

Additionality testing – good rules but sloppy practice?

COP 13 BVEK Side Event “Safeguarding additionality –
practical ways of keeping the CDM credible”, December 10,
2007

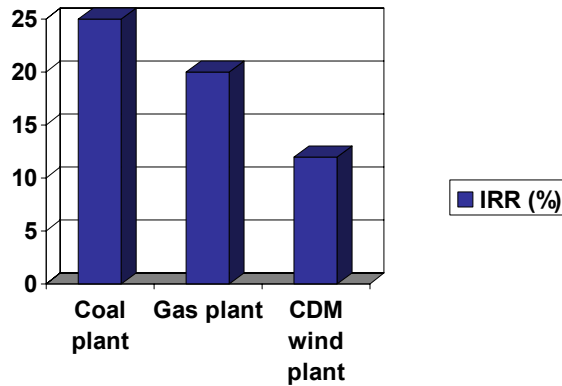
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Additionality principle

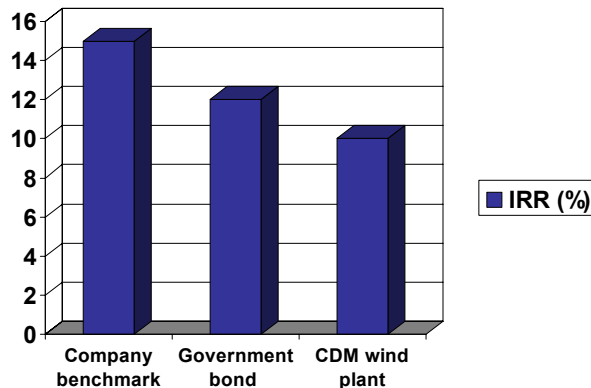
- **General idea:** Project is not “business as usual”
- **NGO position:** no profitable projects should be registered
- **Business position:** intent of developer cannot be judged. **All projects with emissions below the baseline are automatically additional**
- **EB compromise:** Project has to be less profitable than the most attractive alternative or a benchmark or overcome prohibitive barriers – Consolidated additionality tool
 - What is a credible alternative?
 - What is a credible benchmark level?
 - When is a barrier prohibitive?
 - What is common practice?
- **Key role of validators in answering these questions**

Profitable alternatives?



- Is the IRR of the alternatives **realistic**?

Gold-plated benchmark?



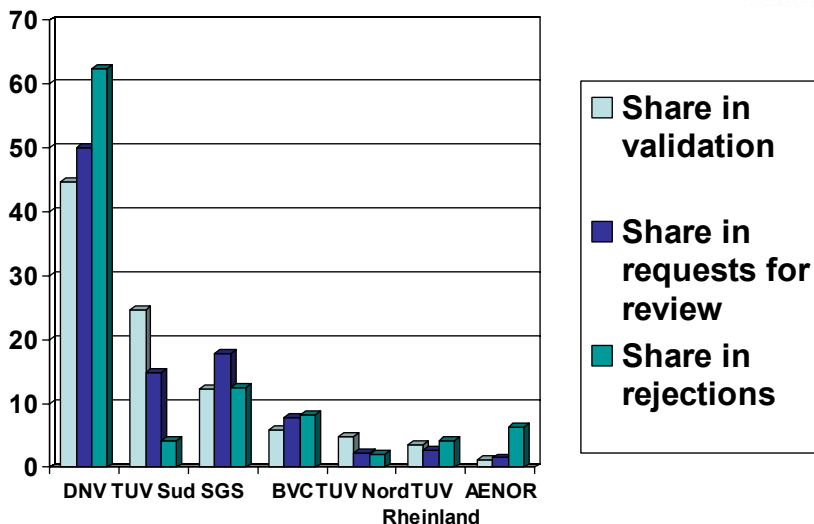
- Is the company benchmark **realistic**?
- Is the government bond shown **relevant**?
- Does the CER revenue **move project above the benchmark**?

Barriers and common practice



- Developers ignore “prohibitive” character of barriers
 - Developer lists a host of barriers in **very general form**
 - There is no explanation why the barriers listed are **prohibitive**
 - Barriers apply to all alternatives as well
- **Gaming of the common practice test**
 - Developer uses **very narrow definition** for assessment of similar projects

Some validators are better than others



Case study from India: I



- JSW Vijayanagar Steel plant waste gas utilisation for electricity production
 - JSW Steel operates **steel plant**, JSW Energy the **power plants** (490 MW, 3 million CERs p.a.)
 - JSW Steel charges JSW Energy a **fictitious transfer price** for the waste gas (=coal price)
 - Investment in the gas storage tank of power plant 1 (260 MW) **pays off after just 100 GWh** of electricity produced from waste gas
 - Group of companies makes **huge profit**
 - Project was registered **without problem!**

Case study from India: II



- Bajaj Auto wind power plants
 - Bajaj's annual report 2000-1: "The project is **extremely beneficial on a standalone basis** and has a **payback period of three years with an internal rate of return in excess of 28 per cent**. In addition to **hedging Bajaj Auto's power costs**, this investment also provides **sales tax incentives and an income tax shield**."
 - Report does **not mention CDM** or carbon credits in the context of the project
 - Projects **rejected** by CDM EB

Case study from India III



- **125 MW wind project in Karnataka**
 - **Wind energy investments attract accelerated depreciation of 80% in the first year**
 - **Effective tax shelter of 24% of the project cost (at corporate tax rate of 30%)**
 - **Wind energy gets a 10 year income tax holiday**
 - **IRR in PDD: 7.3%**
 - **IRR without tax benefits calculated by independent observer: 11%**
 - **IRR with tax benefits: 22%**
 - **Project registered without problem**
 - **Similar project registered though getting even another type of subsidy!**

Case study from Brazil IV



- **Cement blending with blast furnace slag**
 - **Barriers argued:**
 - **Development of logistics for additives supply**
 - **Use of slag increases the production costs of cement**
 - **However, company argued in external report that use of additives enhanced profitability**
 - **When request for review was made, company argued that long distance transport of slag increased its costs. However, the data provided could not corroborate this argument**
 - **Project rejected by EB**

Key areas of concern



- **Inconsistent treatment of additionality**
 - Large projects rarely rejected
 - Renewable energy projects seem to have “bonus”
 - Recent clampdown on cement blending after initial registration of projects with the same characteristics
- **No reaction on DOE underperformance by the EB**
 - First de facto suspension done only Nov. 2007
 - No “naming and shaming”
- **Structural fraud in additionality arguments**
 - Underreporting of plant load factor
 - Chinese hydro
 - Gaming of benchmarks
 - Brazilian one-day government bonds
 - Backdating of board resolutions (India)

Conclusions



- **Additionality remains a key issue for the credibility of the CDM**
- **If the general public understands that CERs come from business-as-usual projects, public support for the CDM can evaporate quickly**
- **Good rules do not guarantee a good outcome!**
- **Independent validation has so far not fulfilled expectations**
- **Expect fraud and introduce incentives to detect/avoid fraud**

Thank you!

Further information:

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