PointCarbon

CDM & JI Monitor

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ViewPoint: LULUCF projects under JI: Will they be impossible?

Joint implementation countries, in particular Russia and Ukraine, hold a vast potential for land-use, land-use change and forestry (LULUCF) projects. Forestry projects in Russia alone could help to off-set one half of the industrial carbon emissions of the US. Whether we can realize at least some of this mitigation potential depends, among other issues, on the finance available through JI and a correct interpretation of the rules governing JI LULUCF projects.

JI permits LULUCF project activities that are not eligible under the CDM. Beyond afforestation and reforestation, JI would allow projects that promote improved forest management; increased fire and pest controls; and preserve old growth forests in the Russia. Therefore JI LULUCF projects have an important demonstration potential for the discussions of a post-Kyoto regime.

Emission reductions (or removals) generated by LULUCF JI projects are transferred to the investor country as ERUs, generated by converting AAUs or Removal Units (RMUs) from the host country's account. Current interpretations of the JI LULUCF raise concerns, as they create restrictions on the development of JI LULUCF projects. The position being taken is that only RMUs (but not AAUs) can be converted into ERUs for JI LULUCF

At present, if a country has not met its Kyoto Article 3.3 or 3.4 reporting obligations, or its accounting under Article 3.3 and 3.4 does not generate RMUs, that country will be barred from hosting JI LULUCF projects. For example, a project to reduce emissions from deforestation will reduce the "consumption" of AAUs, but will not generate RMUs. Thus AAUs must be converted into ERUs, and the Marrakech Accord provides for this possibility. "Track 2 JI" rules also clearly state countries can participate in JI even if they have not met their Article 3.3 and 3.4 reporting obligations. Countries that elected accounting of LULUCF over the entire commitment period will also have problems as they cannot issue any RMU's until 2013.

We believe that the described interpretation being proposed for the ITL are inconsistent with the Kyoto Protocol and Marrakech Accords.

Bernhard Schlamadinger, Joanneum Research

Robert O'Sullivan, Climate Focus

Recent credit purchases

Date	CDM/JI	Vol (tCO_2e)	Delivery	Price category	Price range
23.01.2007	JI	10,000,000	2009-13	3	€11-14
17.01.2007	CDM	630,000	2009-12	2	€6-10
01.01.2007	CDM	56,000	2009-12	4	€13-15
01.01.2007	CDM	145,000	2009-12	4	€12-15
01.01.2007	CDM	160,000	2009-12	4	€13-15

The information provided in the table is from emission reduction purchase agreements (ERPAs) – based on contacts with key traders, brokers and project developers. It does not necessarily represent the complete market. Information has been anonymised in order to respect key players' confidentiality needs. Explanations of abbreviations and acronyms: see page 7 and Glossary on www.pointcarbon.com.
The price categories are developed by Point Carbon and are based on the risk distribution between buyer and seller: 1: The seller does its utmost to deliver a flexible/non-firm volume, whereas the buyer commits to buy what the seller delivers. 2: The seller does its utmost to deliver a flexible/non-form volume, whereas the buyer commits to buy if the seller delivers. The contract is only valid on a set of preconditions. 3: The seller guarantees to deliver a firm volume; the buyer commits to buy if the seller delivers. The contract is only valid on a set of preconditions and usually has a strong force majeure clause. 4: The seller guarantees to deliver a firm volume, and the buyer guarantees to buy if seller delivers.

CDM market comment

The price for issued CERs has softened since Japanese bidding relaxed at the end of last year, and is now reported at €11.5 – €12.5.

However, the price for registered projects has remained stable around the average of €10, as there have been few market movers in the primary market. In the secondary CER market signals remain mixed. Activity has been muted, and the German decision to increase its limit on CER use from 12 per cent to 20 per cent has put pressure on CER prices. Closing prices have been seen just above of 80 per cent of EUA price, with a recent deal reported at 79.6 per cent of the EUA Dec08 to Dec12 average contract price.

