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CHINA-BASED RENEWABLES PROJECTS AGAIN CAME UNDER SCRUTINY AT THE LATEST CLEAN DEVELOPMENT MECHANISM EXECUTIVE BOARD MEETING.

SUSANNA TWIDALE REPORTS

One of the few positives to come out of December's UN climate change meeting (COP 15) in Copenhagen was planned reform of the clean development mechanism (CDM).

The mechanism, which has creaked under the weight of bureaucracy over the past two years, is the second-biggest carbon market in the world and at COP15 the UN promised efforts to tackle some of the problems.

The Copenhagen talks called on the CDM executive board, which governs the mechanism, to review how it should interpret the UN's E+/E- rule, a key principle that offers guidelines on whether to register emissions reduction projects that are impacted by domestic policies to cut emissions.

But just two months into 2010, and a few days after the year's first board meeting, those hopes appear to be dashed, with developers accusing the board of being dogmatic and insisting on a strict interpretation of the rules.

At its February meeting, the board rejected six wind energy projects in China and either undertook a review or requested corrections before registration of a further 36 projects, throwing doubt over whether these schemes will be eventually registered – reopening wounds investors had hoped were healed.

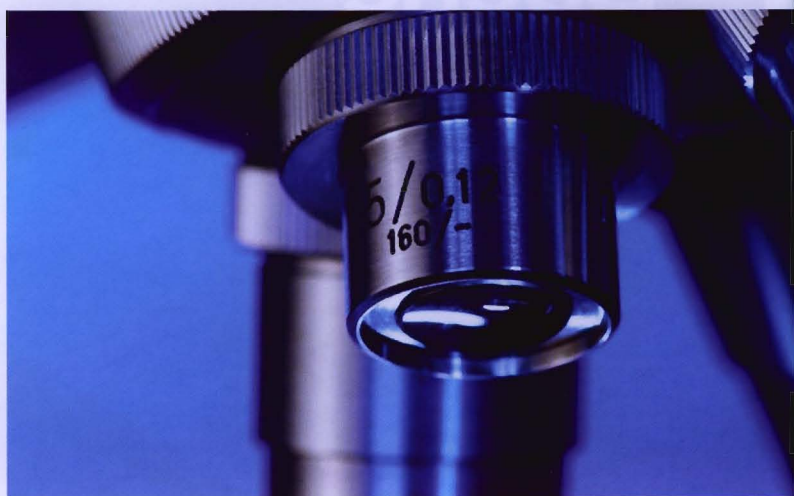
The board also set the spotlight on China's growing hydro project base, undertaking a review or asking for further corrections on 38 proposed hydro projects in the country.

These 74 CDM projects hope to produce almost 38 million carbon credits by 2013 at an estimated value of around €450 million (\$616 million) based on current prices. But developers say it is the bigger picture that is important.

Both project types are in for further scrutiny either because they will receive a lower subsidy, known as a feed-in tariff, than similar projects have, or because the board fears they breach the E+/E- rule.

For one investor, the reason is far simpler.

"Some members of the (board) are concerned that in their eyes China is trying to cheat the system," said John Green, chief operating officer of developer Carbon Resource Management (CRM).



The issue goes back to last year, when the board rejected 10 wind projects in China at its last meeting of 2009, largely due to fears that the country was lowering subsidies in the hope that private investment would fill the funding gap through revenues from the CDM (see *Trading Carbon*, February 2010, pages 30–31).

If true, the board implied, then this would render projects ineligible for the CDM as they are non-additional, or in other words, that they would have happened without carbon finance.

At the Copenhagen summit, parties to the UN Framework Convention on Climate Change promised

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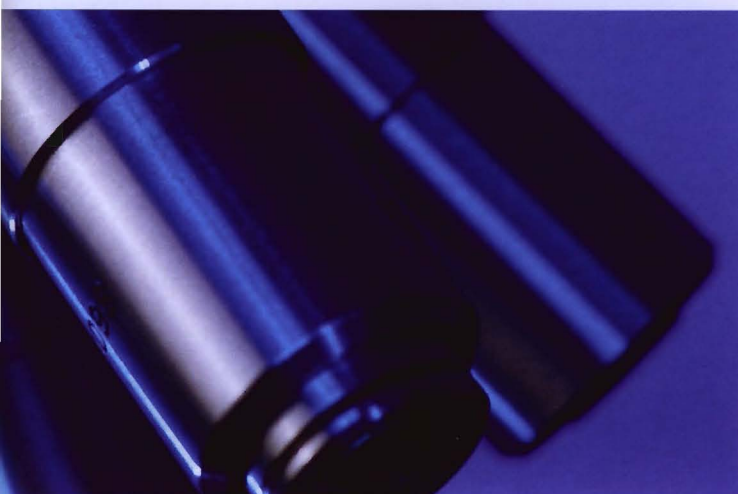
John Green, CRM

clarity on this issue and said that there would be a serious discussion on the E+/E- issue. But this has yet to take place, a move that has angered investors.

