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and Energy

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Editorial

Dear reader,
this year, climate change has reached a yet unknown level of attention. A number of events took up the issue, including the G8 summit in June and a high level meeting on the fringes of the UN general assembly. All the more, a clear message from the UN climate summit in Bali is expected. Starting serious negotiations for an ambitious post 2012 agreement would also be an important signal for the Kyoto mechanisms market, whose investors are keen to know whether the CDM, for example, will continue after the first commitment period of the Kyoto Protocol expires. This issue of JIKO Info focuses on the oncoming UN climate summit. We summarize the Bali CDM agenda and also take a look at the post 2012 negotiations in general. On a different note, we present an article on a JI model project in Germany, which tests a Programme of Activities approach. Finally, we look at the guidelines for large hydro power projects developed by the World Commission on Dams, which have been operationalized for CDM/JI project approval by the German DNA/DFP DEHSt.
On behalf of the editorial team, I'd like to wish you an interesting read and, in case you attend the Bali conference, a successful time in Indonesia.

Christof Arens

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The Bali CDM Agenda – Cleaning up the Leftovers?

Once again, the Meeting of the Parties to the Kyoto Protocol (COP/MOP) will have a full agenda as regards the Clean Development Mechanism. Of particular salience are questions surrounding the environmental integrity of the CDM, the geographical distribution of projects, and the eligibility of projects addressing Carbon Capture and Storage (CCS), HFC-23 and non-renewable biomass. Various of these issues have been on the COP/MOP agenda for some time already and it is not clear whether they will be resolved in Bali. JIKO Info lays out the background to each issue and what the most important controversies are.

This year, several studies and news reports have claimed that the CDM approval process is failing to effectively screen out projects that are actually not additional but would also have taken place without the CDM. Additionality is essential for the CDM since each Certified Emission Reduction (CER) generated will be used to allow one more tonne of greenhouse gas emissions in the industrialised countries to be emitted. CERs that have resulted from business-as-usual projects therefore lead to an increase in GHG emissions globally. *Continued on page 2*

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The Bali Negotiations on Post-2012: A Tailwind for the Carbon Markets?

This year's UN climate summit will be held from December 3 to December 14 in Bali, Indonesia. The rather pessimitic mood prevailing throughout last year's conference in Nairobi has dramatically changed in 2007. An urgent need to take decisive action is called for from the science side, as represented by the publication of the fourth assessment report of the Intergovernmental Panel on Climate Change (IPCC). A number of high-level initiatives were undertaken, including sessions on climate change in the UN Security Council and the UN General Assembly. Underpinned by the mounting awareness on climate change culminating in awarding the Nobel Peace Prize to Al Gore and the IPCC, the oncoming conference will mark a critical moment for the Parties and negotiators to start negotiating on an ambitious post-2012 regime.

The post-2012 negotiations currently run along several tracks: first, the Parties to the Kyoto Protocol established an **Ad-hoc Working Group** (AWG) on further commitments for Annex I Parties (i.e. industrialised countries). Second, Parties to the FCCC in Montreal launched a "**Dialogue** on long-term cooperative action to address climate change by enhancing implemtentaion of the Convention" (the so-called Dialogue). *Continued on page 4*

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The CDM Executive Board has taken steps to intensify its oversight of the project validation process, such as

- establishing a Registration and Issuance Team to scrutinise requests for registration of projects and issuance of CERs,
- strengthening the capacity in the Climate Secretariat in Bonn
- revising the accreditation standards for Designated Operational Entities (DOEs).

Parts of the problem may be traced to the gaps and inconsistencies in the rules on how to document and validate projects. The EB is currently trying to remedy this problem by elaborating a "Validation and Verification Manual". Nevertheless, the issue of additionality can be expected to also occupy the COP/MOP negotiations.

