



This newsletter is published as part of the project JIKO – Development phase 2005-2007 at the Wuppertal Institute for Climate, Environment, Energy – Energy, Transport and Climate Policy Research Group

Dear Reader,

The UN Climate Change Conference in Montreal draws closer. With the Kyoto Protocol now in force, the first official meeting of its parties will be held at the end of November. Apart from attempting to reach decisions on Joint Implementation (JI), the conference will also focus on the future of the climate regime as a whole. Considerations on reform of the Clean Development Mechanism (CDM) have long been an agenda item in climate policy debate. Hence, this issue of JIKO reports on issues ranging from the debate on further development of the CDM to a sectoral mechanism. JIKO also continues its series on current CDM/JI tenders and reviews a new publication on bundling small-scale CDM projects.

Enjoy the read.

*The Editor*

## JIKO News

### Towards a Sectoral Approach to the CDM

**A recent JIKO Policy Paper by Wolfgang Sterk and Bettina Wittneben addresses the emerging discussion on introducing a sectoral approach to the CDM. It describes the perceived weaknesses of the CDM as it is implemented today and outlines how a sectoral approach might attend to some of these shortcomings.**

The central idea behind the sectoral CDM is to define a baseline with a greater scope than that of a single project. This might take the form of either “clustered” projects, where similar projects in one country are bundled into one large project, or “policy-based” projects, where governments implement emission reduction projects and receive Certified Emission Reductions accordingly.

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## JIKO News

### Germany’s Project-Based Mechanisms Act Comes into Force

**With its official announcement in the Federal Gazette, Germany’s Project-Based Mechanisms Act (ProMechG) entered into force on 29 September 2005. The Federal Environment Ministry (BMU) is now working apace on the subordinate Costs Ordinance. Other regulations provided for in the Act are not necessary to allow direct use of CDM and JI involving Germany as an investor country. Additional regulations may be issued at a later date, for example to further simplify the approval process for small-scale JI projects.**

With the “Act Implementing the Project-Based Mechanisms of the Kyoto Protocol”, the German government has transposed into national law the EU directive that regulates integration of CDM and JI into the Emissions Trading Scheme (Linking Directive).

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JIKO News

## Towards a Sectoral Approach to the CDM

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The paper examines the conflicting interpretations of such an approach and outlines issues that need to be resolved: deciding on the role of the actors involved, defining the sector and its baseline, ensuring additionality and tackling procedural issues. The sectoral approach can enable countries to guide their structural development. However, it also opens up a gap between public and private investment that needs to be addressed before conflicts arise. Sectoral CDM activities may be able to lower transaction costs for projects that otherwise cannot compete in the CDM market; they might even pave the way to sectoral greenhouse gas limitation targets in developing countries by establishing the necessary infrastructure for data collection.

At the moment, there are already two projects in the CDM pipeline which pursue a sectoral approach. Should the CDM Executive Board register these projects, the CDM would in effect be able to organically develop towards a sectoral mechanism. Should the issue be funnelled into the international political debate instead, the sectoral CDM may become one of the many elements in the negotiations surrounding the second commitment period of the Kyoto Protocol and thus only be implemented after 2012.

The paper can be downloaded at

[http://www.wupperinst.org/download/JIKO-PP\\_2005-1.pdf](http://www.wupperinst.org/download/JIKO-PP_2005-1.pdf)

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JIKO News

## Germany's Project-Based Mechanisms Act Comes into Force

*Continued from page 1.*

German companies involved in the scheme can now fulfil a portion of their reduction commitments by using certificates from climate change mitigation projects abroad. The Act also regulates the conditions and procedures for CDM and JI project implementation. Project developers who wish to engage in a climate change project may now register their projects in Germany.

The Costs Ordinance will set out the framework for the German Emissions Trading Authority (DEHSt) to levy charges for project processing. The DEHSt will use this framework to establish the actual charges to be levied for individual CDM and JI projects at a later date. When setting the charges, the legislature has provided for full coverage of the costs incurred; the same applies for the framework rates laid down under the Costs Ordinance. Along with the work performed by public offices in processing a project proposal, the costs of general administration also have to be covered: in addition to everyday office and administration overheads, these include cross-sectoral duties that are vital to the use of CDM and JI. Apart from providing information to developers of CDM and JI projects, such duties include the setting up of a CDM/JI database which will serve as the foundation in providing the required level of transparency and public participation.

