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DEVELOPER
FORUM

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To	cdm-info@unfccc.int
From	martin.enderlin@pd-forum.net
Date	12 March 2009
Subject	**Input regarding annotated agenda EB53**

Dear Mr. Mahlung,
Honourable Members of the CDM Executive Board,

The Project Developer Forum would like to provide input to a number of items related to the annotated agenda of EB 53, as well as documents approved at the EB's last meeting and recommendations from working groups and panels. Since the annotated agenda was only released on 8 March, we were not able to submit the letter within the official deadline for formal submissions to EB53. Nonetheless, we humbly ask that our comments on the agenda items be considered by the EB at the coming meeting. We are happy to provide comments on a similar basis for future meetings. Please let us know if you find such input helpful for your deliberations.

Para 19 of the annotated agenda of EB 53 – Tool to calculate the emission factor for an electricity system

> Data to carry out the dispatch data analysis is unlikely to be available in the majority of host countries. While it may be possible that some DNAs are able to collect the information for the preparation of standardised emission factors, this data is unlikely to be available to individual PPs. By introducing this preference, the EB would introduce a requirement for the PP to prove and for the DOEs to validate that the necessary data to carry out this analysis is not available. We believe this adds unnecessary complications which particularly impact projects in host countries where few projects have been implemented.

Annex 4 to the annotated agenda of EB 53 – Compliance with indicative timelines for different processes

> We are happy to see that the Secretariat is reporting on its compliance with the indicative timelines. However, we would like to re-iterate that these indicative timelines and in particular their limitations are not credible. This was illustrated in detail with respect to requests for issuance in our submission to EB 51. The limitation of 50 requests for registration and 40 requests for issuance falls far short of expectations, and we urge the EB to remove or revise the limitation to be more in line with real world forecasts.

Para 20 of the annotated agenda of EB 53 and Annex 8 to MP43 report - Draft "Tool to calculate the weighted average cost of capital (WACC)"

At its 43rd meeting the Meth Panel (MP) produced a draft tool to determine the weighted average cost of capital (WACC). The MP recommended that the Board places this tool on the UNFCCC CDM website with an intention to receive the inputs from the public, before being finally considered by the Board.

Upon review of the proposed tool for determining the weighted average cost of capital (WACC), we find that the concepts used to define the WACC are not necessarily in concert with generally used or accepted financing principles. It appears the document writer(s) attempted to create and change traditional financing principals to fit CDM practices in the developing world and as such recommended to the Board a tool with some conceptual weaknesses. For example:

- the excessively restrictive division into scenarios and sub-scenarios under which the various assumptions and/or calculations need to be made probably results in more, rather than less subjectivity in the calculations and will create a bias for project promoters to pick the scenarios that suit them best rather than the most relevant scenario.
- while several of the financial concepts that are being defined are proposed to be calculated based on standard formula and principles, the proposed draft tool tends to departs from the generally accepted principles and definitions for certain of these concepts as can be found in the reference literature and publication from authoritative authors on this topics (e.g., Aswath Damodaram - http://pages.stern.nyu.edu/~adamodar/).
- one of the key challenges with the paper and the proposed definitions would be its application to (i) the specific context of emerging markets and in particular LDCs for which parameters and data are often not available and/or representative and (ii) the specific activities undertaken under the proposed CDM project which by definition would not be business as usual and may have little precedent or benchmark to draw from.

While the proposed tool may work with and actually be favorable to certain project types and geographies, the lack of consistency with financial practices would create new problems rather than address existing consistency concerns essential to ensuring environmental integrity.

We have also identified four issues with the current draft, which should be dealt with before starting a consultation process on the tool.

First, the proposed tool bases cost of equity on one study using developed country data. This is not appropriate for CDM projects taking place in emerging markets.

Secondly, the guidance is also in contradiction with the current Tool for the Demonstration and Assessment of Additionality, more specifically with Par 6 (c), which asks for the WACC used to be demonstrably and consistently used in the past, i.e. that project activities under similar conditions developed by the same company used the same benchmark. Obviously, the new methodology for calculating WACC will not in all cases coincide with the WACC consistently used in all companies. It does not allow for applying a consistently used WACC by the project owner, which is the simplest way of determining the benchmark where such WACC exists.

We suggest the following modification in Step 1 of the "Draft tool to determine the Weighed Average Cost of Capital", version 01, MP 43:
"Companies that can provide evidence that they have used a specific WACC consistently before in similar projects, can apply such WACC where Case (I) applies." These are cases when the legal entity investing in the project is the only possible investor. As per Option 4C, in similar cases,

companies are allowed to apply their specific equity expectations. We believe that applying such a rule to the entire WACC instead would simplify the financial model to a large extent and would render it more accurate in the context of the legal entity investing.

This change to the tool would allow that some companies, especially those handling large portfolios of projects, establish a WACC for their entire portfolio and update it regularly according to changing financial conditions. The rest of the proposed tool can then be applied for companies that do not have a consistently used WACC value or when the project can also be implemented by other companies. This change would bring the tool in line with the current guidance in the "Tool for Demonstration and Assessment of Additionality", Version 5.02, EB 39, Sub-step 2b: paragraph (6) (c). We note that in many cases, it would otherwise be impossible to use this option of the tool, as the consistently applied company-specific WACCs may not be calculated with the same data used in the proposed tool.

