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**RE: Proposal for an enhanced barrier test for project activities that have a potentially high profitability without CER revenues**

EcoSecurities welcomes the opportunity to provide inputs on the proposal for an enhanced barrier test. Whilst we appreciate the need to maintain strict additionality rules, we feel that there are certain aspects of the proposed test that may be difficult to implement in practice. The Board has requested input on the following 3 aspects:

**(a) What are the criteria for a highly profitable project activity?**

Profitability of projects depends on a large number of very complex factors, and can only realistically be assessed on a project-by-project basis. Profitability is dependent on technology, but also on location, and the type of entity developing the project. Profitability can be understood based on 2 aspects: the rate of return of a project, and the risk associated with developing it (which influences the benchmark or hurdle rate).

*Rates of return* differ greatly from project to project, even amongst projects using the same technology in the same country: for example a waste to energy project that supplies captive power to a facility may have a higher return than one which supplies energy to a grid, since the captive power plant will offset electricity imports (normally at a higher price than the tariff the grid company buys electricity at).

*Risks* vary enormously from project to project, and include country risk, technology risk, equity risk and financing risks. A project with a perceived 'high' return may be attractive in one location, and not attractive in another, due to the differing levels of risk. Similarly even within the same country, a project may be attractive to one developer (e.g. a government entity which has a low expected return on investment), and not to another (e.g. a private company).

**(b) What project activity types can potentially be highly profitable without CER revenues and as such should be subject to an enhanced barrier test?**

As discussed under (a), it seems problematic to use a sector-based approach to classify potentially highly profitable/attractive projects. Providing a top-down listing of profitable technologies does not take into account the project specific context in which they are developed. A classification could perhaps be workable if it took location-specific factors into consideration, principally prices (of grid electricity, raw materials, fossil fuels etc). Project activities using certain technologies and being developed in a region in which high prices prevail can be considered as more profitable than others in regions in which relatively low prices apply. However, such an approach still only addresses the *rate of return* and does not address the specific *risks* as discussed above.

If the Board decides to go in the direction of top-down additionality determination, then an alternative option would be to consider the common practice and market penetration rates of clean technologies in certain regions as a more objective way of determining both additionality and baseline, rather than considering the profitability of projects which is more subjective and does not address the issue of baseline determination.

**(c) How project participants can demonstrate that their project activity with a potential for high profitability without CER revenues still faces barriers?**

1. Demonstrate the project is the first of its kind:

This concept needs to be further clarified. If there hasn't been any other project using a *similar technology* at a *similar scale* in the region, then the CDM project activity should be considered as a 'first-of-its-kind'. Furthermore, any project which was developed with support from development aid money should be excluded from the analysis because it cannot be said to have been developed under *similar circumstances*.

2. Demonstrate that barriers cannot be alleviated by potentially higher revenues:

In practice, in order to demonstrate that a barrier "cannot be directly alleviated...by the potentially higher financial revenues of the project activity but will be alleviated by the CDM", one has to show that the CDM is not only bringing even higher financial revenues, but can also bring other *non-monetary co-benefits* such as:

1. *Prestige benefits*: CDM projects act as highly visible flagship projects with national and UN approval. This brings added prestige and enhanced communication of the co-benefits, and is a major motivation for many project developers (e.g. local/national governments/state companies, private companies with strong corporate social responsibility agenda) who are not only motivated by financial reasons but also by environmental concerns and other development benefits. In some cases, even projects which may be highly profitable would not happen without these additional prestige benefits, which are greatly increased by CDM registration and UN recognition.
2. *Involvement of carbon market actors*: many projects have been made possible (technically or commercially) by a carbon market actor who wouldn't have been involved in

the absence of the CDM. For instance, some landfill gas to electricity projects could be profitable in absence of CDM but are not undertaken either by the landfill owners (e.g. because they are not familiar with the technology or do not have a strong commercial-oriented culture) or by other landfill/electricity operators (because of lack of information/market failure, or perceived risks that outweigh any financial incentive). On the other hand, carbon market actors are primarily interested in carbon credits, and understand the market in high-risk technologies, and thus are often more willing to take on risky projects. They may also in some cases have the most technical expertise in a particular project type, having replicated it elsewhere.

3. *Enhanced revenue stream*: CDM money is a different type of revenue from other revenue streams of the project, in that it:
  - Is more secure/guaranteed (e.g. through a secure emission reduction purchase agreement);
  - Is denominated in a different currency (EUR or USD, versus other revenues in local currency), helping to overcome currency risk; and
  - Diversifies and hedges conventional project revenues, therefore decreasing overall project risk.
  
4. *Increasing investor confidence*: eligibility of a project under the CDM, and the involvement of international carbon market actors increase investor confidence. In many cases, loans or investment can only be obtained after investors are assured of progress towards CDM registration. Sometimes loans/investments can only be obtained because of involvement of a carbon market actor (e.g. acting as guarantor or simply as a trustworthy partner).

Our experience from over 130 registered CDM projects shows that these CDM “co-benefits” (i.e. not just CDM money) do play an important role in the decision to go ahead with many projects. However, as they are less tangible than monetary benefits, it is often difficult to show in an objective, transparent and documented way that they are a decisive element in the decision to do the project – and this will often be open to interpretation.

In conclusion, we anticipate that an enhanced barrier test will be difficult to properly target, given the difficulties outlined above in developing criteria that reflect both project risk and rate of return, which will make it hard to select appropriate project types. Any top-down list of technologies will be a blunt instrument resulting in many projects being inappropriately included in the enhanced test. Furthermore, in order to fulfil the test, it may be necessary to demonstrate convincingly the co-benefits derived from registration as a CDM project, however many of these benefits are difficult to quantify, and therefore a qualitative assessment must be accepted, and only a lower level of assurance will be possible. At the very least the EB should officially acknowledge the importance of the other co-benefits of CDM, and specify what kind of evidence and level of assurance would be acceptable in order to demonstrate their existence, otherwise we are concerned that the demonstration of these co-benefits will present an insurmountable barrier to the development of worthwhile and additional projects which from the economic point of view are particularly attractive. Needless to say that CDM as a carbon market instrument such foster the implementation of

particularly such projects as long as they are additional and not to exclude them or making access to the carbon market more difficult.

We sincerely hope that the Board takes these comments into consideration when deciding whether to implement such an enhanced test. However, if such a test is developed, it should be structured in a way that takes into account the above concerns. We also feel that such a large change to additionality requirements should necessitate a new version of the additionality tool, rather than just an update in guidance.

Finally, in parallel to tightening the process for project types that are perceived to be 'highly profitable', we also encourage the Board to consider simplifying the additionality requirements for project types that are considered to be very additional and desirable. This would particularly benefit those project types and countries that have so far received little CDM investment.

Yours sincerely,



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