Our comments on the WACC tool and a mark up of suggested changes to the tool is provided below:

1. **WACC tool conflicts with the Kyoto Protocol, the Marrakech Accord and The Executive Board's Guidance Investment Analysis and the Additionality tool**

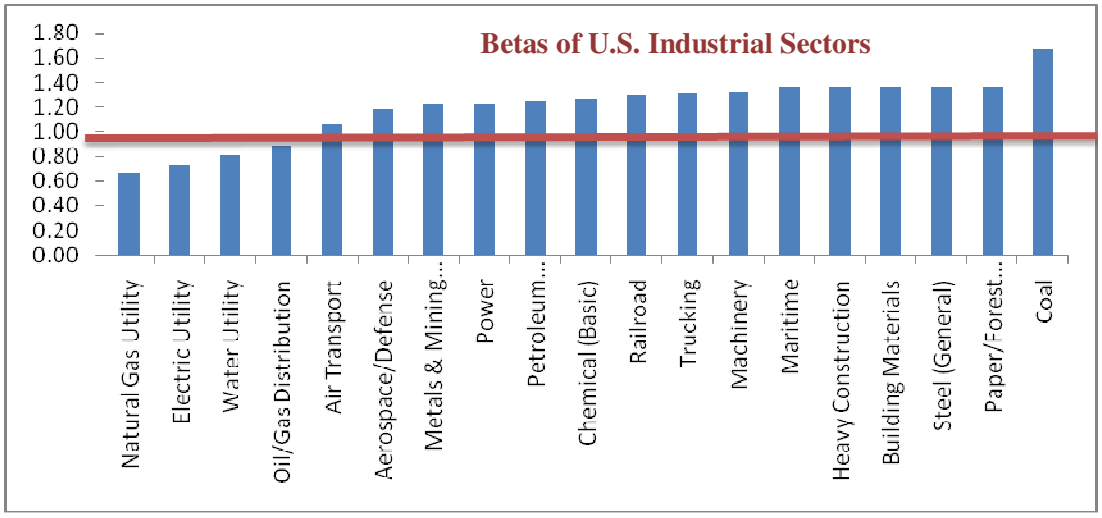
The concept of a generic country level benchmark goes against the Kyoto Protocol and the Marrakech Accord. Both Marrakech Accord (Para 43) and the Kyoto Protocol (Article 12) require Additionality to be demonstrated at a project level; consequently the benchmark used for demonstration of Additionality should also be determined at a project level considering the risks of investment and not at a country level, as has been proposed by the WACC tool.

We also wish to draw attention of the Executive Board and the Meth Panel to the Guidance on Investment Analysis (Para 12) and the Tool for Demonstration and Assessment of Additionality (Clause 5) which clearly set out that: *"the applied benchmark must be suitable for the specific proposed project activity, It is not suitable to compare the return of low risk investments with the returns achieved or achievable by higher risk investments".*

2. **The Benchmark approach ignores the sector risks, thereby creating a bias in assessment and demonstration of Additionality**

Equity investment risks in a project can be decomposed into three component, country risk, sector risk and project specific risk. The proposed approach assumes the Country Default Spread to be a proxy measure of the Country risk and requires the project risks to be accounted for in the cash flow analysis. The sector risks (denoted by Beta in common financial parlance), have been completely ignored.

One of the founding premises of all risk return models in prevalence is that different sectors within an economy carry different levels of risk, depending on their sensitivity to national and international developments. Basic service providers like electricity, water utilities etc carry lower risks as compared to sectors like transportation, construction and infrastructure that have greater sensitivity to economic cycles. Data on beta value of different industry sectors in the U.S. economy provides a clear illustration of this.



Generally, the higher beta value, the higher is the risk, with beta of 1 indicating a risk level similar to the market. As can be clearly seen, beta values of the utilities are typically less than 1 indicating that they carry a below average risk than the market. On the other hand, infrastructure and transportation sectors are high beta sectors.

Therefore, it stands to reason that the benchmark for a project by the utilities ought to be lower than that of projects in other sector and also that of the country. However, the WACC tool assumes the benchmark to be irrespective of the sector and project type. This would mean that projects undertaken by utilities are more likely to be adjudged as additional, because of a higher than required benchmark, whereas projects by other sectors would suffer from a lower benchmark than what is appropriate. Clearly, the WACC tool creates a strong bias in favor of projects by utilities that are relatively less sensitive to market movements (Beta of less than 1) while penalizing projects undertaken by other sectors.

