

October 6, 2004

Comments on the methodology AM0001 "Incineration of HFC 23 waste streams"

*To begin with, in my opinion, from a **process / procedural point of view**, it is not a good idea to reopen approved methodologies. Apart from setting a bad precedence, it creates a sense of enhanced uncertainty in the whole process. I do hope that this does not mark the beginning of such similar review processes for other approved methodologies. Regardless of the nature of information / the motivation, the sanctity of the approval process should NOT have been breached.*

The methodology was approved after providing adequate notice and time for all concerned entities to put forward their views and any decision based on information brought to the notice of the panel subsequent to the approval of the methodology should have been made applicable with prospective effect. Methodologies / projects, once approved should have a stamp of 'finality', without which the credibility of the whole approval process itself is under question.

Whereas I do realize and acknowledge the fact that most highly 'leveraged projects' (i.e. projects involving PFC – aluminum smelting, HFC₂₃,- production of HCFC₂₂, N₂O – production of adipic acid, etc) that involve the incineration / abatement of gases with very high global warming potential, seem to have a very compelling case for establishing 'additionality' and in technical compliance with the 'letter of the law', I would, like to take this opportunity to express my reservations on such projects including the one considered under AM0001, as they pose a significant risk to the other CDM projects, especially those with high Sustainable Development impact, by completely distorting the demand supply scenario.

In addition, I am not entirely convinced about the long term environmental integrity of such projects, especially considering their potential for significantly distorting the profitability projections for most underlying / related units. It may be interesting to point out that whereas for most renewable energy projects, the CER linked revenue (valued at current prices of ~ \$6) form a small proportion of the total revenue, in case of the highly leveraged projects, in some cases, the payback could be less than 1 – 2 year.

My principle area of concern revolves around the fact that for most of these projects it would be very difficult (if at all) to comprehensively establish that the additional revenue from the sale of CERs is not being used to subsidize its core activities, or for that matter being used to increase the sale of its existing products.

The key issues that I have reservations on are :-

- a. How does one comprehensively establish the projected demand for Adipic Acid or for that matter HF22 and thus the demand baseline for the underlying product?
- b. How does one account for the delay in adoption of alternative chemicals, on account of the fact that say the existing HF22 supply could be supplied at a price point which, in the absence of suitable regulatory requirement , would make the switch over decision very difficult to take?
- c. How does one account for increased demand for the underlying product on account of reduced prices (the revenue from CER sale being used to subsidize the final product) to the extent that it starts replacing other less polluting products, perhaps even in new applications?
- d. How does one address 'leakages' on account of shifting polluting production units from annex 1 countries (where the abatement/elimination process would be a BAU) to non annex 1 countries (where the same could be 'additional'). Thereby reducing total cost of production (as these units could now be eligible to generate CERs)?

- e. How does one value the intangibles viz. NGO pressure, adverse publicity, demand from customers etc. Now being addressed by developing the project and ALSO getting a CDM registration.

The primary 'additionality' argument for most highly leveraged projects revolves around "In the absence of regulations requiring HFC23 (say) destruction, it is typically released to the atmosphere because a destruction facility entails significant capital and operating costs and the host entity has no direct economic incentive to incur these costs."

The question that I would like to raise is :

Scenario 1 :

What if an NGO / Foundation were to offer these project developers complete reimbursement of ALL project related expenditure + say a 10% premium, in exchange for extinguishing the resulting CERs.

Scenario 2:

What if a 3rd party were extend an open offer to all (say) HCFC22 manufacturers to buy the HFC23 generated for \$x per tonne i.e. in addition to the offer for setting up the related infrastructure AND then incinerate the gas, without claiming CERs.

The implementation of Scenario 1 and / or 2 above would in effect provide a 'direct economic incentive' (however small) to seriously consider setting up (direct + indirectly) the incineration / abatement projects. Would the project still be eligible for registration under the CDM, if it was comprehensively established that the total \$\$ return from the proposed project activity (direct / indirect implementation) is greater that the total \$\$ cost?

The point that I'm trying to explore is the possibility (if at all) to reduce the flow of CERs from such 'highly leveraged' projects, that, in my opinion do not comprehensively establish their case for registration, WITHOUT changing the current regulations / processes. I am confident that resources can be made available/raised for subsidizing / reimbursing certain category of such highly leveraged project, especially if it helps in promoting high SD impact renewable energy initiatives. I must however stress upon the fact that any such 'solution' should be in line with the existing rules and guidelines.

I do understand that some of the issues raised here does not concern the AM0001 directly, but I am seriously concerned about he potential impact of large inflows of CERs from highly leveraged projects on the fledgling market for CDM CERs, especially in the context of resource transfer. The last thing one want to see is the 'benefits' from the Kyoto Protocol's flexibility mechanism being cornered by a couple of strategically positioned project developers. We must contain the possibility of free riding.



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Disclaimer: I am working with Asia Carbon International B.V., a GHG emissions reduction compliance solution provider having its regional head quarters in Singapore. The views expressed above are my own and NOT necessarily those of the Company.