The Bali agenda can be found at http://unfccc.int/meetings/cop_13/agendas/items/4095.php
Further information on CDM/JI issues, BMU side events and more is available at www.jiko-bmu.de
(in German only)

The **regional distribution** of projects has been a prominent issue for some time now. CDM projects are so far mainly concentrated in a few countries, notably Brazil, China, India, and Mexico. These countries account for about ¾ of all projects currently in the pipeline. The issue of a more equitable distribution had already been raised at COP/MOP 1 in Montreal and then again at COP/MOP 2 in Nairobi. At the request of the COP/MOP, the EB developed recommendations on how to improve the CDM's geographical distribution in its reports to COP/MOP 2 and COP/MOP 3. Controversies at the oncoming COP/MOP can be expected regarding the demands from developing countries for increased capacity building and financial support from industrialised countries for the identification and development of CDM projects in regions that have so far been bypassed. Discussions may in particular focus on the "Nairobi Framework", a joint initiative of various UN agencies to catalyse the CDM that was launched in Nairobi by the then UN Secretary General Kofi Annan. The Climate Secretariat's Executive Secretary Yvo de Boer is expected to announce a new proposal on the Nairobi Framework that will probably require donors.

Another controversial issue in this context is projects that reduce the use of **non-sustainable biomass**, i.e. biomass that is used at a rate faster than the natural replacement rate, e.g. by increasing the efficiency of biomass use or replacing it with renewable energy sources. In 2005, the EB had deleted references to this project type from the small-scale methodologies, thus effectively blocking them. The arguments for the deletion were

- that the emission reductions of these projects stem from preserving carbon stocks by avoiding deforestation, which is not eligible as a project activity under the CDM,
- concerns about the permanence of the achieved emission reductions,
- a possible perverse incentive to start using biomass unsustainably in order to then do a CDM project.

The Bali JI Agenda

In contrast to the full CDM agenda, probably no major JI issues will be dealt with in Bali. The JI Supervisory Committee (JISC) made the mechanism operational in 2006 and is currently mainly working on accrediting Independent Entities. The main discussion item in Bali will probably be the JISC's funding. For the current biennium 2006/07, the JISC still has a shortfall of 1.4 million USD. The JISC will also need further funding from Parties for the next biennium. It currently envisages to become self-financing through its fees in 2010 only.

However, proponents of this project type strongly argue that these projects provide significant sustainable development benefits by cutting the time families need to collect firewood, reducing indoor pollution etc. Least Developed Countries (LDCs) also complain that the EB had blocked one of the few types of projects applicable in their context. After very protracted discussions over the course of this year, the EB was finally able to agree on two new draft methodologies for recommendation to COP/MOP 3. Proponents of this project type will probably still be dissatisfied, though, since the drafts employ a long-term fossil-fuel baseline, assuming that the users of non-sustainable biomass would at some point have to

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323 CDM Biogas Projects are in the current CDM pipeline, 143 of which have been registered by the CDM Executive Board so far.
Source: © Juweltop/ Pixelio

shift to fossil fuels once the available biomass has been exhausted. This baseline would yield less CERs than a baseline based on the reduction of deforestation, though.

Parties will also further pursue the issue of whether the **carbon capture and storage (CCS)** technology can be applied in a CDM project. This project type raises a number of methodological, political and legal questions, such as the definition of the project boundary, leakage, the permanence of the sequestration, and responsiblity after the crediting period of the CDM project ends. In addition, some countries such as the LDCs, the Alliance of Small Island States (AOSIS) and Brazil have voiced serious concerns about the maturity and appropriateness of CCS. At COP/MOP 2 in Nairobi, Parties compromised on a two-year process under the Subsidiary Body for Scientific and Technological Advice (SBSTA), with a view to taking a final decision at COP/MOP 4 in 2008. The Bali summit will thus see only further technical discussions on selected issues.