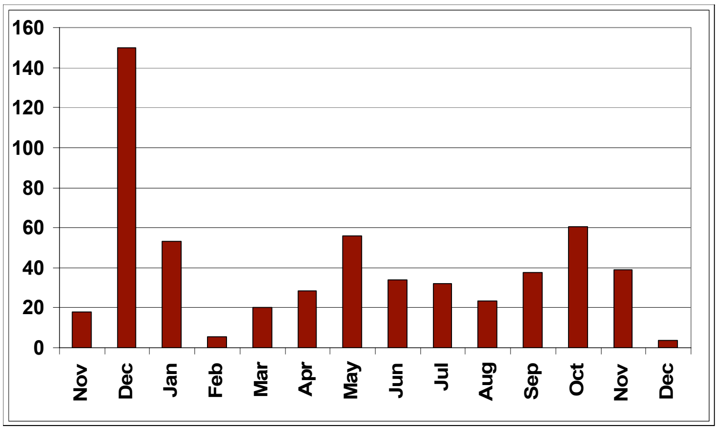
However some bullish signs on price have started to materialise. Most notably, the European Commission has cut the overall allocation in the Dutch and Belgian national allocation plans (NAPs) and is widely expected to make major cuts to several NAPs in the months ahead. If overall allocations in the second phase of the EU ETS are tightened, this could increase the overall demand for CERs, which in turn would give a fillip to the secondary CER market.

Elisabeth Lokshall, Point Carbon

News in brief

- **India** has now approved 456 CDM projects after the country's environment ministry gave the thumbs-up to 46 greenhouse reduction schemes in its latest monthly meeting.
- **China** has also approved a new batch of CDM projects in recent weeks, giving the thumbs-up to 28 in its latest update on the DNA's website, bringing the total to 254, which between them could yield 116.6 million CERs, according to PDDs.
- **Morgan Stanley** has taken a 38 per cent share of **MGM International**, a US-headquartered investor in CDM projects, which could give the US investment bank access to carbon credits generated from projects in Latin America and China, part of a $3 billion investment in carbon finance over the next five years.
- **Thailand's** cabinet has been submitted 15 CDM projects for approval- which would be the first projects to be given the green light in a country where political turmoil has delayed approvals for CDM projects. Among the projects submitted to the cabinet for approval are prompt start GHG reduction schemes that are seeking to gain retroactive credits.
- **Trading Emissions PLC**, the fund that aggregates carbon credits, said in a trading update that its contracted volume of emissions reduction credits stood at almost 25.67 million by the end of last year, up 2.38 million from the end of September.

CDM and JI investments
Monthly in 2005 and 2006 ($MtCO_2e$)



CDM and JI Project Pipeline

So far, 4,383 proposed CDM and JI projects have been registered in Point Carbon's Project Database. Of these, 1,925 projects, potentially yielding 2,230 mtCO_2e of emissions reductions towards 2012, have reached Project Design Document (PDD) level.

	Total			PDDs			Commented			EB/SC			Issued		
	T	14	C	T	14	C	T	14	C*	T	14	C	T	14	C
MtCO_2e	N/A	*	*	2230	2217	+13	1705	1692	+13	742	712	+30	28	26	+2
Number	4414	4383	+31	1925	1902	+23	1500	1480	+20	488	471	+17	120	110	+10

T=Today; 14=14 days ago; C=Change. Total: Number of JI and CDM projects registered in Point Carbon's Project Database; Commented: project submitted for public comments on UNFCCC website as part of validation. EB/SC: projects registered by the CDM Executive Board or JI Supervisory Committee; Issued: CDM EB or JI SC has issued CERs/ERUs (number refers to the number of times CERs/ERUs have been issued). All volumes are total volumes until 2012. For forecasted volumes, see Carbon Market Monitor. See page 7 for explanation of abbreviations.

Recent CDM Developments

• Southeast Asian countries at the **ASEAN** summit have asked Japan for help on expanding the number of greenhouse gas emissions reduction projects in the region.

• Japanese industrial giant **Marubeni Corporation**, which aims to buy a total of 10 million CERs annually, has invested in three new emissions reduction projects in China that could generate 1.2 million credits per year.

• **KfW Bankengruppe**, which operates a €90-million fund that aggregates carbon credits, signed a memorandum of understanding on Monday (MoU) with the **Industrial Development Bank of India** to help promote the CDM.

