values of the forest parameters if no forestry CDM project from their country has been registered
- Projects starting before validation have to prove “serious consideration” of CDM. The EB clamped down on such projects - it rejected two biomass power projects in India, requires corrections for 3 projects and put 10 projects under review due to lack of serious consideration. For one project it was stressed that 45 months elapsed between project start and start of validation.
- Out of 6 projects under review, one was registered, three have to make corrections and two were rejected.
- Out of 38 review requests, one project was registered, 17 projects have to make corrections and 20 projects are put under review. For the 15 Chinese hydro power projects which were the largest category, one registration, ten corrections and four reviews result, which shows a continued unwillingness of the EB to clamp down on those projects. Out of the 20 reviews, 19 relate to lacking additionality.
- Regarding 18 review requests for issuance, 3 projects received the requested quantity, 10 issuance requests (for 7 projects) have to make corrections and 5 issuance requests are put under review. 3 of the corrections entail a revision of the monitoring plan. 4 of the reviews relate to measurement of flare efficiency, which shows that projects involving flaring of methane face a substantially increased review risk.

Baseline methodologies

- 13 new large scale methodologies have been submitted, covering electricity grid connection (two meths), cogeneration (two meths, one for buildings), SF6 reduction in LCD monitors (resubmission of C case), flaring reduction (three meths, use for power plant, transport vehicles and steel industry). Challenging cases will be light rail transport and coal fire extinguishing, with a potentially huge emission reduction. Transport is also addressed in change from road to ship transport. The remaining two cases relate to energy efficiency in metal production.

Designated Operational Entities

- SGS has been accredited for validation of forestry projects
- DOEs have given further details regarding projects having problems at validation (see last issue). Out of 404 projects with such problems by end 2007 listed in the URC pipeline, 15.6% have apparently been resubmitted with a new name, 22.8% are still actively undergoing validation, 25.7% were denied validation, 29.0% have open corrective action requests unlikely to be resolved (22.0 % problems with additionality and 7% problems regarding methodology use). The remaining 6.9% had not yet received a host country approval letter.
- DOEs do not want to check authenticity of material provided by project developers, particularly with regards to “serious consideration” of the CDM, stating that validation contracts dispense DOEs from liability for impacts of “untruthful information”. The DOEs refer to the respective statement to be signed by the top management of project development. DOEs have sent some cases of falsification to the EB but these remain confidential.
- DOEs stressed their unwillingness to embark on validation of PoAs due to their liability and want to limit the liability to “significant deficiencies” in the validation report.
- DNV plans to hire 100 new greenhouse gas auditors but has difficulties with investment banks “poaching” DNV staff. According to the journal Environmental Finance, salaries for CDM consultants with 2-3 years experience reach 45,000 – 60,000 Euro in the London CDM project development companies, while investment banks pay 75,000 – 100,000 Euro.

Designated National Authorities

- Gambia, Montenegro and Togo have notified their DNAs
- The Chilean DNA, which has been renowned for a fast and efficient approval procedure, has been accused by project developers for delaying approvals by several months.
- The DNA host country approval hitlist stands at
 - China: 1295 projects (+98). The new approvals include 63 hydro, 14 waste heat recovery, 9 wind, 3 cement blending, 2 biomass power plants, waste incineration and CMM, and one district heating, waste water and cogeneration project each. Total annual CER volume is estimated at 10.8 million per year, with 1.1 million coming from the district heating project. From May 1, the

Chinese floor price has to be denominated in Chinese Yuan, as the DNA does not want Chinese project developers to suffer from further weakening of the \$. Moreover, it gives a priority listing of buyers, beginning with electricity companies. Banks are second priority and carbon funds the third and lowest one. According to brokers TFS, local consultants circumvent the consultancy fee cap of 0.1 million Euro by charging fees to buyers that are not disclosed.

- Mexico: 189 projects (+0).
- Brazil: 180 projects (+1). The long-standing row regarding the grid emissions factor has now been resolved – Brazil will be treated as a single grid. The new grid factors are to be published soon. For the background of the decision see http://www.mct.gov.br/upd_blob/0024/24563.pdf
- Philippines: 55 projects (+0).
- Indonesia: 51 projects (+4). One geothermal, composting, biopower and industrial energy efficiency project were added with a total annual CER volume of 0.5 million
- Israel: 22 projects (+0).
- Colombia: 23 projects (+3). Two landfill gas and one wastewater project have been added. Total annual CER volume is estimated at 2.9 (+0.3) million
- South Africa: 18 projects (+0).
- The DNA investor country approval hitlist stands at
 - UK: 737 projects (+44). Annual CER volume is estimated at 201 million (+ 4 million)
 - Japan: 303 projects (+27). Annual CER volume is estimated at 112 million (+ 3.6 million)
 - Sweden: 124 projects (+0).
 - Germany: 77 projects (+5)
 - Spain: 72 projects (+0).