The COP/MOP will also still have the issue of CDM projects that reduce emissions of **HFC-23** on its agenda. HFC-23 is a by-product in the production of hydrochlorofluorocarbon 22 (HCFC-22), a refrigerant governed by the Montreal Protocol on Substances that deplete the Ozone Layer. HFC-23 incineration at existing production sites can already generate CERs, but the EB had requested guidance from the COP/MOP on whether incineration at new facilities was also permitted under the CDM. Since HFC-23 CDM projects are quite profitable with costs of only about USD 0.50 per CO_2 equivalent tonne of HFC-23 avoided, there are concerns that permitting such projects would create a perverse incentive to increase production of HCFC-22 for the sole purpose of generating CERs. Countries have so far been unable to agree on how to avoid such perverse incentives. Some are in favour of crediting new installations and have tabled various options on how to remove the perverse incentives, but others hold that it would be best not to credit new installations at all. **WSt**

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This process aims at integrating large developing countries and the United States, which has refused to ratify Kyoto, in constructive discussions on the future of the climate regime. At the most recent conference in Nairobi, two new items relevant to the post-2012 regime were put on the agenda, namely **a review of the Kyoto Protocol** under its Article 9 and the **Russian proposal** on voluntary commitments.

The Post-2012 Agenda in Bali

In the oncoming Bali negotiations, two issues will be at the centre of interest:

Further background information on the AWG can be viewed at: http://unfccc.int/kyoto_protocol/items/3878.php

Firstly, the **AWG** will resume its fourth session started in Vienna in August. The original AWG's mandate was to agree on new emission reductions by Annex I Parties in the second and subsequent commitment periods under the Protocol. It is necessary to decide on Annex I Parties' reduction commitments in the context of the overall post-2012 agreement, however. Contributions from all major emitting countries will be necessary in order to achieve the ultimate objective stipulated in Article 2 of the UNFCCC to stabilize GHG concentrations in the atmosphere at a level preventing dangerous anthropogenic interference with the climate system. Yet the G77+China has expressed opposition to make reference to the ultimate objective. At the fourth meeting in Vienna, the Parties agreed on a compromise: the AWG Conclusion notes information from the IPCC Working Group III indicating that global emissions of GHGs need to peak within the next 10 to 15 years and be reduced to very low levels, well below half their level in 2000 by 2050.

In Bali, the Parties will continue their analysis of mitigation potentials and identification of ranges of emission reductions objectives of Annex I Parties. This includes the timing of submission by Parties, and negotiations on the development of a timetable to guide the completion of the AWG's work.

Further background information on the Dialogue can be viewed at: http://unfccc.int/meetings/dialogue/items/3668.php

Secondly, the **Dialogue** will come to an end at the Bali conference. Although the Dialogue is not a formal negotiation process, it has worked well as a forum to exchange views and consider broader participation in the climate regime. Considering the necessity of global GHG emissions to peak within the next 10 to 15 years, it is indispensable to agree on a follow-up of the Dialogue. At the fourth Dialogue meeting held in Vienna this year, all Parties agreed to the necessity to agree on further steps. It is expected that the future format, mandate, and link of the Dialogue to the AWG and the Article 9 review will be negotiated in Bali. In Vienna, some of the G77+China Parties proposed extending the Dialogue for two more years in the current format. Others from the same group called for a strengthened mandate for more comprehensive and in-depth discussion as a separate track from the AWG. Annex I Parties that ratified the Kyoto Protocol urged setting up a formal negotiation process combined with the AWG in one track. The EU also called for setting a roadmap to lead to an agreement on the comprehensive post-2012-regime in 2009.

Regarding **Article 9**, Parties will consider the scope and content of the second review of the Kyoto Protocol that is to be conducted at MOP4 in 2008. Concerning the **Russian proposal**, the MOP will take notice of a report by its President on the workshop convened during SB 26 to clarify and explore the scope and implications of the proposal. The views expressed by Parties were divergent, especially on appropriate procedures to take the issue further. Therefore, is it not clear whether the issue will be negotiated in Bali or closed after hearing the report.

