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Chair, CDM Executive Board
And
Mr Jean Jacques Becker,
Chair, Methodologies Panel
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29 September 2004

RE: Review of AM0001

Dear Mr Kilani / Mr Becker

I am writing to you to express our concerns regarding the possible revision of AM0001. I am aware of the call for comments, but nevertheless, I am addressing this letter to the Chair of the CDM EB because we believe that the issue impacts upon the whole of the CDM process, and not just AM0001.

Comments on the process of receiving input on the methodology

1) The review of the methodology is based upon the submission from Othmar Schwank pointing out the potential impacts of increased HCFC22 production. These comments were received out-with the defined procedures for stakeholder input to the whole process. This creates some uncertainty about the stakeholder consultation process. You may recall that in our recent request for registration, we included a comment that was submitted after the end of the 30-day consultation period had ended. The discussion on this point was minuted in paragraph 30 b of the EB 15 report, to the effect that only comments received within the period should be considered. For consistency, Schwank's comments should not be considered until they are submitted during the international stakeholder consultation process of an HFC 23 destruction project.

Scope of the revision "to address, inter alia, the potential leakage".

We are very concerned about the basis for this review, on several levels:

2) The discussions around the request for review were held in closed sessions. The inclusion of "inter alia" raises our concerns that there are other issues and we would welcome clarification as to what these are. It would also speed up the review process if all issues were aired at the outset.

3) The allocation of responsibility for the potential increase in GHG emissions arising from the increased production of HCFC22 is problematic:

- i) There is an implicit assumption that the project developer will use the CDM subsidy to lower prices in order to increase market share and production. It is also quite possible that the facility will continue to produce in line with business as usual expectations. This point is linked to the call for inputs on supply, which is addressed in more detail below.
- ii) The project produces a product that is sold and transferred to other parties. Those parties are responsible for its use, recycling, destruction or eventual release. The project is not responsible for these emissions.
- iii) Furthermore, attempting to quantify these emissions would lead to several complications. Firstly, only emissions incremental to planned production levels need to be considered, since only these can be attributed to the CDM project, if at all. Secondly, to the extent that HCFC22

is used as feedstock in PTFE, there would be no such leakage. Thirdly, some leakage will occur in other countries and some will be destroyed or recycled in Montreal Protocol driven recovery / destruction schemes. Fourthly, in swing plants, where HCFC22 or CFCs are produced in exclusive campaigns, increased production of HCFC22 is accompanied by decreased production of CFC. CFCs have a higher GWP than HCFC22, which more than offsets the increased emissions from the HCFC22. For these reasons we think that leakage should not apply because it is neither attributable nor quantifiable.

- iv) As the paper from Ineos Fluor describes in much detail, the CDM is unlikely to cause an increase in the production of HCFC22 at a global level for both coolant as well as feedstock use.

The logical consequences of considering such “leakage” will be profound: For many projects that result in a CDM subsidised product or service, an evaluation of leakage due to incremental production of that product or service would be required. For example, substantial emission reductions may be generated by the capture and flaring of coal-mine methane. This in turn will subsidise the production of coal. The coal is sold and combusted. Under the above provisions, the project would be responsible for the emissions associated with the combustion of the coal. Similarly, for example, energy efficiency measures in the manufacturing industry could reduce the costs of production and therefore increase market share. The emissions associated with the use of the increased production of the consumer product would have to be accounted and deducted from the project. In fact, in both these examples, and as in the case of AM0001, the project has no control over how or where the product is used.

All CDM projects contribute to sustainable development by definition. Contribution to sustainable development usually leads to a rise in income levels in the community. The inevitable consequence of this is higher consumption levels. Would emission increases due to such higher consumption levels also need to be considered as leakage attributable to the project?

- 4) Taking a broader view, we are deeply concerned about the potential impact of requiring projects to account for leakage arising from non-Kyoto GHGs. This represents a fundamental change in the interpretation of the CDM. The justification for the use of the UNFCCC definition of GHGs is clear. However, KP Article 12 paragraph 12 also says that purpose of the CDM is to contribute to the ultimate objective of the CDM, which is of course “the stabilisation of greenhouse gas concentrations in the atmosphere”. To date, all participants have considered the CDM to be limited to the six Kyoto gases. If leakage is expanded to cover all GHGs, I think a strong case can be made to open the CDM to all GHGs. Whilst this would be an exciting development, it would severely test the process in several ways:
 - i) The list of GHGs and their GWP is the subject of scientific speculation and is likely to change over time. The prospect of being penalised for emissions of some hitherto unknown GHG would introduce further uncertainty to the process. To be workable, a list of gases would have to be defined.
 - ii) The burden of defining the methodologies, monitoring and reporting emissions of more gases, accounting for leakage of these gases, and validating and verifying these data would be considerable, causing delay and increasing transaction costs.
 - iii) We foresee a conflict between the inclusion of all gases and the provision for Joint Implementation Projects. JI project accounting would be based on the broader definitions but the AAUs that are transferred between Annex B Parties to match a JI transaction would be based on accounting of the Kyoto gases only. For example, if an HFC23 destruction project were structured as a JI project, and leakage were accounted as discussed, the project might generate for example two million ERs whilst the national inventory in the host country, which accounts for Kyoto gases only, might show a reduction of three million ERs. Two million AAUs would be transferred to investor countries leaving the host country with a net gain of one million ERs. Whilst this is not a direct concern of the CDM EB, it would create additional confusion and complications within the Kyoto Protocol.