Economic theory is clear that Public sector investments carry low risk. As noted by Bailey and Jensen (1972) [http://faculty.london.edu/icooper/assets/documents/InvestmentAppraisal.pdf] the risk profile of investments taken by the public sector entities would be lower because (a) these are supported through public funding which means that the risk of public sector projects are actually distributed over the entire population, (b) Government ownership can serve to eliminate risks to a very large extent, further averaging of risks for public projects is accomplished without any costs of extra financial transactions, (c) private sector firms generally borrow at a higher rate of interest than does the Government. The distinction that public sector entities have low risk of investment and hence lower benchmark is not recognized in the WACC tool, which can lead to overestimation of benchmarks for public sector projects.

The assumption that all sectors and investors undertake the same degree of risk may be a departure from principles of investment and the reality.

3. **The assumption that project specific risks can be accounted for in the Cash flow analysis is not consistent with the existing guidelines for Investment Analysis.**

Paragraph 11 of the Tool for Demonstration of Additionality states that: *"the investment analysis provides a valid argument in favour of Additionality only if it consistently supports (for a realistic range of assumptions) the conclusion that the project activity is unlikely to be the most financially/economically attractive"*

The Sensitivity Analysis is carried out considering reasonable variations in key parameters and the project is adjudged as Additional only if the IRR remains below the benchmark even when optimistic values of the project assumptions are considered. For example: a project, that generates a return of 15% as a favorable case (with benchmark of 12%) and a negative return in the adverse scenario, may still be considered as non-additional. Therefore, even though the risks can be factored in the cash flow analysis, the requirements of sensitivity analysis are such that the IRR must remain below the benchmark under the most optimistic conditions that in all likelihood do not consider the projects risks. This clearly goes to show that even if the project risks were considered (being mindful that risks are scenario based), an optimistic project scenario would still need to be analyzed as a sensitivity case in order to demonstrate Additionality.

Also, as a matter of principle, only conservative values of assumptions are considered; which negates the premise of adjustments to cash flows to account for risks. Further, even though as a matter of convention, sensitivity is also carried out for negative variations in key parameters, these are not considered for Additionality assessment.

It is also important to note that risk analysis at a cash flow level will have high level of subjectivity and the information required for validation of these adjustments may not necessarily be available in public domain. For example, financial results and information published generally carry information for the company as a whole or for a particular business segment. Data on actual performance of projects or Project wise profitability, to assess the extent to which risks have materialized, are most certainly not published even in the most developed and transparent market economies let alone the developing countries where CDM takes place.

Most text books and academic literature recognize this difficulty and advocate for risk to be factored in calculation of hurdle rates i.e. benchmark. Hence, the project specific risks are best addressed through the discount rate i.e. Benchmark rate.

We would therefore request the Executive Board to review the understanding that project specific risks can be accounted for in the Cash Flows.

4. Why a generic ERP cannot be applied across countries

As a concept, the Equity Market Risk Premium is perhaps one of the simplest, representing the difference between returns from a risky equity asset and a risk less asset. However, the assumption that the global equity risk premium should be applicable to investments world-wide is in-principle a flawed one and goes against the finance theory and practice. While we understand that the Meth Panel's objective was to arrive at a default value, the use of the global ERP undermines the basic fundamentals of investment principles and also ignores the definition of Equity Risk Premium.

By definition, the Equity Market Risk Premium comprises of the following elements:

