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International VAT No.: DE 264 407 559

Berlin, 16/01/2012

Call for inputs on CDM policy dialogue

Honourable Members of the CDM Executive Board,
Honourable members of the Panel of the CDM Policy Dialogue,

atmosfair gGmbH is a CDM project developer and carbon buyer focusing on poverty reducing projects. The atmosfair portfolio consists of around 20% of all registered CDM Gold Standard projects.

We welcome the opportunity to provide input for the CDM policy dialogue. From our point of view, a frank and objective analysis of what has been achieved by the CDM until today is necessary in order to discuss the future of the mechanism. It is our hope that the CDM Dialogue Panel may, before discussing how to position the CDM in the prospect of future challenges, first look at the main policy, regulatory, technical and market shortcomings of the CDM so far and how they can be overcome. We hope to provide useful input for this discussion.

We will elaborate on the main issues below. In summary, our main concern is that despite an ever-increasing scrutiny on projects, the efficiency and environmental integrity of the CDM in reducing GHG is still questionable, mainly due to issues with additionality.
It is time to acknowledge that an ever increasing complexity of project assessments does not automatically improve the quality of the CERs, while heavily increasing transaction costs and excluding many, untapped project types especially in the field of household energy and decentralised renewable energy generation. Therefore, we strongly suggest solving the question of additionality on a policy level by establishing a positive list of projects which are unconditionally eligible under the CDM, excluding those project types which have a questionable environmental integrity or reduce emissions from sources that may be tackled more efficiently by legal restrictions (e.g., HFC or N_2O gases). The process of registering CDM projects could then be simplified radically, and the CDM process can focus on a robust, conservative monitoring and verifications.

Efficiency in achieving emission reductions and environmental integrity

Despite the large attention the CDM has attracted since the registration of the first project in 2005 – more than 10,000 projects have started validation – only 1 out of 7 projects finally has made its way through up to issuance stage. Even though the reasons for this low success rate may be manifold – many projects may have not be implemented due to reasons that have nothing to do with CDM – it is still important to analyse the reasons how the CDM rules and processes also contributed to this limited success.

Currently there are more than 3,500 registered CDM projects with over 750 million carbon credits issued (nearly equaling the annual emissions of Germany) (Fenhann 2011[1]). However, half of these credits have been issued to just 10 projects that reduce very powerful greenhouse gases from the production of refrigerants (HFC gases) and fertilizers (N_2O gas). Billions of US$ were probably paid for the carbon credits generated by these 10 projects, a multiple of the real mitigation costs - this of course results in a lowered efficiency of the whole CDM for reducing GHGs. Moreover, CDM possibly created perverse incentives, not only against a ban of such production techniques, but even to increase the production of those gases (Wara 2009[2]).

Therefore, we suggest the panel to discuss the following shortcomings with regard to environmental integrity:

Project types
In terms of issued CERs, the CDM has so far mainly supported large industrial and some large scale renewable energy projects (HFC, N_2O large hydros, coal mines, avoided flaring). But many of such large projects are from our point of view more effectively addressed by policies than by a market mechanism. Examples are not only the mentioned HFC and N_2O projects, but also huge hydropower projects that require large capital investments. Since CDM is only providing a small percentage of these costs and only upon issuance, the additionality of many large hydro projects is very questionable. The same is valid for CCS projects; the latter are also questionably by supporting enhanced use of fossil fuels (e.g., CCS for enhanced oil recovery).

Additionality
The rules for determining additionality have been fine-tuned and have become very sophisticated (e.g., the rules on benchmark analysis). However, additionality according to EB rules probably still depends more on the capabilities of the expert doing the financial modeling (IRR analysis and benchmark calculation) than on the actual financials of the project[3]. Furthermore the level of scruple applied when collecting data and sources for the financial analysis also has an important impact on results of the additionality assessment.

In short: The question whether a project is additional or not is inherently political and additionality assessment on the project level creates incentives for misuse; therefore the question which project types are considered to be additional should be solved on a political level by defining positive lists.
For renewable energy projects, it may also be more suitable to channel funding for GHG reduction through a systematic support of feed-in tariffs in Non-annex 1 countries instead of issuing carbon credits based on a project-level assessment.