Please note that large projects may be approved by more than one investor country!

Project developers

- 176 projects have been submitted. Large new projects in the pipeline are
 - Hydro 450 MW (India, 11.1 million CERs by 2012), with three very critical comments
 - Two hydros of 456 and 309 MW (China, 6.8 and 4.4 million CERs)
 - Waste heat recovery in steel mill (China, 3.9 million CERs)
 - Supercritical coal power plant (India, 3.6 million CERs)
 - Reforestation (Brazil, 3.1 million CERs). This project was already considered in the earliest period of the CDM and raised a lot of NGO opposition
- In a bid to improve the recently battered reputation of CDM project developers, the carbon market associations IETA and CMA have launched a code of conduct for ethical CDM project development. The code aims to protect the integrity of the mechanism by professional and ethical conduct in the market place. Signers will "strive for fair and honest competition and will not mislead the market actors in any way. They "act in a socially responsible manner, within the laws, customs and traditions of the countries in which they operate", and "have zero tolerance receiving or paying bribes." In the context of this effort, a "Project Developers' Forum" is to be set up to lobby the EB.
- Colombian indigenous Wayuu people have criticized the Jepirachi wind power CDM project of not having had the free, prior, and informed consent of the Wayuu to build the wind farm in a sacred territory. Jepirachi was one of the first projects of the World Bank's Prototype Carbon Fund and is generally seen as having a positive contribution to sustainable development, especially local stakeholders. Protesters at the United Nations Permanent Forum on Indigenous Issues claimed that over 200 Wayuu were killed prior to the implementation of the project to clear the area for this and other projects.
- Steel Authority of India Limited (SAIL) is preparing an unprecedented CDM energy efficiency project roll-out, with 38 projects planned to cover coke ovens, sinter plants and blast furnaces and another 33 in basic oxygen furnaces, rolling mills and downstream operations
- Abu Dhabi's Masdar initiative is considering large scale CCS on the back of plans to capture CO₂ from industrial installations and use it for enhanced oil recovery. According to a study, a fully developed capture and CO₂ pipeline network could reduce Abu Dhabi's CO₂ emissions by up to 50% while simultaneously increasing oil production up to 10% and also free up large quantities of natural gas currently re-injected into Abu Dhabi's oil reservoirs. The price tag would be substantial – around 2 billion Euro.
- Trading Emissions is buying Econergy for 34 million Euros.
- Ecosecurities has stopped a number of biodiesel CDM projects due to high palm oil prices, slashing 5.4 million CERs from its portfolio.
- China CDM Exchange Centre Ltd. has raised 20 million \$ through the issue of shares
- Italian oil and gas company Eni is planning to submit a new 450 MW gas power plant in the Republic of Congo as a CDM project. The plant is to be commissioned in 2009.

- In its annual report on the carbon market, the World Bank denounced the “troubling tendency of some companies in the market to point a finger at the CDM and to hold its procedural delays to be solely responsible for the poor performance of their companies” and that “it is simply wrong to blame the regulator for all problems”.
- The Indian newspaper “Deccan Herald” contends that the registered 192 MW hydro project Allain Duhangan in Northern India did not seriously consider the CDM as the Techno Economic Clearance from the Central Electricity Authority stated already in 1996 that the project is economically viable.
- Earthquake damage to Chinese CDM projects seems to be limited, e.g. touching one out of 46 projects located in Sichuan in Ecosecurities’ portfolio. However, the event shows how neglected risks can impact on CER generation.