	Total	New since last update[1]
# projects submitted for EB registration	51[2]	34
# projects registered	489	14
Meths - total[4]	304	4
Meths - approved (A)[5]	71	0
Meths - under revision(B)[6]	24	0
Meths - not approved (C)[7]	81	0
Meth Panel yet to assess	23	0

[1]New since last publication of CJM, 5th January 2007.
[2]Including 15 projects being requested the review by EB, 4 projects under review, 3 projects with corrections requested, 11 rejected and 2 projects withdrawn
[3]Total number of methodologies submitted to the UNFCCC, including Afforestation/Reforestation (A/R) and small-scale methodologies. Revised versions of previous submissions are not included.
[4]Including 5 A/R methodology, 1 AR-AMS (Approved Small Scale) methodology, 21 small-scale and 10 consolidated methodologies approved.
[5]Methodologies which status is currently "B", which means they have to be revised and resubmitted to the UNFCCC.
[6]Methodologies which have gotten a "C" not approved by the CDM Executive Board. Including 15 A/R methodologies. In addition, 10 methodologies have been withdrawn.

UK government may introduce CDM standard in voluntary market

Proposals by the UK government that the retail market for carbon offsets follow the verification and monitoring standards laid down by the Kyoto Protocol is likely to boost demand for CERs from aggregators of carbon credits through the CDM. But the EU ETS and Kyoto compliance markets will remain as the main focus, market participants have told Point Carbon.

The UK's environment ministry, the Department of Environment, Food and Rural Affairs (Defra), launched a consultation document on 18 January in a bid to improve consumer confidence in a market that has expanded massively in the last few years as individuals and companies have sought a way of neutralising emissions from the use of electricity, heat and transport.

The quality of information on the projects used to generate voluntary offsets varies wildly - as does the standard of projects used to salve the consciences of individual consumers and to improve the green credentials of the UK's biggest companies, and the public sector such as government departments, agencies and local councils.

"The credits proposed in the code will be certified emission reductions (CERs), EU allowances (EUAs) and emission reduction units (ERUs) because they are robust and verifiable," Defra said in its consultation document. The UK's environment ministry has also acknowledged that its plans to certify only those projects that are CER standard would help grow the UK's already well-established role in the international carbon market. Defra's proposals mean that CERs could be repackaged for use in the voluntary market as providers of retail offsets may choose to buy in ready-made credits in order to obtain certification from Defra, should it enact the proposals.

Indeed, some offsetters in the voluntary market, such as the Carbon Neutral Company, do this already. Around 20 per cent of the credits in the company's portfolio of offsets are now sourced from the CDM, said Jonathan Shopley, the company's CEO. Climate Care, another offsetter, said the company didn't have any CDM credits currently in its portfolio but will buy CERs - although the company said it was unhappy about Defra's insistence on a CDM market standard.

However the cost - and quality - of CERs compared to high standard voluntary offsets will be key if those companies that have aggregated carbon credits from the CDM can cash in on demand from the voluntary market. Verified emissions reductions are currently a good deal cheaper than CERs (around €3-5 as opposed to €6-10 for a standard offtake CER). Ecosecurities, a London-listed aggregator of carbon credits, suggests that the market for CERs for use in the voluntary market is at a very early stage.

"We've been approached by some corporates to provide offsets for offsetting. Perhaps they foresee that they will need CERs for a future compliance (in a widened emissions trading scheme at EU ETS or intra-UK level).

But in the short term the CERs will be used for voluntary purposes. Caisse de Depots (a French bank) is an example of one of these companies," said Lisa Ashford, principal commercialisation manager, with Ecosecurities. Trading Emissions PLC, a London-listed fund that gathers together carbon credits for the compliance market, in December sold 255,000 CERs to the UK government in order to offset flights taken by cabinet ministers. Ecosecurities suggested that using CERs (or CDM standard) would bring much more transparency on the price of carbon for use in the voluntary offset market and would provide an important signal to consumers.

In addition, by including CERs, more sectors would get involved than are currently used to source VERs. But while some of the more established offset companies welcomed the UK's moves to clarify guidelines for the sector, they contend that the CDM is often a suitable vehicle for the voluntary market.

"If you are trying to get companies or consumers to adopt an offset programme for the first time, voluntary schemes which are more local and community based often have more relevance and consumers can more easily see the benefits," said Jonathan Shopley. James Graham, general manager with Camco, an aggregator of carbon credits for the compliance market, acknowledged that "there are good verified emissions initiatives already out there."