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[1] Fenhann J (2011): UNEP Risoe CDM/JI Pipeline Analysis and Database, November 2011. UNEP Risoe Centre, Denmark. http://cdmpipeline.org/ (accessed in November 2011).

[2] Wara M (2009): Measuring the Clean Development Mechanism's performance and potential. In Schneider S, Rosencranz A , Mastrandrea MD (eds.): Climate change science and policy. Island Press, Washington DC, USA. 522 pp.

[3] see e.g.,http://ec.europa.eu/clima/policies/ets/linking/docs/additionality_baseline_en.pdf

Sustainable development

The second objective of the CDM -its contribution to sustainable development- should also be assessed. We suggest the panel to discuss the following shortcomings of the CDM:

- Unequal geographical distribution of projects. Still the overwhelming majority of all registered projects is located in only four countries. Despite numerous workshops and capacity building activities there is a substantial lack of projects in LDCs. The only real impact that made developers suddenly look (sometimes desperately) for projects in LDCs was the EU announcement to ban carbon credits from projects registered after 2012 which are not located in LDCs, a policy decision outside of the CDM regulatory system. It therefore becomes clear that a lack of capacity in the host country is not the main reason for the unequal distribution.

- CDM rules reward countries with "dirty" economies (e.g., countries with a coal dominated electricity grid) and penalize countries which are not yet contributing much to global greenhouse gas emissions (e.g. because only a small percentage of the population is connected to the electricity grid of because electricity is mainly produced by hydropower).

- Household and community based projects can have a broad impact on sustainable development but are still underrepresented: the number of issued CERs from these project types is negligible. By further improving the access of these project types to the CDM (by simplifying requirements while ensuring environmental integrity) the needs of the poor would be better addressed, and especially women would benefit more from the CDM.

- Programmes of Activities were introduced with the aim to address untapped potentials for emission reductions and sustainable development benefits. However, five years after PoAs became eligible, there are only 14 registered PoAs, and not a single one has issued CERs so far. The rejection of the Cuidemos issuance is a major set back. Transaction costs for PoAs have reached new records, and payback of these costs is more uncertain than ever.

Market failures

The fiscal and financial crisis in the EU, oversupply of certificates under the EU ETS, decreased demand from Japan and no demand from the US, Australia and Canada together with cheap CERs from HFCs/ N_2O projects under the CDM have led to a market crisis which can be characterized as market failure. It implies that there is not a solid financial basis for the planning of CDM projects. The fact that there is still a large inflow of CDM projects at CER prices of 3-5€ may be a sign that projects do not rely on CDM revenue and thus the additionality is questionable.

The way forward: Ideas for improving the CDM

As explained above, we suggest removing case by case validations and registration and replacing it by automatic registrations of projects which fulfill the requirements specified in the positive list.
The achieved emission reductions should then be verified in a conservative, simple and transparent manner against a set of simple monitoring methodologies. Micro scale projects should be evaluated directly by the UNFCCC on behalf of the EB with no need to hire an external DOE.
Also alternatives to the project-based issuance of carbon credits should be considered, such as the financial support of feed-in tariffs in Non-annex 1 countries.

Other issues:

Suppressed Demand

Including suppressed demand in the baseline scenario is a major step to allow for the realization of project activities in developing countries which are not yet emitting greenhouse gases on a larger scale and thus supporting them to get on a green development path. However the concept of

suppressed demand also provides great incentives for misuse as the number of carbon credits which can be generated are huge. Besides an assessment of the suppressed demand scenario (e.g., in the case of dissemination of water filters, if water is really boiled in the baseline case) a comprehensive options assessment[4] on how the suppressed demand can be best addressed is also necessary (e.g., is the demand for light in houses best addressed by distributing solar lamps including batteries which need to be replaced or would be a community based micro electricity grid be the more sustainable solution for the problem) together with a very strict and independent monitoring approach.

We hope that we were able to provide some useful input and are looking forward to the results of the dialogue.

Yours sincerely

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[4] See as an example Step 2 of the World Commission on Dams guidelines for assessing projects. http://www.unep.org/dams/documents/Default.asp?DocumentID=664