Head and Members of the CDM Executive Board
UNFCCC Secretariat
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Re: Proposal for an enhanced barrier test for project activities that have a potentially high profitability without CER revenues

We warmly receive the efforts and activities to critically review and improve the additionality guidelines to prevent unintended use and effects of the Clean Development Mechanism.

As we understand the EB has requested the Meth Panel to advice on how to deal with project activities, where project participants for demonstrating additionality choose to only use the barrier test, while it can also be anticipated that the project activity - even without the revenues of CDM - is highly profitable[1].

General comment

Within the present CDM additionality framework it is not possible to determine what can be characterized as “highly profitable” due to the omission of the measurement and quantified assessment of risk. The request does imply that concerns exist that certain projects that are not additional in reality could receive CERs by using the qualitative barriers test route.

We share the concerns of the EB. From our experience, we have observed that for projects for which additionality is not easily demonstrated using the investment analysis method, tend to use the barriers test. It provides the benefit of reducing the transparency of the project dynamics and increases the chances of obtaining approvals. This is not always done intentionally, for a large part this comes from the lack of knowledge with project participants and developers in estimating and quantifying risks.

This is further supported by the lack of guidance on incorporating analysis and valuation of risks in the investment analysis. The value and impact of potential barriers is easily demonstrated if the correct financial and statistical tools are applied as used in other (regulated) sectors.[2]

We would like to advise the Meth panel and the EB to not exclude project participants of the obligation to financially analyze and demonstrate additionality when they choose the barrier test approach. Ideally the Additionality tool should include tools and techniques to demonstrate the value of barriers to invest or operate in the investment analysis.

The AT and the EB request underlying this response is focused on the revenue benefit for projects of CDM. It is now time to expand and quantify the risk reduction effect of CDM.

Regarding the Proposal

We have structured our further response according to the proposal in order to keep in line with the work already done.

(a) How to identify the category of project activities to which this concern might be potentially applicable?

COMMENTS: Before selecting projects it seems critical to identify the criteria that will be used to identify unwanted projects instead of categories. From our observations, project developers and participants are still uncertain on how to effectively demonstrate a reasonable relation between risk and profitability. It is therefore appreciated if the term “highly profitable” could be further defined,

[1] As described in the Thirty-third meeting report of the CDM Panel
[2] Further in detail comments and tools and techniques are available on request.

incorporating risk. These criteria could be identified after the mismatch between the additionality principles and the observed profitability has been mapped.

(b) How to screen these project activities with a view to excluding non-additional project activities, which only use the barrier test.

COMMENTS: It is difficult to learn and further develop the screening process if the use of a barrier test omits the obligation to provide quantified investment information, including the project specific risk or barrier that the CDM can overcome.
The information should at minimum include the financial value and effect of the CDM approval. This could be the value of reducing the currency risk (hedging value), technology risk (venture capital approach) and operational risk (additional costs /insurances). The effort required to provide this information is minimal and gives the CDM panel the insight needed to further analyze the request.

(c) How to implement and present the results to PPs and DOEs.

COMMENTS: Add additional tools and insight in how to measure, estimate and quantify the risks discussed in the barrier tests. This could be the use of Value at Risk (VAR) methods or an adapted Real option approach. Additionally the further development of the "benchmark" approach used could reduce the uncertainties that can be observed in arguing a reasonable rate of return. This could be strengthened by providing the cost of capital for technologies /sectors and countries that could be used as reference for a project specific rate to attract financing.

With Kind regards,

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