



Annex 3

THE APPLICATION OF E+/E- POLICIES IN THE ASSESSMENT OF ADDITIONALITY

Working paper for policy discussion by the Executive Board

A. Background

1. The CDM modalities and procedures require that national/sectoral policies be taken into account in the establishment of a baseline. However noting that this may create perverse incentives for the adoption of policies which contribute to the ultimate goal of the Convention the Board, at its twenty-second meeting (Annex 3), adopted clarifications which defined two forms of national/sectoral policies.
2. The first form of policies are those which give comparative advantage to more emissions intensive technologies or fuels (E+). These policies can only be accounted for in establishing the baseline scenario if they were in place prior to the adoption of the Kyoto Protocol (11/12/1997). The rationale for this is to prevent Host Parties adopting policies which create artificial baseline scenarios for proposed CDM project activities.
3. The second form of policies are those which give comparative advantage to less emissions intensive technologies or fuels (E-). The impacts of these policies can be excluded in establishing a baseline scenario if they have been implemented since the adoption of the Marrakesh Accords (11/11/2001). The rationale for this is to ensure that the CDM does not create a perverse incentive for Host Parties not to introduce policies which would contribute to emission reductions.
4. When adopting version 5 of the Additionality Tool at its thirty-ninth meeting the Board included a footnote to the calculation of financial indicators in investment analysis which stated that the inclusion of subsidies as revenues in investment analysis would be subject to the Board's guidance on E+/E- policies.
5. At its fifty-first meeting the Executive Board requested the secretariat to draft Guidelines for the consideration of the E+/E- policies in the demonstration of additionality for consideration at a future meeting. This document elaborates the current understand of the Board's requirements to serve as a basis for a policy discussion which will inform the secretariat in drafting the requested Guidelines.

B. Issues in application of the current guidance

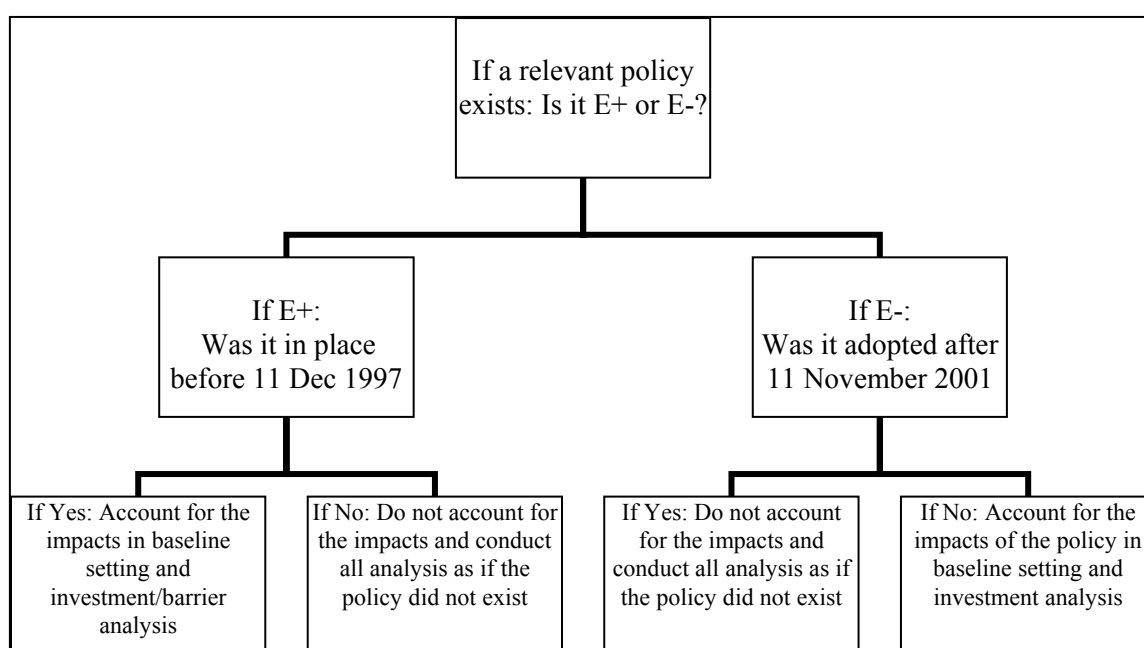
6. To date the Board has not provided guidance regarding how the extent of a subsidy should be calculated. In many cases, such as direct investment subsidies, such guidance may not be necessary. However for policies such a differentiated tariffs the precise extent of the subsidy may not be simple to estimate. More complex support mechanisms such as efficiency standards, renewable portfolios, or tax-related incentives can also be difficult to assess in terms of the direct subsidy. Examples:
 - (a) A mandatory energy efficiency standard for new buildings can be considered an E- policy, however it has no direct subsidy and could distort the costs of the project activity and baseline to the extent that it may no longer be possible to assess the additionality of the project activity;
 - (b) The subsidy of a feed-in tariff or renewable portfolio standard will be difficult to assess as it will be directly related to the future costs of fossil fuel based power generation and, in the case of renewable portfolios, to future increases in the portfolio standard;

7. Furthermore the additionality tool also requires that other non-market costs and benefits of the project be included in investment analysis when a public investor is involved and such non market valuation is standard practice. This guidance will also be applicable in case public investment/involvement in the project activity comes in the form of a subsidy given that the subsidy will be designed to leverage these non-market benefits.

C. Framework for application of E+/E-

8. The secretariat considers that the implementation of the Board's current guidance should take the form as described in figure 1 below.

Figure 1. Determination of the treatment of national/sectoral policies or measures



D. Issues for consideration by the Executive Board

9. The Executive Board may wish to consider:
- Whether the "decision tree" outlined in Figure 1 above correctly reflects the Board's understanding of the current guidance;
 - Whether differentiated tariffs for renewable and non-renewable energy can be considered to be an E+/E- policy;
 - Whether the proposed guidelines should be drafted in a broad manner to address a wide range of potential policies or drafted to be focused on specific known policies.