When levying charges in accordance with the full costs principle, the Environment Ministry faces the challenge of having to calculate acceptable charges that are commensurate with the level of effort involved in project processing while still at a phase in which project costs increase at an initially slow rate. The Costs Ordinance is expected to be approved at the end of October.

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JIKO News

## CDM and Sustainable Energy Supply in Latin America

### Expert Workshop Debates Outlook

*By Wolfgang Müller and Dieter Seifried*

**Last April, the Federal Ministry for Environment, Nature Conservation and Nuclear Safety (BMU) hosted an expert workshop in Buenos Aires. Entitled “Clean Development Mechanism and Sustainable Energy Supply in Latin America – What must be done to help this concept move forward?”, the workshop had two specific aims: to identify the opportunities that the Clean Development Mechanism (CDM) offers for the transfer of clean energy technologies and to highlight the obstacles that prevent use of renewable energy resources and implementation of sustainable energy management in Latin America. Experts from Argentina, Brazil, Chile, Columbia, Cuba and Mexico came together in Buenos Aires to exchange their opinions and ideas. The workshop was conducted in cooperation with the International Solar Energy Society (ISES) and Öquadrat, a Freiburg-based environmental economics consultancy.**

In both 2006 and 2007, energy will again take its place on the agenda of the UN Commission on Sustainable Development. The Clean Development Mechanism can serve as a key instrument in designing sustainability-based energy policy. In the countries of Latin America, a range of different trends are evident. Some are undergoing highly dynamic economic development with all the energy supply problems it brings. Others, both countries and regions, are striving to alleviate the energy supply deficits caused by the lack of economic development. Thus, when it comes to using the CDM, Latin America is an extremely attractive target region and negotiations are already well advanced on drawing up the necessary intergovernmental agreements (Memoranda of Understanding, or MOUs) between the German government and some countries in the region.

While the CDM is seen to make a significant contribution to initiating projects towards sustainable energy management and the use of renewable energy resources, the

workshop nevertheless highlighted a number of weaknesses. It also emphasised the fact that the CDM alone is not sufficient to assist the much-needed breakthrough in transition and developing countries that would allow them to adopt sustainable energy management practices. Conditions in the energy supply industry itself also need to be improved.

### Conditions in the Energy Supply Industry: An Evaluation

Workshop participants reported the following key weaknesses in the Latin American countries under discussion:

- Compared with Germany’s Act on Renewable Energy Resources, none of the countries has clearly defined, reliable legislation on feeding energy into the grid. Nevertheless, both Brazil and Mexico are making serious attempts to introduce regulations that give preference to renewable energy projects. Chile has new rules which allow potential investors to be offered long-term guarantees on pre-determined feed-in tariffs during project negotiations.
- Energy and electricity prices are heavily subsidised in most Latin American countries and the viability of energy efficiency measures suffers as a result.
- Policymakers in Latin America have not recognised energy policy as a priority area. The opportunities offered by the CDM have so far gone unnoticed.
- Knowledge on new technologies (for use of renewable energy resources and efficiency technologies) is not particularly wide-spread.

In all six countries, though, progress has been made when it comes to recognising the importance of renewable energy resources and efforts are now underway to change the conditions in the energy supply industry. However, more detailed, country-specific analysis is needed to enable a well-founded assessment of the effects of the intended new legislation as regards improving opportunities to implement CDM projects.

### Weaknesses in the CDM Process

The expert discussion highlighted some very clear weaknesses in the CDM process. Although it was generally acknowledged that the CDM can provide an attractive incentive for renewable energy projects (and for energy efficiency projects, albeit in more limited scope), changes are needed if the mechanism is to reach its true potential.

The process must be made more operational, more transparent for all concerned and usable for projects that promise a positive social outcome but remain beyond the scope of the CDM framework because of the high transaction costs involved.

Transaction costs must be reduced to give small-scale and medium-sized projects a chance to enter the CDM process. Information and education work is also needed to heighten industry awareness to the opportunities afforded by the CDM – something that has gone unrecognised (or has not been adequately recognised) in Latin America so far.