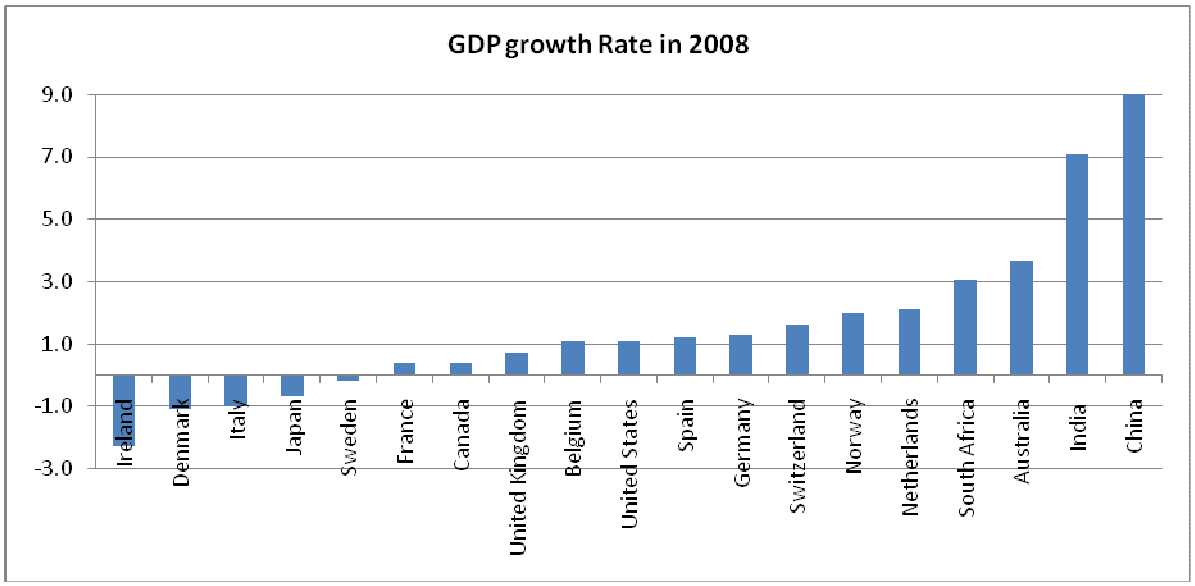
1. Growth rate of real dividends
2. Rate of expansion of P/D multiples
3. Annualized mean dividend yield
4. Real exchange rate depreciation

This can also be verified from the source "World-wide Equity Premium, A smaller puzzle" by Dimsom, Marsh and Staunton, from where the global equity risk premium is derived in the tool. We draw attention to page no. 23 of the publication [http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID891620_code254274.pdf?abstractid=891620&mirid=4]

4.1 Growth rate of real dividends

Assuming that the dividend pay-out rate remains constant over a period of time, the growth rate in real dividends would be the same as the growth rate in earnings which are in-turn strongly influenced by the growth rate in the economy and the particular industrial sector in context. The earnings growth will be higher for countries with countries with higher GDP and industrial growth rates.

The average GDP growth rate achieved by the 17 countries are presented in the chart below, alongside, we have also presented the growth rate registered by developing economies like India and China.



The GDP growth recorded by countries like India and China are more than two times that of the best performing countries in the group of 17, many of which have stagnant or contracting economies. Historical data in the recent times provides good evidence to this; not only this, the project growth rates of these countries also point towards a sustained high growth rate up to the year 2050 [http://www2.goldmansachs.com/ideas/brics/book/BRIC-Full.pdf] ranging from 7% to 9% annually. Consequently, the earnings growth rate in these countries would also be commensurate with the high GDP growth rates and significantly higher than that in the group of 17.

Given the finite life of CDM projects, which are typically 10 – 20 years, the projections of high growth would be applicable throughout the entire life cycle of the projects. A high earnings growth rate translates into a higher Equity Risk Premium and hence applying a default value of Equity Risk Premium that is based on data set of 17 mature economies (with stagnant or contracting economies), to developing countries, is not appropriate.

4.2 Real Exchange Rate Depreciation

The real exchange rate depreciation is calculated using the GDP deflator principle i.e. by comparing the real GDP growth rates of two countries over a period of time. As explained in the foregoing sections, the GDP growth rate of the developed countries considered as data set is substantially different than that of emerging countries where CDM takes place. Also, these rates are dependent on the prevailing exchange rates of different currencies and hence cannot be generalized.

Basic Economic principles mandate that the difference between economic characteristics of each country be acknowledged and considered while calculating the exchange rate depreciation. There is no such thing as a generic depreciation rate that can be applied across countries or across currencies. In light of this, we request the Meth Panel and the Executive Board to review the applicability of a generic ERP to projects all over.