Implications for the Future Carbon Markets

The post-2012 negotiations in Bali are going to have implications for the future carbon markets in four ways:

Firstly, an **agreement on the post-2012 regime** by 2009 is essential for the regime to come into effect without a gap between the first and the second commitment period. The EU has reiterated its intention to continue its emissions trading scheme even without a international post-2012 regime. However, it is unclear whether EU companies are going to accept reduction targets in this case. Furthermore, the developing international carbon markets would also break down because of the lack of a long-term framework and perspective. Considering that the ratification of a possible post-2012 agreement is going to

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Coal provides the fuel for 39% of electricity production globally. At the same time, fossil fuel combustion is responsible for a major share of anthropogenic carbon dioxide emissions. The picture shows a coal-fired power plant in Werne, Germany.
Source: Wuppertal Institute

take more than three years, it is necessary to reach an agreement on the post-2012 regime by 2009. This implies starting the negotiations on this agreement now and organise them in a way that allows conclusion within two years.

The full agenda for the Bali climate summit, all relevant documents as well as comprehensive background information can be viewed at: http://unfccc.int

Secondly, **the level of stringency** of the targets for Annex I Parties as well as the level of reduction efforts taken at the domestic level are going to have a significant impact on the future carbon markets. The AWG 4 conclusions recognize that Annex I Parties would be required to reduce emissions by 25-40% below 1990 levels by 2020 to achieve the lowest stabilization level assessed by the IPCC. Another analysis estimates, however, that *domestic* reductions by Annex I Parties of 30% compared to 1990 are required *in addition* to reducing GHG emissions in developing countries to bring global emissions on a 2°C trajectory. Maintaining CDM demand while staying on a 2° trajectory would therefore require that Annex I targets will be stricter than -30%.

Further background information on the Bali climate summit can be viewed on the Wuppertal Institute website at: http://www.wupperinst.org/en/projects/topics_online/international_climate_policy/

Thirdly, the **participation of major emitting developing country Parties** will affect the future supply of credits. There may be some Parties that will commit to absolute – but perhaps not so stringent – reduction targets. In such a case, those Parties will supply surpluses to the carbon markets through emissions trading or a scheme similar to the current JI. Furthermore, some major emitters, namely Brazil and China, have shown a positive attitude to commit to sectoral targets in the post-2012 regime if financial and non-financial support is provided, although they are against national targets in principle. The credit supply from these countries would in this case depend on the stringency of the targets they commit to.

Fourthly, **participation** of the Annex I Parties that did not ratify the Kyoto Protocol, namely the **United States and Australia**, can be expected to dramatically increase the demand for credits.

Outlook

The Bali negotiations on the post-2012 regime will affect the future, but also the current development of the carbon markets. If the negotiations do not move forward, the mounting interest to invest in mitigation projects in both Annex I and Non-Annex I Parties will quickly disappear. The carbon markets are waiting for a tailwind from the tropical coast in South-East Asia. **RW**

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Programme of Activities (PoA) in Annex I States: Germany as a Host Country for Energy Efficiency Projects

Malin Ahlberg and Wolfgang Seidel, German Emissions Trading Authority

Malin Ahlberg, an environmental engineer, has been working with the German Emissions Trading Authority (DEHSt) for four years. She is responsible for the implementation of the German Project Based Mechanism Act. Before joining DEHSt, she worked for a Swedish environmental consultant company for three years.

Dr. Wolfgang Seidel is a lawyer and has managed the Process Management, Quality Assurance, Fees and ProMechG Enforcement Section at DEHSt since 2004.

Germany is unusual in that its Project-Based Mechanisms Act provides for JI projects to be conducted on German territory. Many other Annex I states with similar emissions reduction commitments do not allow JI projects on their territory. This is despite the fact that domestic JI projects provide an opportunity to exploit additional emissions reduction potential.

One interesting development in Germany's role as a JI project host country is that the programmatic approach to the CDM has progressed into a key project category in its own right. This Programme of Activities (PoA) category, which was originally developed for the CDM, allows JI projects in areas such as private households, small and medium-sized business and the transport sector. These take the form of groups of project activities (CDM programme activities, or CPAs) which are consolidated and registered as a single CDM project. According to the definition set out by the CDM Executive Board, a PoA is "a voluntary coordinated action by a private or public entity which coordinates and implements any policy/measure or stated goal (i.e. incentive schemes and voluntary programmes), which leads to GHG emission reductions or increases net greenhouse gas removals by sinks that are additional to any that would occur in the absence of the PoA, via an unlimited number of CPAs."

