

MARCO MONROY and GAUTAM DUTT tackle the many stages in realising a successful CDM project

Getting ready for market

Getting a potential Clean Development Mechanism (CDM) project to market may be defined as passing a series of tests. The first test is to win trust. Approaching potential project sponsors in developing countries has been a complicated task. The number and types of players is large. It is not easy to judge the pros and cons of working with local consultants, international institutions, foreign governments, private companies and even diplomats. And even when the trust of project developers is achieved, we have to overcome the CDM technical tests.

The CDM permits Annex I (industrialised) countries ratifying the Kyoto Protocol to 'acquire' greenhouse gas (GHG) emissions reductions credits from non-Annex I (less developed) countries. Since the non-Annex I countries have agreed to no quantitative reductions in their GHG emissions, the Marrakesh Accords define ways by which the global community can determine whether the emissions acquired are genuine.

The technical tests are described in terms of a baseline study using an approved methodology and monitoring and verification procedures, again following an approved methodology. The CDM Executive Board (EB) proposed methodologies for certain categories of small-scale projects, determined by size and project type, and this reduces the tasks involved. However, while there is reduced effort this is balanced by reduced project size and value, and other transaction costs, such as project identification, baseline study, monitoring methodology development, contract negotiation, validation and verification, remain virtually unchanged. Thus few small-scale projects have been presented so far, including three from us, and only two others world-wide!

Baseline and monitoring

For projects that do not classify as small scale, the CDM Executive Board has requested that project design documents, which are required for all proposed CDM project, must include proposed baseline and monitoring methodologies. The main body of the project design documents should also show how the methodologies will be applied to the project in question. Half of the first 14 such projects submitted were rejected outright and the other half were asked to modify specified aspects of the application and resubmit. This caused consternation among project developers as it added delays and costs to an already cumbersome procedure. As *Carbon Finance* went to press, while nine methodologies had been given an A rating – as being acceptable – only two of these have been formally approved and

designated with AM0001 and AM0002 ratings. It is important to support the development of high quality methodologies and we approve of the CDM Executive Board's decisions so far. However, when we meet our clients and pass on the decisions of the CDM Executive Board, we face the next test.

This is the patience test. The Kyoto Protocol was signed in 1997, but it is yet to go into effect. The procedures for CDM development were not outlined until the Marrakesh Accords in November 2001. There has been a continuous process of learning by doing for project proponents, project developers, designated national authorities, institutional purchasers, the CDM Executive Board and its Methodology Panel, and project validators.

Waiting

Meanwhile, we are waiting for submitted methodologies to be approved, for our approved methodologies to be used in the submission of similar projects, for submitted projects to be validated, for validators to be accredited, for national governments to designate a national authority, for designated authorities to approve projects, and for projects approved by all the parts involved to be registered by the UNFCCC. And all of us are waiting for a key country to ratify the Kyoto Protocol and bring it into effect! Specifically, our company is awaiting national decisions for two small-scale projects to be definitively validated. In two others, we await methodologies to be approved, and also to present similar projects.

The CDM is about promoting investment and technology transfer. Once projects go through the CDM acceptance criteria, we face the investment test, which has to consider country risks and political realities. For many countries, this test may be difficult to meet, and could entirely undermine the objectives of the CDM.

Added to this there is the market risk test. In the emerging carbon market, prices for Certified Emissions Reductions (CERs) are 'forecasted' on a speculative basis, since very few real transactions have occurred and these have been by institutional buyers that specified the prices. Thus, we are caught between sellers expecting high prices for CERs and buyers perceiving large uncertainties, such as the magnitude of so called 'hot air', available.

There is of course also a cultural test. Sponsors, developers, validators, reviewers, stakeholders, sellers and buyers come from all corners of the world. There are enormous and fascinating differences between north and south besides language, which must be overcome along the way.

All of these bring us to the final and most important CDM institutional test. CDM was intended to overcome barriers in order to promote sustainable development while stabilising GHG emissions. So far, the CDM process appears to have created a number of barriers of its own. All of us have to contribute to meet these tests and in so doing, help overcome these and more traditional barriers. We hope that the participants will have the patience, while we create CDM institutions that are strong and transparent, and the CDM can indeed be an effective tool for climate change mitigation.

Marco Monroy is the president and Gautam Dutt is technology manager of MGM International, a company based in Miami, Latin America and India to develop CDM projects E-mail: marcogmonroy@mgminter.com and gdutt@mgminter.com

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