*Workshop Participants in Debate.*  
Source: Büro Ö-quadrat

Workshop participants found that the CDM process has a poor input-output ratio. The level of effort is too high and the returns on the sales of certificates are either too low or too unreliable. Also, the existing CDM process delays project implementation, acting more as a barrier than a door-opener.

The CDM is not self-perpetuating, neither in respect of renewables (with the exception of landfill gas use) nor in energy efficiency. Two changes are necessary: host countries must improve investment conditions and the CDM process must be adapted to meet the requirements already outlined.

### Better Information

One key barrier to investors can be seen in the complex and varied energy industry structures in individual countries. This makes it extremely difficult for potential investors to conduct a timely and reliable assessment of the situation. An

internet platform could help solve this problem by providing key information such as statutory regulations, investment-specific details and an outline and analysis of the latest trends.

An online network of this kind would seem appropriate considering that exchange between Latin American countries on potential projects and suitable technologies would be beneficial – especially seeing that projects proposed by industrialised countries do not always meet the needs of the target countries.

The representative from the Federal Environment Ministry emphasised that the ministry's plans to set up an internet platform must take account of the interests of those Latin American countries who did not attend the workshop. Also, consideration would have to be given to the potential investors and the global players (e.g. World Bank, GEF, other international financial institutions and the UN organisations involved in the process) to be integrated into the network. A further workshop to discuss these issues will be held in Latin America in spring 2006.

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**Dieter Seifried**, an engineer-economist, is the owner and manager of Büro Ö-quadrat (an environmental economics consultancy). Ö-quadrat specialises in issues concerning energy technology, the energy industry and the economy. Its work involves the development and evaluation of projects for the use of renewable energy resources and sustainable energy management.

JIKO News

## Testing Ground Facility Moves Forward

*By Ash Sharma*

**The Testing Ground Facility (TGF) is a specialist regional facility which purchases AAUs and ERUs from energy related and other projects developed in the Baltic Sea Region on behalf of German and Nordic governments. The TGF is currently entering a new phase of becoming a Public Private Partnership by inviting private investors and rapidly developing its project portfolio. As such it is a unique example of regional cooperation in the field of carbon finance.**

In September 2003 an intergovernmental agreement was concluded between governments in the Baltic Sea Region establishing a regional Testing Ground Facility for Joint Implementation projects with the dual aim of stimulating an early follow-up of the Kyoto Protocol and to help the countries of the Baltic Sea Region to position themselves favorably in respect of fulfilling their own commitments under the Kyoto Protocol. As the last country in the region Russia has announced its signature to the agreement as a priority issue. The Testing Ground Facility is managed by the Nordic Environment Finance Corporation (NEFCO).

The TGF invests in projects with a potential for delivering cost-effective ERUs (according to Article 6 of the Kyoto Protocol) and AAUs (according to Article 17 of the Kyoto Protocol for projects delivering emissions reductions prior to 2008) for the account of the investors, which provide good examples of JI thereby helping to further clarify central issues of the project mechanism, develop the procedures and promote common understanding in the countries of the Baltic Sea Region. Priority will be given to projects located in host countries in the Baltic Sea Region Testing Ground area, currently Poland, Lithuania, Latvia, Estonia and Russia. Currently, the bulk of the portfolio is in Russia, reflecting the unparalleled technical potential across a wide typology of projects for JI in that country.

The TGF's initial capital is expected to increase through additional governmental and private sector investment during 2005/2006, with a target size of around € 30 million. Currently, NEFCO is seeking investments from selected private sector companies in the Baltic Sea region to allow it to expand its activities and meet its objectives of becoming a Public Private Partnership. ERUs acquired by the TGF can be used in the EU ETS for compliance purposes. Purchasing through the TGF reduces project risks through diversification as well as lowering compliance costs. Initial discussions have already been held with major German utilities, and the capital raising exercise is expected to take place in late 2005.