5. WACC tool considers Country Default Spread to be the same as Country Risk Premium, which is incorrect.

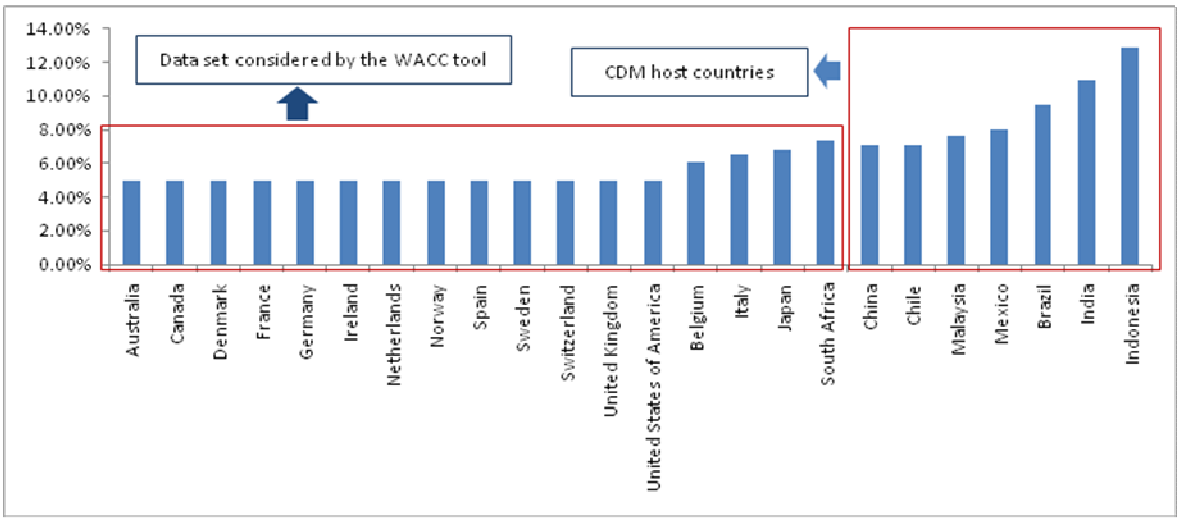
Dr. Aswath Damodaran, one of the foremost authorities on risk return models, provides a clear description of how to estimate country risk premium in his publication [http://www.stern.nyu.edu/fin/workpapers/papers99/wpa99021.pdf]. Dr. Damodaran writes: *The Country risk measure is an intermediate step towards estimating the risk premium to use in risk models. The Country Default Spreads provide an important first step but still only measure the premium for Default Risk. Intuitively we would expect the Country Equity Risk Premium to be larger than the Country Default Risk spread. To address the issue of how much higher, we look at the volatility of the equity market in a country relative to the volatility of the country bond, used to estimate the spread. This yields the following estimate for the country equity risk premium:*

$$\text{Country Equity Risk Premium} = \text{Country Default Spread} * \left(\frac{\sigma_{\text{Equity}}}{\sigma_{\text{Country Bond}}}\right)$$

Where:

$\left(\frac{\sigma_{\text{Equity}}}{\sigma_{\text{Country Bond}}}\right)$ = Annualised standard deviation of the equity index/Annualised standard deviation of the Government bond

Dr. Damodaran has calculated the equity risk premium for a number of countries. We provide a snap-shot of the equity risk premiums for the 17 countries considered in the WACC tool and that of the key host nations to CDM is provided below for comparison.



As can be seen, the average equity premium for the matured economies is about 5% whereas the risk premium for developing countries ranges from 7.1% to 12.8%.

The WACC tool assumes the Country Risk Premium to be same as the Country Default Spread, which is incorrect since the CDS only captures the default risk. It also means that the WACC tool considers the risk of investing in equity to be the same as the risk of investing in the risk free rate. This is a clear contradiction of basic principles of finance.

It is also important to note that while the publication THE WORLDWIDE EQUITY PREMIUM: A SMALLER PUZZLE - Elroy Dimson, Paul Marsh, and Mike Staunton - London Business School [[http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID891620_code254274.pdf?abstractid=891620&mi

rid=4] estimates the Equity Risk Premium for the rest of the world, it does not provide any opinion on the blanket applicability of the same across different countries. On the other hand, there are numerous academic research and publications which unequivocally advocate separate risk premiums for different countries; especially higher for emerging economies. For instance, if we consider the case of India, as per "The Equity Premium in India" by Rajnish Mehra, University of California, Santa Barbara and National Bureau of Economic Research, January 2006, shows that this premium equals 9.7% (returns on Sensex) over 1991-2004.

