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| **To** | cdm-info@unfccc.int |
| **From** | Rachel.child@pd-forum.net |
| Date | 14 August 2011 |
| Page | 1/8 |
| Subject | **Call for input on First-of-its-Kind and common practice** |

Honorable Members of the CDM Executive Board,
Dear Mr. Hession,

As requested in EB 62, the PD Forum would like to take this opportunity to comment on the use of the first-of-its-kind barrier and the assessment of common practice.

**PD Forum Guiding Principles**

In formulating this response, the PD Forum developed the following over-arching principles:

1. The barriers associated with developing a First-of-its-Kind (FOIK) project (as described in response to questions 1a) and b) below), apply equally to projects number 2,3,4,5…n up to the point at which a technology reaches a certain market share (say 5%[1]) in the geographic area under consideration and the manufacturer attaches a guarantee of performance to the technology in question.

2. Therefore, we suggest that terminology is changed from 'first of its kind' to 'rare practice' (or 'early movers' or similar).

3. Projects that are classified as 'rare practice' can, therefore, be considered additional without the need to further demonstrate this by means of a barrier analysis or investment analysis.

4. Projects should be classified as 'rare practice' if the following criteria are met:
   (i) Market share of technology in question is <5% for the sector and geographic area under consideration
   (ii) No performance guarantee from manufacturer
   (iii) No local manufacturer and/ or no locally available expertise

5. Projects that cannot be considered prevailing practice or 'rare practice' (i.e. those with a market share of >5% but not the dominant technology) may still be additional; this will need to be demonstrated using other methods (i.e. barrier analysis or investment analysis).

[1] For example, in the case of power generation, the market share refers to the percentage of total installed capacity; in the case of waste gas utilisation projects, the market share refers to the number of sites with the technology installed as a percentage of all the sites in the geographic area under consideration.

6. Data needed to prove 'rare practice' in a particular country or region may be collected by PDs for individual projects or may be published by DNAs to promote development of CDM projects in that country/ region.

For example, grid-connected electricity generation in an Advanced Developing Country may involve the following technologies:

| | **Prevailing** | **Common** | **Common** | **Rare** | **Rare** | **Rare** | **Rare** |
|---|---|---|---|---|---|---|---|
| Technology | Coal fired power generation | oil | hydro | nuclear | Natural Gas | Wind | Solar (PV) |
| Fitness for purpose E.g. will suppliers guarantee operational performance | Highly suitable | Highly suitable | Highly suitable | Highly suitable | Highly suitable | Not suitable – local suppliers will not yet guarantee performance | Not suitable – local suppliers will not yet guarantee performance |
| Expertise available in country | Available | Available | Available | Available | Not Available | Available | Not Available |
| Available off-the shelf as opposed to imported | Yes | yes | yes | Partly | No | yes | No |
| Operational support / spare parts / maintenance availability (local / imported) | Yes | yes | yes | Partly | No | yes | No |
| % of available market which uses this technology | 79% | 8% | 8% | 2% | 0.1% | 3% | 0% |

From this analysis;

- Coal fired power generation would be considered prevailing practice
- Power generation from wind, PV and natural gas would be considered 'rare practice' and potential CDM projects using these technologies can be considered additional.
- Hydro projects could not be considered prevailing practice or rare practice and therefore additionality should be assessed on a case-by-case basis using barrier analysis or investment analysis.

In response to the specific questions raised in Annex 7 of the EB62 report, we offer the following response:

**1. First of its Kind (FOIK)**

**(a) How would you normally define "prevailing practice" and what influences the consideration of whether such prevailing practice constitutes a barrier?**

Prevailing practice is the most common situation in the sector and geography in question. For

example,
- for power and heat generation projects, this is the dominant technology or technologies (e.g., the majority of power on the Viet Nam national grid is generated from natural gas).
- for waste gas utilisation projects, this is the most common use (or lack of use) of the gas in the region (e.g., in Shanxi province, China, the majority of VAM is vented to the atmosphere and not utilised or destroyed).

New technologies cannot generally compete with what is prevailing practice due to the barriers identified below:
- Lack of expertise for installation, operation, maintenance etc.
- Often lack of servicing capabilities and spare parts locally leading to delays and increased costs for project owners
- Lack of regulatory framework and experience e.g., over-taxation and import restrictions
- Difficulty in attracting finance due to perceived higher risk, primarily due to the above barriers

**(b) In light of the previous answer, in your understanding, is a "first of its kind" project always facing barriers due to prevailing practice?**

Yes, a FOIK project will face barriers due to prevailing practice e.g.,
- The operational risk is increased for a project that is the 'first of its kind'. There is no available installation, operational and maintenance experience meaning that the project owner is unable to find and employ skilled and/or properly-trained labour to operate and maintain the technology. Moreover, no local (in-country) education/training institution is able to provide the needed training.
- In some instances, the operation risks may not only influence the CDM project itself, but could also influence the operation of the larger facility e.g., for a CDM project that generates power from waste heat/ steam in an iron and steel factory, steel production could be affected due to failings of the CDM power generation project if the grid cannot provide enough electricity to supplement the power shortage in time.
- The regulatory framework may not be in place to support the adoption or deployment of the new technology in question, e.g., taxation may not be defined, licensing for power generation for that technology may not be possible, etc.
- Finally, in many instances, the technology adopted by a FOIK project will not have been produced in the project host country and key facilities and skilled labour will need to be imported from abroad. This means that the design, construction and operation of a FOIK project will have to rely on technical input from a foreign company, which increases costs and risks.