### Benefits of Carbon Finance

Use of carbon finance can significantly improve the project economics of an investment by securing additional, euro-denominated revenue which makes the project more bankable, reduces risk and enhances equity return. Benefits to project owners and developers include

- A defined geographic focus benefiting from NEFCO's in-depth knowledge of the region, especially within Russian Federation
- NEFCO's direct experience of energy, environmental and municipal environmental infrastructure projects, from financing to implementation with access to in-house advisers on environmental technologies
- Excellent political goodwill in the host countries through the Testing Ground Agreement, akin to a multilateral Memorandum of Understanding, helps to reduce political risk
- Potential access to project co-financing from NEFCO and cooperating financial institutions for project financing (risk capital, debt and grant facilities) and co-purchasing of credits for larger projects, for example from its investor countries
- An ability to accept smaller projects (<250,000 tCO<sub>2</sub>e over the crediting period) – "small scale JI" is an important part of its mandate, especially in the Baltic states

### Portfolio Development Priorities

The TGF invests in projects owned and operated by private enterprises, public utility companies, public-private partnerships and municipal, regional or governmental authorities. Energy related projects are given priority with a focus on renewable energy (biomass, small scale hydropower, wind power and geothermal), fuel switching, energy efficiency and energy conservation. However, also other sectors such as waste (e.g. waste to energy, capturing of methane from landfills) and projects related to reduction of other greenhouse gases (such as nitrous oxide) are eligible for financing from the TGF.

Much of 2004 was spent developing the project pipeline, but the Facility has been moving forward rapidly since the appointment of a full time Manager in June 2005. Operational priorities currently include closing the projects already at an advanced stage of contracting, further development of the pipeline for 2006 and the private sector capital-raising. Constraints are the pace of institutional developments for project approvals, especially in Russia, but these are expected to ease by the end of 2005. Already two projects are at the draft ERPA stage, both involving renewable energy investments in the Baltic States (one biogas and one wind power). Other projects at latter stages of contracting include

- Russian Federation – district heating rehabilitation, methane capture and energy from municipal wastewater treatment, power plant energy efficiency, industrial fuel switching at paper and pulp mill
- Lithuania – landfill gas capture and utilisation, biogas from animal waste

The broader pipeline also includes projects from Latvia and three Ukrainian projects, and several projects were received prior to the September 2005 Investment Committee meeting. In total, the current qualified pipeline is over 5 million tCO<sub>2</sub>e, or twice the current subscribed capital of the Facility.

A Call for Expressions of Interest was made in August 2004. However, TGF projects are identified continuously and project ideas from project owners, developers and consultants are welcome at any time.

### Contact

For additional information about the TGF, submission of project ideas or the private sector capital raising, please contact:

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### JIKO Review

## Bundling to Reduce Transaction Costs

### New guide to bundling small-scale CDM projects

**Small-scale CDM projects are said to make a significant contribution to sustainable development, yet they still attract very little capital investment. One huge barrier in this regard are the CDM-specific transaction costs that can often prevent implementation of a small-scale project from the outset. A possible solution comes in the form of 'bundling', meaning joint development and implementation of projects to share and thus reduce transaction costs. While many studies recommend this solution, practical experience is sorely lacking. A new guide aims to close the gap.**

The “CDM Pool” project, which is supported by the EU SYNERGY programme to promote innovative energy projects, focuses on the conditions for small-scale CDM projects in India. Using the findings of their studies, the Indian and Dutch researchers working on the project have published “A Guide to Bundling Small-Scale CDM Projects”. The aim of the publication is to provide guidance on successful project bundling because, according to the authors, simply bundling projects without giving careful consideration to the issues involved can actually result in an increase in assigned transaction costs. The guide also contains recommendations for policymakers on ways to improve the CDM framework.

Following a brief presentation of the simplified rules for small-scale projects, the authors describe the requirements that the project and the bundling organisations must meet in order to survive in normal market conditions. The descriptions largely focus on bundling activities in which third parties act as the bundling organisation for projects from a range of different project developers. Basing their findings on theoretical studies, the authors conclude that under certain conditions, bundling small-scale projects can improve the implementation chances for first-class small-scale CDM projects:

- Promising project bundles should fully exploit the allowed capacity threshold of 15 MW and comprise similar projects wherever possible.

- The activities to be bundled should ideally be from a single category and must be able to apply a common baseline.
- Electricity supply projects designed to feed energy into the grid are more suitable than those involving off-grid facilities because the latter involve an extremely high level of monitoring effort.
- The project bundle should involve as few project partners as possible to keep the complexity and the legal challenges to a minimum.

The bundling organisations must, say the authors, possess a range of different skills, legal and technical know-how and marketing expertise. Because it is difficult for any one organisation to fulfil such requirements, third parties must be commissioned to perform individual work modules.