The above is not without reason though; investment is one of the basic pre-requisites of economic growth and therefore the equity risk premium of high growth countries needs to be higher in order to attract investment flows. For example, if the equity market risk premium in India would be the same as the equity market risk premium in Sweden, Investors would be indifferent when it comes to choosing an investment destination between the two nations. This understanding also finds its place in the academic paper used by the WACC tool. "The Worldwide Equity Premium: A Smaller Puzzle" by Elroy Dimson , Paul Marsh and Mike Staunton, London Business School states that In 1792, Dutch and UK markets were 190 and 94 years old. The NYSE was 1 day old. Share of global equities was 0%. In 2006, US share of global equities was 48% and cites the reason for growth as the higher equity premiums offered by the U.S. market.

6. The academic paper cited in the WACC tool does not consider data for emerging markets that are host to CDM projects

The research paper cited in the "The Worldwide Equity Premium: A Smaller Puzzle" by Elroy Dimson , Paul Marsh and Mike Staunton, London Business School also states that data for countries like Russia, Austria – Hungary, India, China, Latin America have not been considered in the analysis.

In any case, a generic Equity Risk Premium should not be applied across the board.

7. Why Equity Risk Premium over 106 years should not be applied to a project of 10/20 years.

Projects that apply for CDM have life periods that typically range from 10 to 20 years; hence it stands to reason that the Investor, while making the investment choice, would consider a historical investment returns over a period that is similar to the project life. A 106 year time horizon may seem appropriate from a macro economic perspective, but the application to a 10 year or a 20 year project creates a severe erroneous timing mismatch; one that is unlikely to be accepted by the investing community.

This also ignores the important premise that Investor preferences and risk aversion changes with markets and over time; simply put, Economic climate of a country determine the choices that an Investor has and therefore strongly influence the risk-return preferences. To quote an example, pre – 2000, dotcoms were seen as lucrative yet safe avenues for investment, the situation reversed completely after the tech crash in 2000. To assume that an Investor in India in the year 2010 would consider the same Equity Risk Premium as that of an Australian Investor in the year 1935, is not only incorrect but also unrealistic.

To summarize, investment decisions are always based on conditions that are more recent and hence relevant from a risk-return perspective.

8. The generic ERP provides unrealistic estimates of Benchmark

We take the case of India to illustrate the foregoing arguments. If the WACC tool is applied, the benchmark for projects in India would work out to about 11%. Equity investors, not only bear the risk of investing into the project, but also invest their time and effort to secure the projected returns on investment. On the other hand, there are a number of passive investment opportunities, which provide similar or higher returns without any corresponding increase in risk. We cite some of these sources below:

Asset Class	Annualized Return over last 10 years	Standard deviation
Gold	14.84%	13.03%
Bank Deposit Rate	7.29%	1.33%
Long term Government Bonds	8.33%	1.77%

As can be seen, if the data for the matured economies is applied to India, it completely negates the rationale for equity investments. If the 11% benchmark number is considered, Investors will be better off investing in passive investments like Gold which provides better returns at a lower risk.

We however would like to thank the Meth Panel and the Executive for taking initiative to standardize the benchmark approach. We believe a certain modifications to the WACC tool would help address the issues discussed above, the suggested changes are provided below as mark ups to the WACC tool.

Methodological Tool

"Draft tool to determine the weighted average cost of capital (WACC)"

(Version 01)

I. DEFINITIONS, SCOPE, APPLICABILITY AND PARAMETERS

Definitions

For the purpose of this tool, the following definitions apply:

Discount rate: The discount rate is the interest rate used in discounting future cash flows in a project financing assessment; it is also called capitalization rate or hurdle rate.

Legal entity: It is the organization that is officially registered[1] in the host country of the CDM project and that has all the assets and working capital of the proposed CDM project activity in its accounting books. The legal entity may be privately or state owned company.

Credit Rating: A rating assigned by an independent credit rating agency. An opinion of the future ability, legal obligation, and willingness of a bond issuer or other obligor to make full and timely payments on principal and interest due to investors. The opinion is based on a qualitative and quantitative analysis by the rating agency.