Considering the points raised under 3) and 4) above, we believe that almost all of the methodologies approved to date would need to be reviewed. We think that this would be a very negative step and would send out entirely the wrong message to the community of project developers and potential investors at a time when the CDM is just starting to deliver.

In our opinion, the issue of potential leakage under AM0001 is a “red herring”. It will divert attention from the real issues, delay the approval of new methodologies, delay the development of new projects and delay the delivery of CERs from CDM projects. For these reasons, we believe that the EB should:

- Reaffirm their commitment to the stakeholder consultation process and time limits around those consultations
- Confirm that the scope of the CDM is currently restricted to the 6 Kyoto gases
- Re-instate AM0001, and
- Failing the previous bullet point, as soon as possible, confirm in writing that the suspension of the methodology does not impact upon the two projects already submitted for registration.

Call for inputs

With regard to the points listed on the call for inputs, I believe that these are somewhat different from the issue of “potential leakage” cited as one of the reasons for the suspension of AM0001. None of the points listed makes any reference or explicit link to leakage. In my opinion, none of these points are sufficiently significant to require the suspension of the methodology.

However, the call for inputs has been made and therefore I have the following comments:

Possible alternative approaches to assessing the baseline scenario:

In our view, the approach used by AM0001 for assessing the baseline scenario is quite appropriate, for the following reasons:

- It uses the actual historical emissions for the past three years as a cut-off ratio. These plants use expensive raw materials, and hence, if it was technologically feasible and commercially viable to implement technologies to reduce the cut-off ratio, commercial enterprises driven by profit motive would have done this. Therefore, taking actual historical emissions ensures that CERs are restricted to emissions that actually arose in the past, and reflect a “business as usual” scenario.
- Further, using data for the past three years ensures that this covers a period during which the project developer had no knowledge of CDM and hence, the cut-off ratio would not be influenced by any perverse incentive due to knowledge of CDM. Three years after the approval of AM0001, this may need to be reviewed.
- Only the lowest cut-off ratio of the last three years is used – this ensures conservatism in approach.
- For a new plant, or where no historical data is available, the lowest IPCC default value shall be used, but this is not explicitly quantified.
- Lastly, actual CERs are allowed only based on actual emissions, which are independently verified, but subject to a maximum ceiling of the cut off ratio as determined above. This ensures that projects cannot claim higher credits by increasing emissions later.

The only point that could be reviewed is the application of the IPCC Default factor of 4%, which seems out of date. Based on my experience, plants would be running inefficiently to emit 4% of HFC23 based on the quantity of HCFC22 produced. The driving factors for efficiency are the raw materials, some of which are expensive. Therefore the default of 4% is unreasonably high.

It is recognized by IPCC in the Good Practice Guidance, that it is possible to reduce formation of HFC23 by changes to the process operation.

Two alternatives are proposed:

- 1) The maximum default value is set at 3%, reflecting some optimisation.

2) When, for example five or more projects have been registered, their average baseline emissions could be applied as the default factor – thus the average would be based on verified historic data from a population that is more representative of the plants that enter the CDM.

For existing plants with no historical data, the lower of the two values should be used.

For new plants, the baseline should be:

- (i) the expected efficiency, if this can be verified; or
- (ii) the lowest baseline emissions from a registered project – reflecting best practice as the baseline for new plants.

However, it must also be emphasised that the monitoring methodology requires the direct measurement of HFC23 in order to calculate the CERs, and these cannot exceed the cap established above.

Common practices in this industry:

Common practices in the HCFC22 industry dealing with HFC23 include:

- Where so required by legislation, HCFC22 manufacturing units control or destruct HFC23 emissions
- Where there is a known market for HFC23, these units capture HFC23 for sale
- Where it is technically feasible and commercially viable to implement technologies for reduction of HFC23 emissions, HCFC22 manufacturing units would do this, to optimise on raw material efficiencies and cost of production
- Where there is neither legislation to control HFC23 emissions, or a known market for HFC23, these units emit HFC23 into the atmosphere.

Possible impacts of such project activities on the supply and demand of HCFC22:

Demand: The CDM will have a negligible impact upon the demand for HCFC 22 as this is already the cheapest coolant of its type available. This point has been well presented by Dr Andy Lindley of Ineos Fluor.

Supply: The CDM will prove a very effective mechanism to reduce HFC 23 emissions in Non-Annex 1 countries, for which credits will be claimed. IPPC regulation in the EU / tougher environmental regulations will stop / greatly reduce HFC23 emissions elsewhere, but there will be no credits. (If experience from the UK ETS is anything to go by, allowances will not be awarded to HCFC 22 producers for avoided emissions of HFC23, because reductions in emissions will be considered as business as usual.) This will mitigate against HCFC 22 production in Annex 1 and other developed countries (i.e. USA). Supply will shift to non-Annex 1 countries with the result that a greater proportion of HCFC 22 will be produced without HFC 23 emissions. If CDM progresses well, it is possible that these emission reductions will be achieved sooner than in the business as usual situation.

Given this scenario, it is clear that production will increase in some Non-Annex 1 plants and new plants may also be constructed. Clearly this will benefit early movers who may be able to increase production (although this is not possible in some countries under the Montreal Protocol).

The only legitimate question is whether crediting should be constrained to a business as usual level of production. In my opinion, there should be no limit on the activity level, and paragraph 46 of the Marrakech Accords would support this position.

In conclusion, the CDM creates a market environment to stimulate reductions in GHG emissions. Attempts to regulate the market by tackling specific problems in individual sectors run the risk of having much greater un-intended impacts elsewhere. This is most certainly the case when considering the possible revision of AM0001.

Yours sincerely



Gareth Phillips