**(c) Consequently, is there a need for a FOIK concept in the additionality and combined tools or can the normal - or further improved - investment analysis or barrier analysis test sufficiently or even better capture the additionality of a project?**

One of the original objectives of the CDM was to trigger and promote sustainable development and transfer of up-to-date technology to developing countries/regions. The concept of FOIK is fundamental to reach this target. A simplified framework to demonstrate the additionality of projects that lead to the transfer of new technologies to developing countries will aid the realization of this fundamental objective of the CDM mechanism.

For FOIK projects, neither a financial analysis nor a specific barrier analysis is appropriate. For example,
- The current guidelines for investment analyses do not allow for any reflection of the

risks associated with the project to be included (e.g., technological, operational, maintenance, servicing, etc.).

- The guidelines for barrier analyses require that claimed barriers are substantiated by third party evidence. Providing evidence that something that does not exist (as is often the case with FOIK projects) is inherently difficult. .

The PD Forum strongly believes, therefore, that FOIK should remain one option for demonstrating the additionality of a project; either as part of the barrier analysis or as a separate category.

**(d) Is it sufficiently clear what constitutes a technology that is FOIK or is additional guidance required (e.g., geographical limitations, methodologies, industry and technology, other differentiating factors...)? How would one define this guidance?**

It is the view of the PD Forum that determination of whether a project is FOIK should sit with the validating DOE.

However, it is our experience that currently DOEs are nervous of concluding that a project is additional based on a FOIK argument alone. In addition to demonstrating FOIK, DOEs have required PPs to conduct an investment analysis to further demonstrate the additionality of a project. We believe that this nervousness stems from a perception by DOEs that submitting a project for registration, where additionality is based on FOIK alone, will lead to questions about the additionality of a project from the EB and/ or Secretariat.

In light of this therefore, we suggest that further guidance should be made available to DOEs by the EB. For example, we suggest that demonstration of FOIK should be in line with current guidance on common practice, i.e. consider all projects in the same country/region and/or that rely on a broadly similar technology, are of a similar scale, and take place in a comparable environment with respect to regulatory framework, investment climate, access to technology, access to financing, etc.

We suggest, also, that the EB makes clear that small, demonstration test or research-type projects are excluded from the FOIK analysis. We believe that FOIK be limited to technologies in commercial application.

Finally, we believe that further guidance is needed on the type of evidence that is acceptable for demonstrating FOIK. As mentioned above, one of the inherent difficulties of the FOIK argument is the absence of information that is available to show that something has not been done. Therefore, the EB should state what evidence is sufficient: for example, expert opinions, research reports by local academic institutions and surveys could all be considered acceptable third party evidence for demonstrating FOIK.

**(e) Should there be technologies that are automatically deemed FOIK or technologies that are deemed never to be FOIK?**

There are of course some emerging technologies that do not yet have commercial application anywhere in the world e.g., wave and tidal power. Therefore, in principle, the PD Forum would support the development of a 'positive list' of technologies that are automatically FOIK, if it could be assured that the benefits of developing such a list outweigh the costs (in terms of time and effort) needed to develop it in the first place.

We do not believe, however, that technologies that are not on this list cannot necessarily use the FOIK argument to demonstrate their additionality. In addition to the list described above, there are many technologies that may have been used in some countries and not in others. Those projects that introduce a new technology to a country or region should also be able to

use FOIK to demonstrate additionality, as they are also facing the barriers listed response to questions (a) and (b) above. In effect, technologies that are completely new to a country or region are no different, in terms of risks of deployment and successful operation in these countries and regions, as technologies that have never been deployed anywhere commercially.

Similarly, we do not believe that a list of technologies that are deemed never to be FOIK is appropriate.

**(f) Since FOIK is meant to reflect a barrier due to a very limited and quite unique application of a (new) technology, would it then be necessary to demonstrate how CDM helps to overcome this barrier?**

No. The PD Forum strongly believes that it should not be necessary to demonstrate how the CDM will overcome the barriers that a FOIK project faces. We suggest that this will add additional complexity to projects that are clearly facing significant barriers.

Further, one of the original objectives of the CDM was to trigger and promote sustainable development and transfer of up-to-date technology to developing countries/regions. The concept of FOIK is fundamental to achieving this. A complex demonstration of how the CDM helps to overcome the barriers associated with FOIK projects will undermine the fast and efficient facilitation of technology transfer.