By way of illustration, the authors give three brief examples of very different project bundles in India. These are all still in the development phase. In comparing the project models, the authors reach similar conclusions to those drawn using theoretical considerations. As a practical guide for organisations wishing to enter the bundling sector, the Guide contains a template text of a business plan drawn up by a bundling organisation and a project concept note for a bundled biomass project. Finally, the authors draw upon the experience gained with the CDM Pool to present a list of recommendations aimed at simplifying the bundling process: apart from improving local policy frameworks (a well-functioning DNA, good governance), these include abolishing the 15 MW threshold for small-scale project bundles.

The Guide provides interested parties a good insight into the challenges, opportunities and limitations involved in project bundling. For project developers, it serves as a practical decisionmaking tool, with easy-to-follow graphics, decisionmaking trees and tables. Some of the information is rather sketchy, however. For example, the projects used for theoretical consideration are not described in detail. An unidentified bundle comprising facilities that feed energy into the grid is compared with some 120,000 self-sufficiency systems. From this comparison, the authors conclude that grid-feeding systems are more appropriate than off-grid systems. If the former were five biogas facilities, the result would hardly be surprising and would not be transferable. It would also have been helpful if the

experience gained in India had been presented in a different context: it goes unmentioned that the baseline requirements can be extremely complex in cases where energy is fed into the public grid and there is no available data. This would mean a significant increase in CDM-specific start-up investments for projects of this type.

The Guide is available at <http://www.cdmpool.com/publications.htm> (51 pages, PDF format, 1.8 MB). Unfortunately, no 'text only' version has been provided for less powerful computers and networks.

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## JIKO News in Brief

### Public Participation in JI Projects in Germany

The German validator RWTÜV has published project documentation on 51 small-scale JI projects hosted in Germany. The projects involve using mine gas in Germany's Ruhrgebiet coal-mining region, the aim being to use the gas for energy and reduce methane emissions. RWTÜV has now published the project documentation online to allow the general public and anyone directly affected to inform themselves and respond. The documentation can be accessed at [www.global-warming.de](http://www.global-warming.de), where readers also have the opportunity to enter their comments directly online.

### Policy Paper on the Emerging Spot Market for Certified Emission Reductions

The CDM Executive Board is expected to issue the first CERs in the near future. A policy paper recently published by Thomas Langrock, Wolfgang Sterk and Bettina Wittneben outlines what still needs to be done to enable countries and companies to trade in CERs. National governments and the UNFCCC Secretariat still have to set up the CDM registry, the Independent Transaction Log and the national registries. Governments will also need to invest substantial efforts in meeting the eligibility criteria for participating in the CDM and the Emissions Trading Scheme under Article 17 of the Kyoto Protocol. If these efforts are neglected, the development of a spot market for CERs could take another one or two years. It may also be necessary to explicitly allow the parking of CERs in the pending account of the CDM Executive Board until the conditions for their transfer have been met.

The policy paper is available for download at: [http://www.wupperinst.org/download/JIKO-PP\\_2005-2.pdf](http://www.wupperinst.org/download/JIKO-PP_2005-2.pdf)

### Experience with the CDM in Africa Sought

Few CDM projects have been implemented in African countries so far. The Wuppertal Institute is thus conducting a study on how well these countries have prepared themselves for CDM activities and the steps that need to be taken to increase their capacity to participate in the process. Alongside a direct analysis of the institutional and procedural conditions in the host countries, specific project activities conducted by foreign companies, CDM funds and development agencies can give African countries an insight into practical experience with the CDM. Project developers naturally face the risk of failure in trying to implement projects under such difficult conditions. To determine how best to advise host countries, the experience gathered by project companies, CDM funds and development practitioners when working on these projects is of key importance.

The Wuppertal Institute invites companies and project developers who are working on projects in African countries to report on their experience and submit ideas on how cooperation structures can be improved. The information received will be used, among other things, to develop country profiles.

The Wuppertal Institute is conducting the study as part of the JIKO project commissioned by the Federal Environment Ministry. Interested parties are requested to contact Dr. Bettina Wittneben at: [jiko@wupperinst.org](mailto:jiko@wupperinst.org).

## JIKO Info

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