Another possibility for small-scale projects would be to bundle several projects to form a single CDM project. Under certain circumstances, however, a PoA has significant benefits compared with bundling. With a PoA, neither the exact site nor the individual activities need be determined in advance. The individual activities (CPAs) can be "uploaded" into the PoA at any time without the need for further validation. This is the point from which emissions reductions are calculated. The downside is that the same methodology must be used for each CPA under a PoA and proof of additionality must be provided for each of the CPAs.

With JI projects conducted in Germany, proof of additional emission reductions as called for in national and international climate change policy forms a significant portion of the approval assessment. This means that from the state's perspective, the project provides for a zero balance between carbon credits and its carbon inventory. The potential for domestic JI projects is restricted by Germany's far-reaching legislatory requirements and funding programmes that focus on climate change mitigation – for example, the Renewable Energy Sources Act (EEG) and the programmes run by the KfW Bank in its capacity as the state's promotional loan bank. The programmatic approach enables carbon saving potential to be exploited that is not yet covered by statutory regulations or funding programmes.

By way of example, a project idea taken up in North Rhine-Westphalia (Joint Implementation Model Project, or JIM NRW) aims to save 215,000 t of CO_2 by replacing old heating and steam boilers by 2012. The project combines an unspecified number of individual energy efficiency measures carried out in industry and in office buildings. In a similar way to the CDM Executive Board's PoA requirements, it must be ensured that the programme and each individual programme activity are additional. In the case of JIM NRW, this is largely ensured by clearly differentiating between the programme and statutory requirements and promotional funding programmes. The project design document (PoADD) sets out eligibility requirements for each separate group of programme activities, so that the activities that have already received funding from other sources, or which only comply with statutory requirements, do not become part of the project. To calculate the number of ERUs for the period until 2012, a JI PoA determines the overall maximum emission reductions for the programme in advance. No restrictions are placed on the number of individual activities involved.

The project structure used in the JI PoA approach provides for a healthy balance between the organisational effort involved and the economic benefits achieved. For many

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Energy efficiency is at the heart of JIM. NRW concept: a modernised heat station. Source: BBT Thermotechnik GmbH

companies, verification of minimal carbon savings is unviable due to the high level of effort and the associated transaction costs. The long payback periods for measures with minimal carbon savings prevent small and medium-sized businesses from implementing such projects. Germany plans to allow a number of similar activities to be conducted as JI projects in industry and private households.

Many Annex I countries have vast carbon saving potential, especially in energy efficiency, and PoAs could for example serve in modernising a country's heating systems and in effecting a fuel switch (from oil/coal to gas, installing pellet-fired heating systems, district heating systems). This is especially the case in countries where few promotional funding programmes have been introduced in this sector and where the necessary statutory regulations are not in place. For example, there is great potential for this project category in Russia, the Ukraine and some of the new EU member states. PoAs will probably also be taken up in other Annex I states. With regard to the latter, JI PoA projects are thinkable in areas like energy efficiency in small and medium-sized retail businesses (modernisation of air conditioning systems in supermarkets, biogas systems for sludge and agricultural waste) and in the transport sector (switch to more environmentally sound modes of transport).

At the time of writing, PoAs are only possible under JI First Track. The JISC considers itself to have no mandate to approve such projects for JI Second Track. To ensure that JI does not lag behind the CDM, the JISC should develop requirements that are both demanding and can be met by project developers with a reasonable amount of effort and open up the JI Second Track process to PoAs. The programmatic approach could then become a key project category in its own right and make an effective and lasting contribution to climate change mitigation.