**(g) Should CDM projects (registered or under validation) continue to be excluded from the FOIK test in the long term? What would be a reasonable term?**

Yes, we believe that CDM projects should continue to be excluded from the FOIK test in the long term.

## 2. Common Practice

**(a) Is there a need for a CP concept in the additionality and combined tools or can the normal - or further improved - investment and barrier analysis tests sufficiently capture the additionality of a project?**

The Common Practice test was introduced as a credibility check for large-scale projects to increase the environmental integrity of the CDM. However, it is often very difficult to collect the data required for the analysis. Demands for data have increased in line with availability in some major CDM countries and sectors. However, similar expectations are placed on sectors and countries with less CDM participation, creating a real hurdle for projects. We believe that this situation has resulted partially from the EB rules on common practice and partially from the fact that DOEs are nervous about signing off on anything with less data than what they are used to.

Inevitably, due to the difficulties in data availability described above, the quality of data presented in the PDD and the level of assurance is lower than is desirable. This suggests that there is limited 'value added' to the environmental integrity of the CDM by continuing with the CP test in its current form.

We recognize however, that the CP test forms a vital 'cross-check' of the proposed project against other similar projects. However, we would suggest that rather than having a separate CP credibility check, that a CP element is introduced to the existing barrier and investment analysis for large scale projects.

For example,

- Investment analysis: According to the VVM, version 1.2, para 113 "*On the basis of its specific local and sectoral expertise, confirmation is provided, by cross-checking or other appropriate manner, that the input values from the FSR are valid and applicable at the time of the investment decision*".

  This could mean that the DOE cross-checks that the FSR value for tariff is valid by cross-checking the actual tariff that the project receives according to the PPA or that the FSR value for capital costs is valid by cross checking this value with the actual price paid according to the EPC.

  Equally however, cross-checking could be performed by comparing the IRR input values with those of other comparable projects (both CDM and non-CDM) and industry standards in the geographic area in question[2].

- Barrier analysis: According to the VVM version 1.2, para 117 "*The DOE shall ensure that existence of barriers is substantiated by independent sources of data such as relevant national legislation, surveys of local conditions and national or international statistics".* Here too the validity of barriers presented in the PDD can be authenticated and validated by comparison to the barriers faced by similar projects in the relevant geographical area.

**(b) Should this concept be introduced early on in the assessment of additionality or should it continue to be implemented as a final stage of the assessment acting as a credibility check?**

As described above, due to poor data availability we believe that there is limited value in having a separate CP test in the assessment of additionality. Rather, we suggest that a CP element is incorporated in the investment and barrier analyses.

[2] We are aware that a number of DOEs already do this.

If, however, the CP test is retained as a separate test, then we suggest that it should continue to be implemented as a final stage of the assessment as a credibility check.

**(c) Do you agree with the current approach to determine the CP of an activity?**

As described on our response to question 2a) above, we suggest that a CP element is incorporated in the investment and barrier analyses.

If, however, the CP test is retained as a separate test, we believe that if one project is implemented without the CDM this should not mean that no other similar projects are additional, as the one non-CDM project may have been implemented as a result of, for example, a bad investment decision or some other unique reason. Rather, we suggest that as long as the majority of similar projects have been implemented with the CDM, this should be sufficient to demonstrate that the project is not common practice.

**(d) Is there a need to better define what constitutes a "similar activity" and the criteria used to identify essential distinctions (e.g. geographical scope, methodology, industry, technology, size, local circumstances, others criteria including the current criteria in the existing guidance)**

It is the view of the PD Forum that definition of "similar activity" should lie with the PD and be validated by the DOE. The listed criteria do generally capture a reasonable selection of 'similar'. We do not believe that further definition is necessary as situations vary according to technology and country, in particular when we get to sectors and countries that are less represented in the CDM.

**(e) Is there any other alternative approach to determine the CP of an activity?**

As explained above, we would suggest that rather than having a separate CP credibility check, that a CP element is introduced to the existing barrier and investment analysis for large scale projects. For projects relying on investment analysis to demonstrate the additionality of a project this could take the form of a matrix comparing key parameters of the proposed CDM project in question and other similar projects.

**(f) Should CDM projects (registered or under validation) continue to be excluded from the CP test in the long term? What would be a reasonable term?**

If the CP test is retained as a separate test then yes, we suggest that as long as CDM projects are registered they should continue to be excluded from the CP test. If a project reaches the end of its crediting period or fails to get re-registered at the renewal of a crediting period then it should no longer be excluded from the CP test.

**(g) Should there be a list of activities that are exempt from the CP test?**

As described on our response to question 2a) above, we suggest that a CP element is incorporated in the investment and barrier analyses for all large scale projects.

Whether the CP test is retained as a separate test or incorporated into the investment and barrier analyses, we firmly believe that certain projects should be exempt from the test. Currently small scale and microscale projects are excluded from the CP test and we believe that this should continue. In addition, projects that are FOIK should also be (by definition)

exempt from the CP test.

Kind regards,

Rachel Child
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