Incentives for CDM investment

- The price difference between issued CERs and EU allowances reached a record of 10 Euros. Market observers see the EU Commission’s reluctance to allow CER imports as the main reason. At the end of May, it stood at 8 Euros.
- According to the World Bank, 79% of primary CER transactions were done by private companies. 73% of sales came from China, 6% each from India and Brazil. Africa has emerged with a 5% share. A premium of ¼ to ½ Euro per CER is reported for non-Chinese projects.
- The first tentative trades in Australian trading scheme units reached prices of 12 Euro. At that level, no demand for CERs would materialize from Australia.
- According to the World Bank, the emergence of “guaranteed CER” portfolios managed by large banks was the key event on the CDM market in 2007. These portfolios can be traded on an exchange and have a discount of only 1 Euro compared to issued CERs.
- The restructuring of key ministries announced by Russian Prime Minister Putin will slow down approval of Russian JI projects, prolonging an agonizing waiting period for the first approval
- The EU Commission and member states have released a draft for interpretation of the World Commission on Dams guidelines in the context of hydro plants above 20 MW
 - If a bundle of smaller hydro plants exceeds 20 MW, the WCD check has to be done if there is a “technical or environmental link” between the projects
 - Compliance with WCD criteria has to be validated by a DOE or AIE accredited for hydro projects or an “other qualified independent third party recognised by the Member State”. Such validation requires a site visit and interviews with stakeholders. A validation question template with 39 questions is provided some of which may be difficult to resolve in strongly centralized host countries
 - The earliest stage at which an LoA can be issued is at the project preparation stage
- EIB and the Inter-American Development Bank plan co-financing of investments in transmission, transformation and rehabilitation of hydro plants in Central America
- State Bank of India, one of the largest Indian banks has entered into an agreement with KfW for financing of CDM projects
- The Indian mountain state of Himachal Pradesh has defined a draft “Policy for Climate Change-2008 Carbon Credits through Clean Development Mechanism (CDM)”, where all ministries are to identify CDM projects and support PDD development. The final policy shall be agreed by December 2008. The key sectors are forestry, where a PDD is under development with World Bank support, and hydropower.
- The Gold Standard registry is administered by the US company APX; the registry is used both for CERs and VERs.
- Credit Suisse, South Pole and ALL Structured Finance have launched a fund to provide equity and mezzanine finance to Gold Standard projects; target investment level per project is 3-15 million Euro
- The Post-2012 Carbon Credit Fund which is financed by the five banks EIB, Caisse des Depots, Instituto der Credito Oficial, KfW and the Nordic Investment Bank has been closed with 125 million Euro. It will buy CERs and ERUs until 2022 wants to include CCS projects.
- In Sri Lanka, a so far disappointing CDM host country (see issue 53), a Sri Lanka Carbon Fund was launched, which is a joint venture between the government and private sector. The fund has no own resources and aims to bundle projects into a portfolio, whose CERs would be sold by the fund. The fund claims a portfolio of two hydro and two gas power plants and considers a substitution of diesel by electric locomotives.
- Qatar’s Doha Bank has postponed plans for CER trading until 2009, citing the world financial crisis

- Canada joins Greece in being declared in non-compliance with the Kyoto Protocol registry requirements and thus cannot participate in the Kyoto Mechanisms.
- Lobby group IETA has in principle accepted limiting CER imports into the EU to 50% of the gap between the business-as-usual path and the Kyoto target.
- In the context of post-2012 climate negotiations,
 - The International Maritime Organization (IMO) has stated that it wants to agree on a binding agreement for international shipping by 2009. The agreement could involve a levy on marine bunker fuels whose proceeds are invested in CER acquisition, a concept similar to the Swiss Climate Cent which collects a levy on transport fuels and invests it into CERs.

Web news and downloads of the month

- The World Bank's "State and trends of the carbon market 2008" is available at http://carbonfinance.org/docs/State___Trends--formatted_06_May_10pm.pdf. It values the 2007 CDM market at 12.9 billion \$ (551 million primary CERs traded for 7.4 billion \$ and 240 million secondary CERs at 5.5 billion \$)
- Point Carbon's "Carbon 2008 - Post-2012 is now" annual report on the state of the carbon market, is available free of charge at http://www.pointcarbon.com/polopoly_fs/1.912721!Carbon_2008_dfgrt.pdf. Survey respondents expect a carbon price of 24 Euros in 2010, and 35 in 2020.
- An econometric analysis of 250 methodologies and 1000 projects with final decisions by the EB done by researchers of the Center for Comparative and International Studies (ETH Zurich and University of Zurich) shows that not only formal quality criteria but also political-economic variables determine EB decisions. The study "UN approval of greenhouse gas emission reduction projects in developing countries: The political economy of the CDM Executive Board" by Florens Flues, Axel Michaelowa and Katharina Michaelowa is available for download at <http://www.cis.ethz.ch/publications/publications>
- Key information for the post-2012 negotiations is available at <http://www.climate-l.org>
- The media blitz against the CDM continues. The "Guardian" titled "Billions wasted on UN climate programme", referring to the Wara and Victor article quoted in the last issue, www.guardian.co.uk/environment/2008/may/26/climatechange.greenpolitics?gusrc=rss&feed=networkfront More balanced, but still critical the "Economist" in "A moment of truth", www.economist.com/world/international/displaystory.cfm?story_id=11376587 For a nice example how climate policy sceptics are using the current controversy about the CDM to argue that climate policy is nonsense see "Three letters to fear – CDM" http://www.torontosun.com/News/Columnists/Goldstein_Lorrie/2008/05/22/5633761.php
- An interesting interview with EcoSecurities' cofounder Mark Stuart is available at http://news.cnet.com/8301-11128_3-9947454-54.html. It should be read together with the interview with the company's chief financial officer, available at <http://www.accountancyage.com/accountancyage/features/2216626/profile-james-thompson-fd>
- Wuppertal Institute's Wolfgang Sterk has published a paper "From Clean Development Mechanism to Sectoral Crediting Approaches – Way Forward or Wrong Turn?", essentially cautioning that sectoral approaches are no cure-all. He proposes top-down methodology development. Download the paper at http://www.jiko-bmu.de/files/inc/application/pdf/policy_paper-cdm-post-2012.pdf
- Four case studies on potential CDM transport and biofuel projects in large Asian cities are available at http://www.curb-air.org/proj_res/
- Harvard's Joe Aldy, Robert Stavins discuss "Economic Incentives in a New Climate Agreement" <http://belfercenter.ksg.harvard.edu/files/RS-JA%20Paper%20Economic%20Incentives%20080430.pdf>
- IGES' databases on CDM and JI projects are getting more and more sophisticated, reaching the quality of commercial databases. Now, even the grid emissions factor used by each project is included! Moreover, CDM in Charts has been updated to include EB 39 results. A must-read at http://www.iges.or.jp/en/cdm/report_kyoto.html