India's SRF reports big profit from CER sales

SRF, an Indian chemical company that owns one the world's largest greenhouse gas reduction projects, said in an earnings release on Tuesday that sales of carbon credits earned the company Rupees 122.28 crores (€21.23 million) in the final quarter of 2006, underlining the huge revenues that companies can generate by reducing the potent greenhouse gas HFC-23.

With the quarterly earnings season set to move into full flow in the coming weeks, SRF is the first of the major chemicals companies with CDM projects to deliver its financial results, the profits generated from the company's CDM project accounted for around 30 per cent of total revenue, a huge return on its investment despite lower prices for CERs during the second half of 2006. "Maintaining the trend from earlier quarters, cash flows from the transfer of certified emission receipts (CERs) was strong," said chairman of SRF, Arun Bharat Ram, in a statement.

The company, which makes technical textiles, refrigerant gases and packaging films for the pharmaceutical sector, reported revenues from the company's combined operations of Rupees 450.36 crores in the October-December quarter of financial year 2006/07, compared to 296.27 crores the corresponding period in 2005.

SRF added: "While the company has realised around Rupees 122.28 crores during the quarter from the transfer of CER units, cash flows from carbon credits are expected to vary & may not recur uniformly from quarter to quarter."

SRF did not report a figure for earnings from CER sales for the October-December period in 2005, even though it has been generating sales from CERs since mid-2005, with Shell Trading, EDF Trading, Barclays Capital, Icecap and Barclays listed among the buyers.

To date, the executive board of the CDM has issued SRF with 6.85 million CERs, the biggest volume of carbon credits earned by any one company. The project has the potential to generate 32 million CERs by 2013.

The massive profits generated by companies such as SRF from sales of CERs have drawn strong criticism from environmental groups and developers of renewable energy in the CDM, who claim that such projects have crowded out investment in sectors such as wind farms. And non-governmental organisations (NGOs) claim that the chemical plants in which CDM projects are based harm the local environment through pollution of the air and water. However, the companies involved deny this.

The cost of developing the SRF project is estimated at around €5 million, ensuring that the company has generated huge returns from reducing HFC-23, a by-product of HCFC-22, which is itself a climate changing gas. HCFC-22 also harms the ozone layer and production of the refrigerant is controlled by the 1987 Montreal Protocol.

However, supporters of projects such as SRF's argue that the Indian government had shown little interest in forcing companies to cut emissions of HFC-23, and that the global warming potential of the greenhouse gas, which is 12,000 times more powerful than carbon dioxide, is a compelling reason for its capture.

HFC-23 projects are also praised by some carbon traders for kick-starting the CDM by encouraging the trading of CERs in the early stages when many other types of project were small in scale or still on the drawing board.

Other chemical companies yet to declare results, such as Gujarat Fluorochemical, another big HCFC-22 producer based in northern India, and French group Rhodia, which has developed projects to reduce nitrous oxide (N2O) in South Korea and Brazil, are expected to show big earnings from the sale of CERs.

In the case of HFC-23 projects, the extent to which chemical companies will be able to make eye-watering profits will be coming into sharper focus early next month as the CDM executive board (EB) debates whether projects can earn CERs from reducing HFC-23 from 'swing' HCFC-22 production. In May, United Nations-sponsored meetings will discuss whether a newer generation of HFC-23 plants not currently covered by the CDM can be included in the Kyoto mechanism, an issue that is sure to a major talking point at the next United Nations summit.

Russia will not cap JI volumes

Proposals to cap the amount of carbon credits that could be generated from JI projects in Russia did not make it into the final version of the procedures currently making its way through the bureaucracy.

Five Russian government departments agreed on a set of procedures for carrying out JI projects on 29 December. In the run-up to the interministerial agreement, several proposals for various special rules had been put on the table, including one to limit the number of emissions reduction units (ERUs) Russia should allow in the Kyoto compliance period.

"This was not included in the final version," an official in the Russian ministry of industry and trade told Point Carbon.

The cap proposal had caused some worries among market participants that JI in Russia could be launched only to suffer from severe restrictions. At the time of publication, 13 project design documents (PDDs) have been submitted to the JI supervisory committee (JISC) under Track-2 of JI, proposing to cut emissions by a total of 67.8 million tonnes of carbon dioxide equivalent (mtCO2e). Many more projects are being developed.