DEHSt will be hosting a side event on the JI Programme of Activities approach at the UN climate summit in Bali. The event will take place on 6 December from 18–20 h. For further information, please check online announcements at http://unfccc.int.

More information on the JIM. NRW model project can be viewed at: http://ea-nrw.de/Emissionshandel/page.asp?TopCatID=2177&CatID=6358&RubrikID=6358

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Standardised Evaluation of Hydropower Projects in the EU

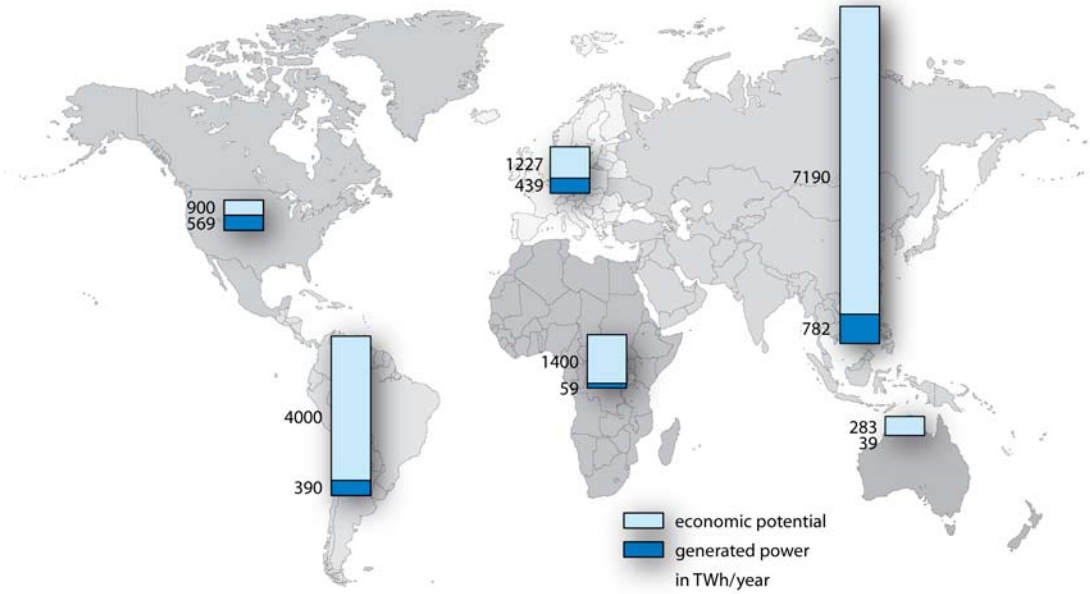
German Emissions Trading Authority Presents WCD Recommendations Guideline

Under the EU Emissions Trading Scheme (ETS), credits obtained from hydropower projects with capacities exceeding 20 MW may only be used if they meet international criteria and regulations. The strictest standards applied to hydropower projects are the recommendations issued by the World Commission on Dams (WCD). Compliance with the WCD recommendations is to be ensured during the project approval and evaluation process. The EU Linking Directive makes no provision for ex-post evaluation regarding the origin of carbon credits used under the ETS or proof of compliance with the WCD recommendations. While these requirements are enshrined in the EU Directive and in subsequent member-state legislation, they have not been operationalised.

With over 650 projects (25 percent), hydropower projects represent the most frequent type of project activity. The German Emissions Trading Authority (DEHSt) has received a large number of proposals for this project type. Against this backdrop, it appeared prudent in 2007 to replace the case-by-case approach to project evaluation (which up to then was thought to be adequate) with a standardised, transparent process. After several months of preparation in close cooperation with development cooperation organisation GTZ and the German Ministry for Economic Cooperation and Development (BMZ), DEHSt published the first edition of its WCD guideline in October 2007. It provides DEHSt with a binding decision-making framework for use in processing project proposals and gives project developers a clear set of guidelines to work with (see next page). DEHSt will update the guideline on a regular basis to reflect experience gained in the approval process.