Other news

- Carbon Expo had a record of 3000 participants, an increase of 600 compared to 2007. 258 companies participated in the exhibition. Next year's Carbon Expo will be held in Barcelona from 27 – 29 May.
- The lawyers who developed the CERSPA CER sales contract that tries to have a balanced distribution of rights and penalties between seller and buyer are preparing a second version and invite inputs and comments to t.chagas@climatefocus.com

Country of the month: Norway

Norway was crucial in introducing the concept of project-based mechanisms into the UNFCCC negotiations in 1991. It also played an important role in the AIJ pilot phase during the mid-1990s when it supported several projects in Costa Rica. But then, the government somehow went into hibernation from which it only recently surfaced. This was due to Prime Minister Stoltenberg embracing the concept of “carbon neutral” Norway, which meant that by 2030 the Norwegian emissions target should be zero. Market mechanisms would be the key to achieving this far-reaching goal. And with a stroke of the pen, small Norway got the biggest budget of any country for acquisition of CERs and ERUs – 500 million Euro! In autumn 2007, the acquisition programme was launched through the website www.CarbonNeutralNorway.no and has the aim of buying 30 to 35 million tons for delivery during 2008-2012. The first acquisition of 1 million CERs from a 200 MW Chinese hydropower plant led to an intense discussion in Norwegian media about the role of the CDM in Norwegian climate policy in general and additionality of CDM projects. Therefore, the Norwegian Ministry of Finance held a seminar on Norwegian CER acquisition policy on May 22, whose webcast is available at: http://media01.smartcom.no/Microsite/dss_01.aspx?eventid=3123 .

In contrast to government, Norwegian private business has consistently pioneered the CDM market. Norway is the home of PointCarbon, the leading information provider in the carbon markets and DNV, the market leader of DOEs. The think tanks CICERO and Fridtjof Nansen Institut provided important inputs on CDM-related research in the early years of the Kyoto Protocol.

Number of the month

5%: CER import cap floated in the current version of the Warner-Lieberman bill, seen as lifeline by many in the CDM business

CDM counter (as of June 1, 2008)

- Pending large-scale baseline methodologies: 39
 - of which forestry: 0
- Pending small-scale baseline methodologies: 8
- Approved and published large-scale baseline methodologies: 76 (including 15 consolidated ones)
 - of which forestry: 10 (including 1 consolidated one)
- Approved and published small-scale baseline methodologies: 35
- Notified DNAs: 131 (105 host countries, 26 buyer countries)
- Companies applying to become operational entity: 25
- Accredited operational entities: 18
 - Of which 7 for verification
- Projects currently open for public comments on PDD: 176
 - Of which 0 are PoAs
- Projects that are undergoing and have undergone the public comment period: 2385
 - Of which 39 have officially applied for registration
 - for 32 of which a request for review has been launched
 - Of which 51 have to make corrections
 - Of which 21 are undergoing review
 - Of which 66 have been rejected
 - Of which 15 have officially been withdrawn
 - Of which 2 are PoAs
- Expected CERs until 2012 from those projects: 1360 million
 - Of which 24.1 million from those that officially applied for registration
 - Of which 55.8 million from projects with request for review and corrections requested

- Of which 14.9 million from those undergoing review
 - Of which 45.4 million from rejected ones
 - Of which 5.0 million from withdrawn ones
 - Registered projects: 1079
 - expecting 1319 million CERs by 2012
 - Of which 0 are PoAs
 - Host countries: 50
 - Buyer countries: 20
 - Issued CERs: 148.8 million
 - Projects with issued CERs: 347
 - CER price: 1.5-5 Euro for post-2012 vintages, 8-10 Euro for medium-risk forwards, 10-13 Euro for low-risk forwards, 10-14 Euro for registered projects, 14-16 Euro for issued CERs, 17.9 Euro Dec. 2008 future price on Nord Pool exchange
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