The procedures agreed upon by the ministries of economic development and trade, foreign affairs, industry and energy, and natural resources as well as Roshydromet (the agency responsible for weather monitoring) on 29 December are currently under scrutiny by the ministry of justice. According to Russian law, the ministry of justice must ensure that the procedures have been created in a legal manner. If the ministry approves the document, it will be submitted to the government for approval.

According to the procedures, the ministry of industry and trade will act as Russia's focal point on JI, and will thus have the final say on awarding host country approval to Russia-based projects. However, the ministry of industry and energy will also participate in the review process of PDDs, the official said.

On 11 January, Russia's ministry of industry and trade resubmitted a draft proposal on a green investment scheme (GIS) to the government apparatus. The bureaucracy refused to accept the ministry's proposal of last year, and some of its comments have now been incorporated into the new version. The ministry of industry and trade official said he was hopeful that some progress could be made on a GIS this spring.

Recent JI developments

• The Japan's Marubeni Corporation has signed a contract to purchase 2 million ERUs annually from a JI project in Ukraine over the five-year period from 2008 to 2012. The project, which will capture methane emissions from the Zasyadko coal mine, has been approved by the Ukrainian government and is expected to get the green light from the Japanese designated national authority shortly.

• Europe's largest utility, Russia's RAO UES, has told its power generation subsidiaries to speed up elaboration of investment plans that can be implemented under the Kyoto Protocol's flexible mechanisms. The majority state-owned utility has 72.4 per cent of installed electricity generation capacity in Russia. It intends to invest 2.1 trillion rubles (€61 billion) in upgrading existing activities and expansion in the 2006-2010 period.

• The Latvian parliament will vote on a green investment scheme in the middle of this year, and says several countries are interested in buying carbon credits.Valdis Bisters, director of the Latvian government's climate and renewable energy department said he expected legislation to pass parliament in the middle of this year.

• Germany's Dresdner Bank and the Russian Gazprombank have announced the establishment of Carbon Trade & Finance, a joint venture which will invest in JI projects.The Luxembourg-based joint venture, which was approved by the EC in December but has not yet filed an application to Luxembourg regulator CSSF, will develop and purchase ERUs in Central and Eastern Europe.

AE	Applicant Entity
AAU	Assigned Amount Unit
Annex I	**Countries are the 36 countries and economies in transition listed in Annex I of the UNFCCC.**
AWG	**Ad-Hoc Working Group on Further Commitments, as required under Article 3.9 of the Kyoto Protocol**
CCS	Carbon Capture and Storage
CDM	Clean Development Mechanism
CDM EB	CDM Executive Board
CER	Certified Emission Reduction (CDM trading unit)
CMM	Coalmine methane
CCGT	Combined-cycle gas turbine
COP	Conference of Parties to the UNFCCC
DNA	Designated National Authority
DOE	Designated Operational Entity (third party)
EB	CDM Executive Board
EBRD	European Bank for Reconstruction and Development
ERPA	Emission Reduction Purchase Agreement
ERU	Emission Reduction Unit (JI trading unit)
EU ETS	European Union Emissions Trading Scheme
GHG	Greenhouse gas
H	Hydropower
HFC-23	Potent greenhouse gas; byproduct from production of cooling medium HCFC-22
JI	Joint Implementation
JISC	Joint Implementation Supervisory Committee
LNG	Liquified Natural Gas
MOP	Meeting of Parties to the Kyoto Protocol
MoU	Memorandum of Understanding
MtCO2e	Million tonnes of carbon dioxide equivalent
N/A	Not applicable
N2O	Nitrous oxide
PDD	Project Design Document
tCO2e	Metric tonne of carbon dioxide equivalent emissions
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change

See also "Glossary" at www.pointcarbon.com

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Recent CDM & JI reports
- Setting the cap: Towards scarcity in Phase II
- UN Climate Change Conference, Nairobi 6-17 November: Summary and Implications
- Carbon Policy Update: The CDM Executive Board's 27th meeting
- Carbon Policy Update: Overview of NAP-2 in regards to CDM & JI
- Carbon Policy Update: JI Supervisory Committee's 5th meeting

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