"The further delay of the E+/E- discussion is a serious pity as the fog remains and it hampers progress of this kind of renewable project in developing countries," said Martin Enderlin, chairman of the Project Developer Forum (PDF), a representative organisation for developers.

CRM's Green said that presently the board will only register grid-connected renewable energy projects if investors can prove that using the highest feed-in tariff awarded since 2001 means their internal rate of return (IRR), a measure of profitability, is below a benchmark of 8 per cent, excluding carbon credit revenue.

microscope



“The board in their assessment is in some cases referring to subsidised tariff levels that were not ever awarded to projects,” Green said.

“It does not seem appropriate that only the highest tariff is used to determine whether a project can now be considered additional, when only one single project in the region has ever obtained that level of support,” he added.

“I am very disappointed to see that the board is still using the ‘historical highest tariff’ approach, in which (it) is using other, not relevant, projects’ tariff to substitute the proposed projects’ tariff to calculate the IRR for additionality,” said Liming Qiao, policy director at the Brussels-based Global Wind Energy Council

But it appears now that the board is not just looking at wind. It is turning its eye to hydro. The inclusion of so many hydro projects in the pipeline has led to fears that they will now face similar problems to those that have hampered carbon credit issuance of many of China’s wind projects.

“In principle, we are not worried by (the number of hydro projects under scrutiny) because it is important for the board to carry out checks,” said Lau Saili, policy analyst at the International Hydropower Association (IHA). “In practice, however, it is worrying because the process is a black box creating unnecessary fear and speculation which is undermining confidence in the market,” he said, referring to the board’s lack of transparency.

“Some of the hydro projects (under review or needing corrections) are suffering from the same issues as the wind projects, that the IRR potentially crosses the benchmark when the highest tariff ever of the region is applied” agreed PDF’s Enderlin.

“This 8 per cent IRR is externally set,” said Mischa Classen, senior project manager at developer and consultancy First Climate in Zurich. “It would be very helpful if the NDRC

(China’s National Development and Reform Commission, which sets the tariffs) would open up the data on tariffs to CDM developers or the board so that we can see the different tariffs applied in different areas,” he said.

In many cases, the projects have not received the tariffs the board uses to calculate the IRR. Classen said that knowing what feed-in tariff was being applied to the projects in which regions would make it easier for the developers and the board to know whether or not the projects risk breaching the 8 per cent IRR benchmark.

This lack of clarity could lead to a slowdown in investment in China-based renewable projects, said IHA’s Saili.

“The tail is wagging the dog at the moment and I think the (board) is playing a dangerous game with China. (The CDM) is the only thing that enables private capital to be mobilised in developing countries to facilitate clean development, and China has been one of the success stories of this,” he said, referring to China’s position as the number one country in terms of projects registered under the CDM.

“We really need a systematic look at how the regulatory system is structured, because at the moment (the board) is going to incite the wrath of the Chinese and undermine clean development in developing countries,” he added.

“One developer has cancelled plans for two 50-MW wind farms in China following failure to get their first project registered under the CDM,” said CRM’s Green, adding that the board has created a lot more uncertainty around such projects.

The meeting, which ended on 13 February, discussed other issues, including electing a new chair and vice chair (see ‘on the move’, page 10), but failed to deliver discussions on whether developers should have a right to appeal – something that COP15 had advised the board to discuss.

The only positive move for developers from the meeting was a decision to defer the payment of registration fees for any country with less than 10 projects until the first carbon credits are issued.

“We welcome this move, but registration fees are just a small part of the process. The issues surrounding the clarity of the future of the CDM are still there and that is what will affect future investment in the projects,” said First Climate’s Classen.

The board has also waived registration fees for projects in least developed countries (LDCs). The LDCs include 33 African countries, 15 Asian countries and Haiti.

The meeting notes also showed that the UN made \$56.6 million in CDM revenues in 2009, including \$17.1 million in registration fees. ●