Debt/Equity Ratio or Debt-to-Equity Ratio: The ratio of a firm's debt to its equity. In a project scenario this represents the project's ratio of debt to equity. The ratio is usually expressed as a relative proportion, as in 50/50, 60/40 or 70/30. The higher this ratio, the greater the financial leverage and financial risk (that is, risk of illiquidity and insolvency) of the firm.

Equity: Net worth; assets minus liabilities. The stockholders' residual ownership position. The capital invested in a business venture without a contractual obligation from the business venture for repayment or servicing. In project financing, this is the cash or assets contributed by a sponsorer.

Scope and applicability

This methodological tool provides procedures to determine the weighted average cost of capital. It can also be used to determine only the cost of equity or the cost of debt.

The WACC or its components are required in an investment comparison analysis or a benchmark analysis for the purposes of determining additionality or selecting the baseline scenario. The WACC can be used as financial benchmark and be compared with financial parameters of an investment alternative, such as the internal rate of return (IRR) among others, or it can be used as discount rate in calculating financial parameters of an investment alternative, such as the net present value (NPV) or the levelized costs of production.

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[1] The minimum condition is registration at the local Internal Revenues Service or equivalent agency.

Any investment analysis must be done in the same currency selected for the WACC calculation. All cash flows for income, expenses, costs, etc must be standardized using a single currency or reasonable equivalent in the timeframe of the assessment.

Parameters

This tool provides procedures to determine the following parameters:

Parameter	SI Unit	Description
r	-	WACC
k_d	-	Average cost of debt financing
k_e	-	Average cost of equity financing

Note: No methodology-specific parameters are required.

II. METHODOLOGY PROCEDURE

The weighted average cost of capital (WACC, *r*) is calculated as follows:

$$r = w_d K_d (1-T) + w_e K_e \quad \textbf{(1)}$$

Where:

r	=	WACC
w_d	=	Percentage of debt financing
w_e	=	Percentage of equity financing
k_d	=	Average cost of debt financing
k_e	=	Average cost of equity financing
T	=	Applicable corporate tax rate

The parameter r calculated as above is to be considered as an after-tax benchmark/discount rate i.e. the economic/financial analysis using this parameter shall include the corporate tax expense.

The WACC or its components should be calculated in the same terms (real or nominal) as in the investment comparison analysis or benchmark analysis.

Apply the following steps to determine the k_d, k_e, w_d, , w_e and T.

Step 1: Determine whether r is estimated based on the situation of the entity undertaking the project activity or based on standard market expectations for the project type

Document and justify in the CDM-PDD which of the following two situations applies to the project activity:

(I) The project activity can only be implemented by the project participants and not by an entity other than project participant, or

(II) The project activity could also be implemented by entities other than the project participants.

Where case (I) applies, the financial discount rate or financial benchmark shall be determined based on the specific financial/economic situation of the entity undertaking the project activity.

Where case (II) applies, the financial discount rate or financial benchmark shall be determined based on parameters that are standard in the market, considering the specific characteristics of the project type, but not linked to the subjective profitability expectation or risk profile of a particular project developer.

Step 2: Determine the status of the legal entity that will host the project activity assets

Where case (II) in Step 1 applies, document and justify in the CDM-PDD which of the following two situations applies to the project activity:

(a) The accounting books of the legal entity reflect at least the total value of all the assets needed for the project activity; or

(b) The accounting books of the legal entity do not reflect the total value of all the assets needed for the project activity.

If case (a) applies, w_e and w_d will be determined based on the accounting books of the legal entity. If case (b) applies, the default debt-equity ratio should be applied.

Step 3: Determine the average cost of debt financing (k_d)

Use one of the following options to determine k_d:

Option 3A: Use the weighted average cost of debt financing of the legal entity

This option can be used if:

- Case (I) in Step 1 applies;
- Case (a) in Step 2 applies; and
- The legal entity owning the project assets uses some form of debt financing with a maturity of more than one year. [2]

Under this option the project participants should document the following:

- For **bonds:** the key parameters of the bond including time to maturity, yield, registration issuance in the financial system and set-up in the market.
- For **loans from a financial institution:** the contract of lending between the financial institution and the legal entity owning the assets of the project activity. In absence of the contract, provide a letter from the bank stating its intention to award the loan and the key terms for the loan.
- If the legal entity uses **debt financing from a parent company** (corporate treasury or headquarter), the transfer of capital to the legal entity must be documented with:
    - The parameters of the corporate bonds as mentioned above. This option is only valid for corporate bonds issued in the host country of the CDM project;
    - The contract of lending between the parent company and the legal entity owning the assets of the project activity.