Thirdly, we note that the tool excludes the consideration of a risk premium in the determination of the WACC, and relocates the consideration of risk to the additionality tool:

> "*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.*"
> Sub-step 2C para 8 reads:
> "*In calculating the financial/economic indicator, the project's risks can be included through the cash flow pattern, subject to project-specific expectations and assumptions (e.g. insurance premiums can be used in the calculation to reflect specific risk equivalents).*"

We anticipate that this will be problematic. Whilst risk premiums for sectors and countries are available from published sources, the inclusion of risk in cash flows is much more subjective. It is unlikely that insurance premiums are available for many of the risks which project developers in the CDM may face; in the event that such policies are available, they may be subjective and reflect the insurers understanding of the risks, not the developers. In short, the tool suggests moving from the use of independent published risk factors to subjective and less verifiable means of assessing risk.

Fourthly, the tool also suggests that the debt to equity ratio is determined from the accounting books of the legal entity that will host the project activity, and in the event that the accounting books do not show the total value of the assets, then a default debt to equity ratio of 50:50 is utilized. In the situation where validation is taking place prior purchase of assets, the default values will be applied. Depending on individual circumstances, these could advantage or disadvantage the PPs. It would be better to apply the planned debt to equity ratio because these values must be defined early on in the financial planning of the project.

We certainly welcome the consultation of stakeholders on this tool but because of the general and specific flaws mentioned in this brief review, we recommend to the EB to ask the MP panel to revise the tool based on considered advice from financial experts before launching a call for public inputs.

Annex 9 to EB 52 report - Procedure for the submission and consideration of a proposed new baseline and monitoring methodology for large scale CDM project activities

We recognise that making considerations of submitted PNMs conditional to priorities set by the EB (para. 5) is well intended to facilitate the development of methodologies for sectors, technologies or countries, which are currently underrepresented in the CDM.

However, we are concerned that this prioritisation may lead to individual submissions that do not match these priorities to remain at the end of the queue indefinitely due the large workload. Additionally, we feel that this procedure has to be looked at in the light of the experiences with the current ruling. Therefore we bring following issues to your attention for consideration in drafting the new procedure:

In the past the consideration of some proposed new methodologies (PNM) was kept on hold because an issue with an interrelated methodology needed to be resolved first. The new procedure misses to include a mechanism that prevents the processing of a PNM from being put on hold on the grounds of ongoing deliberations over a related approved methodology. This has happened in the past in a number of instances, e.g. in the process of consolidation, while a PNM could have been merged with existing methodologies (for example ACM0006).

The new procedure clearly draws up the process and timeline for PNM assessments to be considered by the Meth Panel. However, it does not take account cases where the Meth Panel is not able to consider it due to time constraints or pending decisions by the COP. We would therefore advocate automatic consideration of any methodology within a certain number of Meth Panel meetings.

In order to achieve the ultimate goal set out, to facilitate the development of underrepresented CDM areas, not only proposing new, but also revising existing methodologies is important. From the project developers' view developing new methodologies has over the past year(s) become a cost ineffective and daunting endeavour. If ever possible, the revision of existing methodologies is in most cases the favoured option as it is perceived to be more goal-oriented. Considering this recent trend, the process for proposing revisions is much more commonly employed and the EB should consider how the procedure for PNMs works in concert with the procedure to revise approved methodologies and we therefore recommend harmonizing the two, in particular in terms of timelines.

Annex 53 to EB 52 report - Guidelines on the registration fee schedule for proposed project activities under the clean development mechanism (version 01)

and

Annex 59 to EB 52 report - Procedures for requesting post-registration changes to the start of the crediting period (version 02)

We welcome the changes to the registration fee schedule and the procedure for changes of crediting periods as it gives project participants in countries that are underrepresented in the CDM, who typically face difficulties in benefitting from carbon credits, greater flexibility in developing and implementing their projects.

Annex 60 to EB 52 report - Guidelines for assessing compliance with the calibration frequency requirements

The new guidelines do not provide for a procedure in case there exists no local/national standard and no specification has been given by the manufacturer. It therefore still leaves uncertainty for project participants and DOEs on what calibration frequency should be applied in such cases.

There remains a discrepancy between the calibration requirements for small scale (SSC) and large scale (LSC) project activities as it is not clear whether the new guidelines also apply to SSC project activities. We therefore like to seek clarity from the EB what the frequency requirements for SSC project activities are.

Under the current methodology guidance[1] for SSC projects it is required to calibrate at least every 3 years. Since simplified procedures should be applied to SSC project activities it would seem logical to apply the new guidelines, which stipulate that calibration has to be undertaken according to the provisions in the applied methodology, local/national standards or according to the manufacture's recommendation, which may be less frequently than every 3 years. We therefore recommend that the new guidelines are applicable also to SSC projects and to revise the document 'Indicative Simplified Baseline and Monitoring Methodologies for Selected Small-Scale CDM Project Activities Categories' accordingly.

In many cases the accuracy of monitoring devices is ensured by regular maintenance and checking of the equipment rather than actual calibration, which is cost and time consuming, in particular if the equipment has to be sent to the manufacturer. In our view the Board should clearly distinguish between cases where a calibration is required and where maintenance or checks of the devices' accuracy is needed. Developing a guidance document on the maintenance of monitoring devices might prove to be useful.

Par. 54 of the annotated agenda of EB 53 and Annex 13 to EB51 - "Policy options to assess grid emission factors published by DNAs"

Para 4.(b) and 6.(c) – qualified DOEs should also be eligible to participate as a assessment team member. Increasing the role of the RIT (which is temporary) at the exclusion of the DOEs (which are permanent) does little to foster understanding and trust between the EB, secretariat and DOEs.

We hope that you find the above comments useful and we look forward to receiving your response.

Kind regards,

Martin Enderlin
Chair of the PD Forum

CC: - UNFCCC Secretariat, Daniele Violetti

[1] Indicative Simplified Baseline and Monitoring Methodologies for Selected Small-Scale CDM Project Activities Categories (Version 12.1), http://cdm.unfccc.int/Reference/Guidclarif/ssc/methSSC_guid06.pdf