A number of issues remain unaddressed, however, both from an EU and an international perspective. At EU level, efforts should be made towards standardising approval requirements and practices in the member states in parallel to and independent of the pending review of the Linking Directive. The use of different approval standards across the EU would result in distortion of competition and, by enabling certain processes to be circumvented in that proposals could be submitted to other EU member states, it would completely negate the specific requirements for hydropower projects. The EU has taken up the debate and a dedicated workshop will be held in January next year, organised with the support of Germany's Environment Ministry (BMU).

The situation is, of course, the same when it comes to approval practices in non-EU Annex I states. Fruitful talks with these countries would do away with the need for debate at UN level. It must also be remembered that tried and tested approval practices make the WCD recommendations all the more attractive, including to CDM host countries that have so far either viewed the WCD with scepticism or refused to acknowledge it at all. **TF**



There is still huge hydropower potential around the world, especially in Asia, South America and Africa.
Source: VDMA

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Large Hydropower Projects in JI and CDM

The German Guideline to determine Compliance with the Recommendations of the World Commission on Dams

Malin Ahlberg, German Emissions Trading Authority

When asked for approval to a large hydropower project, the German DNA/DFP DEHSt requires an additional report from DOEs, which proves compliance with the WCD recommendations, see the preceeding article. DEHSt has now developed a guideline in order to facilitate the production of this report. JIKO Info explains the main elements of this guideline in the following.

The WCD recommendations point out five core values that must be met when planning, carrying out and running dam projects. These criteria are equity, sustainability, efficiency, participatory decision-making and accountability. To ensure that these five core values are complied with, the WCD recommendations set out seven strategic priorities. Chapter 8 of the WCD report focuses on these strategic priorities with their underlying principles, see box next page. The structure of the compliance report required by DEHSt therefore should be modelled on chapter 8 of the WCD recommendations.

Following the structure of chapter 8, projects can be reviewed at a given stage on the basis of the seven strategic priorities. Each of the priorities must be evaluated and shortcomings must be pointed out in the DOE's compliance report. In order make transparent in how far the measures foreseen can be enforced, it must be clear who is responsible for their implementation and what the financial framework is. For example, if land is going to be lost, the question of land replacement must be raised, as land-for-land compensation is the preferred option. The obligations of authorities and investors should be laid down in a legally binding way – e.g. through treaties, administrative acts and other safeguards.

In developing countries, hydropower covers around 45 percent of electricity demand – more than that supplied from oil. Its use will increase considerably in the coming decades. The picture shows the Furnas Power Plant on the Rio Grande River, Brazil.
Source: Jose F. Carli, morguefile.com

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In general, the robustness of statements made in the report must be substantiated by documents like Environmental Impact Assessment, documents relevant to the planning procedure, and the stakeholder consultation plan. Where projects involve resettlements, a compensation and resettlement plan is also needed for the compliance assessment.
Some JI or CDM hydroelectric power projects are co-financed by internationally operating banks, which have signed up to the World Bank standards. These standards comply with most of the WCD recommendations such as a comprehensive assessment of all effects and mitigation or compensation for detrimental economic effects. The DOE can refer in the report to those standards. Since the first two WCD strategic priorities are more ambitious than the World Bank standards, the DOE should go beyond them in the WCD compliance report.

Based on the WCD compliance report handed in by the DOE, the German DNA/DFP will issue a Letter of Approval. This will state whether compliance with planned mitigation and compensation measures should be assessed at the time of project verification. In case of no resettlement and no serious social and environmental impacts of the project, the DNA/DFP will refrain from requiring an additional report during the verification process.

The German DNA/DFP has already approved two large hydropower projects in China and thus confirmed the WCD compliance of those projects.

Seven Strategic Priorities for Hydropower Projects

1. Gaining Public Acceptance
2. Comprehensive Options Assessment
3. Existing Dams
4. Sustaining Rivers and Livelihoods
5. Recognising Entitlements and Sharing Benefits
6. Ensuring Compliance with Rules and Regulations
7. Sharing Rivers for Peace, Development and Security

Source: WCD

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