The parameter k_d should be calculated as the weighted average cost of debt funding of the legal entity owning the project activity. For bonds, use the weighted average yield of the bonds during the last three months prior to the submission of the CDM-PDD for validation or prior to the investment decision, whichever is earlier. For loans, use the weighted average cost of outstanding long-term debt.

[2] Debt with a maturity below one year is typically current debt with different interest rates than the interest rates of long term debt and should not be considered in the analysis.

Option 3B: Use the cost of debt of the financial system

This option can be used if:

- Case (II) in Step 1 applies; or
- Case (I) in Step 1 and case (b) in Step 2 apply and the debt finance structure for the project is not yet available (e.g. a letter of intent for debt funding is not yet available).

The parameter k_d should be calculated as the cost of financing in the capital markets (e.g. commercial lending rates and guarantees required for the country and the type of project activity concerned), based on documented evidence from financial institutions with regard to the cost of debt financing of comparable projects. In the case this data is not available, use the commercial lending rate in the host country for the calculation of k_d.

Option 3C: Use the cost of government bond rates as cost of debt

This option can be used if:

- Case (II) in Step 1 applies; or
- Case (I) in Step 1 and case (b) in Step 2 apply and the debt finance structure for the project is not yet available (e.g. a letter of intent for debt funding is not yet available); and
- The government of the host country has issued at least one bond.

The parameter k_d can be assumed as the yield of a 10 years bond issued by the government of the host country or, if this is not available, the bond with the maturity which is closest to 10 years.

Step 4: Determine the average cost of equity financing (k_e)

Option 4A: Use the average global expected equity return

This option can be used if:

- Case (I) or (II) in Step 1 applies.

This approach represents an estimated equity return based on a average historical global equity risk premium.

The parameter k_e is calculated equivalent to a risk free rate (calculated as the yield of a government bond issued by the host country minus the country default spread) plus a global equity risk premium, as follows:

$$K_e = [GB_i - CDS] + PE_g \times (\sigma_e/\sigma_b) \times (\beta) \quad \textbf{(2)}$$

Where:

k_e	=	Average cost of equity financing
GB_i	=	Yield of a government bond issued by the host country
CDS	=	Country Default Spread
PE_g	=	Global equity risk premium
σ_e		Standard deviation of the equity market Index
σ_b		Standard deviation in Government bond returns
β		Beta applicable to Project activity

The parameter K_e should be determined as follows:

- GB_i should be determined as the yield of a ten year government bond issued by the host country, as observed on average in the past 3 years prior to the preparation of the CDM-PDD . If such a bond is not available, the bond with maturity which is closest to 10 years should be used. This bond will have the following options:
  - GB_1, a bond issued in USD terms;
  - GB_2, a bond issued in local currency of the CDM project host country;

- ~~CDS is calculated from a reliable source of Country Default Spread Database, using the rating of the country hosting the CDM project. An international source with at least 5 years in the market and a clear methodology for emerging/developing economies credit rating will be used (e.g. A.M. Best, Standard & Poor's, Moody's or Fitch Ratings, among others);~~

- Assume a default value of 4.7% for the parameter PE_g.[3]

~~Note: The project risk is not included in this equation because project participants can reflect the project specific risks in the cash flow analysis in the investment comparison or benchmark analysis as laid out in the sub-step 2C, paragraph 8 of "Tool for the demonstration and assessment of additionality".~~

~~This tool may include some guidance on project risk measurement in future versions.~~

Option 4B: Use the country specific equity return

This option can be used if:

- Case (I) or (II) in Step 1 applies.

This approach provides an equity return which differentiates according to the country risk. This means that for a country with a high country risk (as reflected in its government bond) a higher equity return (k_e) will be calculated compared to a country with a low country risk.

