



## The CDM methodology approval process and the exclusion of avoided fuel switch projects

*An explanatory briefing to accompany the letter sent by 143 Brazilian groups and individuals  
to the CDM Executive Board, June 2004.*

### Introduction

The week of 7-11 June 2004 will see the World Bank/IETA sponsored Carbon Expo in Cologne, Germany, and the annual meeting of the World Bank's carbon funds. The meetings will provide a platform for the Bank to promote its "high-quality" projects and its role as a front-runner in the emerging carbon market. Yet on the day after the Carbon Expo, the Executive Board of the Kyoto Protocol's Clean Development Mechanism (CDM) will meet in Bonn and consider a recommendation from its Methodologies Panel to exclude "avoided fuel switch" projects from the CDM, a ruling that would almost certainly terminate the Bank's two large plantation-based projects in Brazil – Plantar and V&M do Brasil. Far from representing "high-quality" carbon credits, the Methodologies Panel thinks these two Bank projects represent a "moral hazard"<sup>1</sup>.

Ahead of the Board's meeting, 143 Brazilian NGOs, church groups, unions and individuals have written to the Executive Board urging them to accept the Methodologies Panel's recommendation, and ensure that the CDM is not used as a new subsidy for the unsustainable tree plantations industry. This briefing is an accompaniment to that letter and explains the process by which CDM projects have their methodologies approved, the background to the Methodologies Panel's request, and the implications it would have for the World Bank's carbon market activities. Both the letter and copies of this briefing can be downloaded from [www.cdmwatch.org](http://www.cdmwatch.org), or [www.sinkswatch.org](http://www.sinkswatch.org).

### Methodology approval – an overview

All CDM projects must use a baseline and monitoring methodology that has been approved by the CDM Executive Board, unless they are small-scale projects. The Board has delegated the assessment of new methodologies to a specially constituted panel – the Methodologies Panel – which makes recommendations to the Board.

The baseline methodology is used to construct the project's baseline, which estimates the level of greenhouse gas emissions that would occur in the absence of the registered CDM project and, based on this, the amount of greenhouse gas emissions that the project will reduce, store or avoid. These reductions are monetised as tradable "carbon credits", with 1 tonne of CO<sub>2</sub> equivalent equalling one carbon credit.

Once a methodology has been approved, a project can then seek validation – essentially approval - from an operational entity that has been accredited by the Executive Board. This operational entity is commonly known as the Validator. An approved methodology can also be used by other projects, while a rejected methodology can be resubmitted. If a project cannot get its methodology approved, and cannot use another, it cannot be approved as a CDM project.

### Avoided fuel switch projects and "moral hazard"

In early 2003, the V&M do Brasil avoided fuel switch project sought approval for its baseline and monitoring methodology. The V&M do Brasil project is being developed by the International Finance Corporation-Netherlands Carbon Facility (INCaF)<sup>2</sup>. V&M do Brasil uses plantation-derived charcoal in the production of steel. They claim that in 2002 they would have switched to using coal instead, causing higher greenhouse gas emissions, if not for

<sup>1</sup> This is the phrase used by the Meth Panel as part of its recommendation. See the following section of this briefing: "Avoided fuel switch projects and "moral hazard", for a full explanation.

<sup>2</sup> The IFC is a part of the World Bank Group and as such we talk about "World Bank" projects.

the possibility of using carbon credits to finance replanting. The carbon credits are claimed for avoiding the switch to coal and the resulting increase in emissions. The World Bank PCF's controversial Plantar project also claims carbon credits for avoided fuel switching and indeed the two projects use the same baseline. If V&M do Brasil's methodology is approved, it could be used by the Plantar project<sup>3</sup> and other plantation-based CDM projects.

At its meeting in May 2003, however, the Methodologies Panel rejected V&M do Brasil's proposed methodology due largely to concerns that the project was non-additional; that is, V&M do Brasil couldn't demonstrate that the decision not to switch to coal was dependent on carbon credits. V&M do Brasil resubmitted a new version of its methodology in September 2003. Two months later the Methodologies Panel sought the guidance of the Board about V&M do Brasil's revised methodology, and more broadly avoided fuel switch projects as a category. They wrote:

*"The meth panel seeks the guidance of the Board on the project type of avoided fuel switch and expresses concern, based on the consideration of NM0029 [ie V&M do Brasil], related to immaterial nature of the project activity and the moral hazard<sup>4</sup> that is related to the fact that the project activity consists of continuing current practice"* [emphasis added].

Essentially, the Panel was recommending that avoided fuel switch projects be excluded as a project category. The Board's decision whether to follow this recommendation is expected at the 12-14 June Executive Board meeting in Bonn, Germany.

### **The implications for the World Bank's carbon funds**

If the Board accepts this recommendation it will almost certainly mean the end of the V&M do Brasil and Plantar projects and have a significant impact on the World Bank's carbon market activities and aspirations.

The V&M do Brasil and Plantar projects are expected to generate over 16 million carbon credits in total by 2012, the end of the Kyoto Protocol's first commitment period. Plantar's 6 million carbon credits are more than 10% of the 51 million credits that all 43 projects currently being developed by the PCF are expected to generate by 2012<sup>5</sup>. The 5 million carbon credits that the Dutch Government intends to buy from V&M do Brasil represents half of the expected total of 10 million credits that will be sourced through INCaF<sup>6</sup>.

The impact of the Executive Board adopting the Methodologies Panel's recommendations and rejecting the revised methodology presented by V&M do Brasil would go beyond the loss of credits. For the World Bank, the larger issue is likely to be the impact of the failure on the Bank's reputation as a carbon fund manager, and its efforts to promote the use of sinks projects. Plantar, after all, was meant to provide a template for future CDM projects using industrial plantations. The 2002 Project Appraisal Document for Plantar is explicit on this point: "*The project is expected to prepare the ground for similar projects in the future*".

The CDM is meant to promote sustainable development, not an unsustainable tree plantations industry. The Executive Board must act to stop this subsidy for the tree plantations industry by excluding avoided fuel switch projects at its 14<sup>th</sup> meeting of 12-14 June 2004.

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<sup>3</sup> Although Plantar will also have to seek separate approval for its "sinks" component.

<sup>4</sup> This is one of the many available definitions: "*The risk that a party to a transaction has not entered into a contract in good faith, has provided misleading information about its assets, liabilities, or credit capacity*".

<sup>5</sup> These figures were provided by the World Bank's carbon finance helpdesk, 24.10.03. Note that this figure is for the total amount of credits that the projects are expected to generate, but the PCF itself does not buy all the credits.

<sup>6</sup> The IFC press release of 4.2.03 - "IFC, V&M DO BRASIL do Brasil, and Toyota announce the largest ever CDM transaction to purchase emission reductions" - states that INCaF will buy 5 million credits from V&M. The 10 million credit figure is from an email to CDM Watch from Vikram Wedge, Program Manager, Carbon Finance, IFC, 10.10.03.