The parameter k_e is calculated equivalent to a risk free rate plus a country risk premium plus a general equity risk premium, as follows:

$$K_e = GBi + PE_g \times (\sigma_e/\sigma_b) \times (\beta) \quad \textbf{(3)}$$

OR

$$K_e = RF + CDS + PE_g \times (\sigma_e/\sigma_b) \times (\beta) \quad \textbf{(4)}$$

Where:

k_e	=	Average cost of equity financing
RF	=	Risk free rate
GB_i	=	Yield of a government bond issued by the host country
CDS	=	Country Default Spread
PE_g	=	General equity risk premium

[3] *"The worldwide equity premium: A smaller puzzle"* by Elroy Dimson, Paul Marsh and Mike Stauntun from London Business School.

σ_e	Standard deviation of the equity market Index
σ_b	Standard deviation in Government bond returns
β	Beta applicable to Project activity

Equation 3 should be used if the government of the host country has issued a bond with a maturity of at least one year. Otherwise, equation 4 should be used.

The parameter K_e should be determined as follows:

- GB_i should be determined as the yield of a ten year government bond issued by the host country in its local currency, as observed on average in the past 3 years prior to the preparation of the CDM-PDD. If such a bond is not available, the bond with maturity which is closest to 10 years should be used;
- CDS is calculated from a reliable source of Country Default Spread Database, using the rating of the country hosting the CDM project. An international source with at least 5 years in the market and a clear methodology for emerging/developing economies credit rating will be used (e.g. A.M. Best, Standard & Poor's, Moody's or Fitch Ratings, among others);
- RF is determined as the yield of a ten year USD bond, as observed on average in the past 3 years prior to the preparation of the CDM-PDD;
- For PE_g a default value of 4.1% is used.[4]

~~Note: The project risk is not included in this equation because project participants can reflect the project specific risks in the cash flow analysis in the investment comparison or benchmark analysis as laid out in the Sub-step 2C, paragraph 8 of "Tool for the demonstration and assessment of additionality".~~

~~This tool may include some guidance on project risk measurement in future versions.~~

Option 4C: Use the specific equity expectations of the legal entity

This option can be used if:

- Case (I) in step 1 applies;
- The legal entity can document that one specific expected equity return has been consistently used in the past, i.e. that project activities under similar conditions developed by the same company used the same value for k_e.

The parameter k_e should correspond to the value consistently observed in the past for k_e. Provide transparent documentation in the CDM-PDD on the consistent use of this value in the past[5].

Step 5: Determine the percentage of debt financing (w_d), and equity financing (w_e)

Option 5A: Use the latest balance sheet under local fiscal/accounting standards and rules

This option can be used if:

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[4] *"The worldwide equity premium: A smaller puzzle"* by Elroy Dimson, Paul Marsh and Mike Stauntun from London Business School.

[5] The equity may include common stocks and preferred stock.

- Case (I) in Step 1 applies;
- Case (a) in Step 2 applies; and
- The legal entity owning the assets of the project activity has balance sheets audited by a third party within two years prior to the submission of the CDM-PDD for validation.

The values of the long term debt and equity should be taken as documented in the accounting books of the legal entity.

The parameters w_d and w_e should be determined as follows:

- w_d should be calculated by dividing the total value of the debt with a maturity above one year by the sum of (a) the total value of the equity and (b) the total value of the debt with a maturity above one year;
- w_e should be calculated by dividing the total value of the equity by the sum of (a) the total value of the equity and (b) the total value of the debt with a maturity above one year.

Option 5B: Default value

This option can be used if:

- Case (II) in Step 1 applies; or
- Case (I) in Step 1 and case (b) in Step 2 apply and the debt finance structure for the project is not yet available (e.g. a letter of intent for debt funding is not yet available).

Use a default value of 0.5 for w_d and 0.5 for w_e.

Step 6: Determine the applicable tax rate (T)

The applicable tax rate will be the official value of the corporate tax rate as issued by the *internal revenues service agency* or similar institution in the host country of the CDM project. If the Government has differentiated values according to the revenues levels of legal entity; document and justify this scale.

III. MONITORING METHODOLOGY

No monitoring provisions apply.

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History of the document

Version	Date	Nature of revision(s)
01	EB 53, Annex # 26 March 2010	To be considered at EB 53.
Decision Class: Regulatory **Document Type**: Tool **Business Function**: Methodology		