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Why Bother with the CDM?
Thoughts From a Hopeful but Frustrated Practitioner

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The CDM is a Radical Experiment

- Nothing like this has ever been attempted before

> A market mechanism to link industrial and developing countries for **capital**, **technology**, and **deployment**

- Essentially, the **past** is subsidizing the **future**
  - But, only insofar as the Market efficiently allows transfers and prices them competitively against other options
- The CDM is supposed to support both **emission reductions** *and* **sustainable development**
- Five years in and signs are mixed…

Emissions policy Basics

Cap & trade: efficiently achieves a quantitative environmental result from a set of participants

- But, less effective as covered sources grow smaller, more diffuse

Taxes: uncertain short term elasticity and long term behavior shifts

Emission caps – or taxes - for developing countries is a non-starter

- **This doesn’t mean there are no significant opportunities to effectively reduce emissions from such sources**

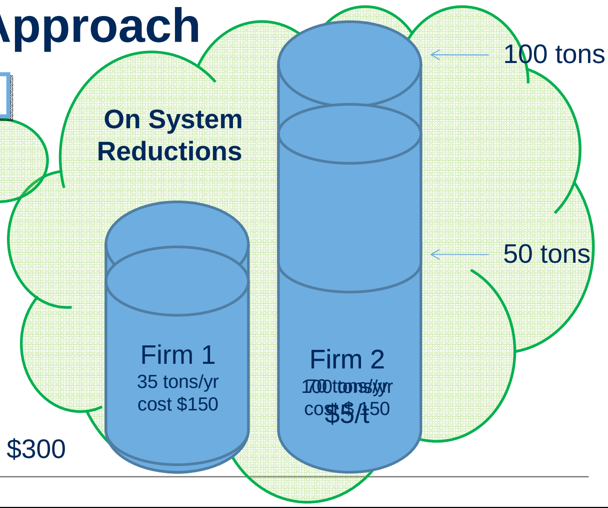
We talk about “on system” and “off-system” reduction opportunities

- **CDM is the principal off-system opportunity**

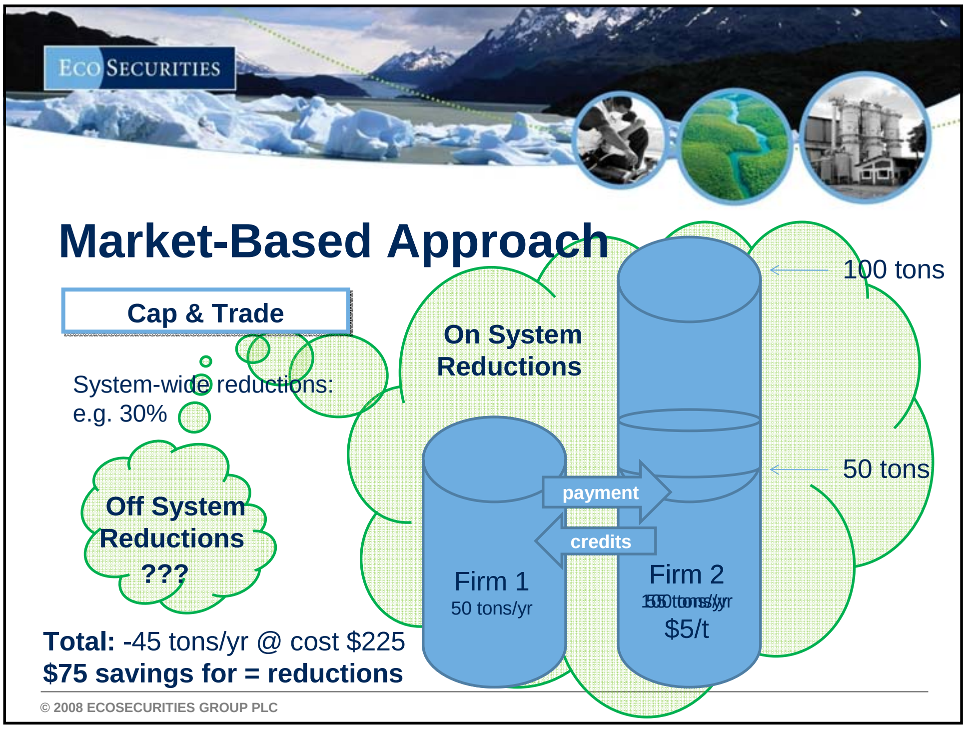
Traditional Approach

Command & Control

Across the board reductions: e.g. 30%



Total: -45 tons/yr @ cost $300


EcoSecurities
Market-Based Approach
Cap & Trade
System-wide reductions:
e.g. 30%
Off System
Reductions
???
On System
Reductions
100 tons
50 tons
payment
credits
Firm 1
50 tons/yr
Firm 2
100 tons/yr 55 tons/yr
$5/t
Total: -45 tons/yr @ cost $225
$75 savings for = reductions
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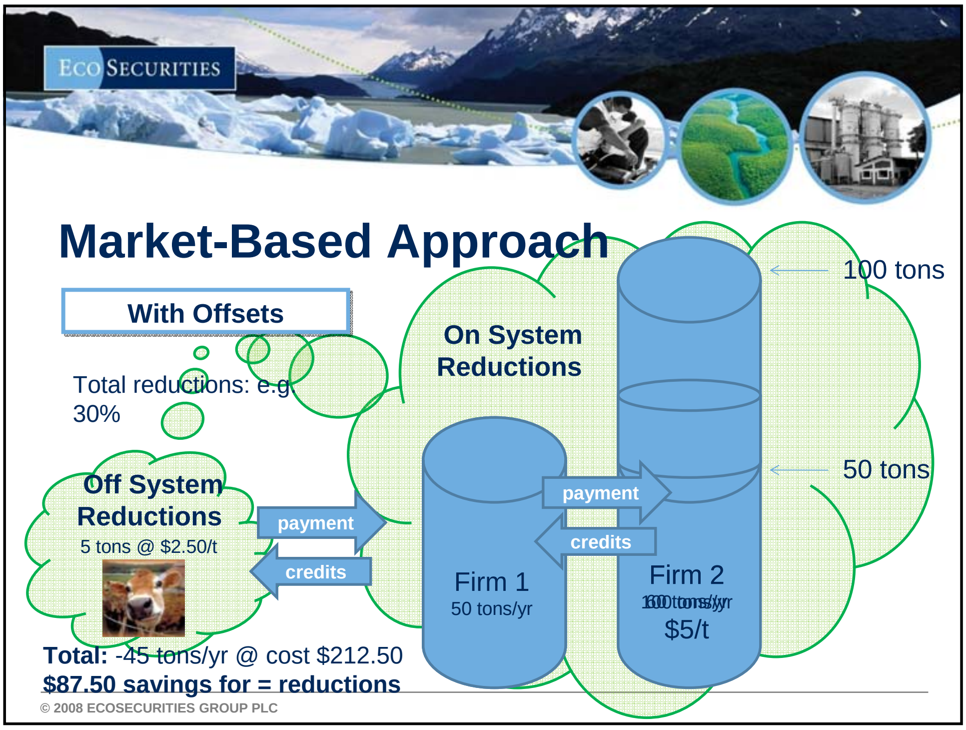
EcoSecurities
Market-Based Approach
With Offsets
Total reductions: e.g
30%
Off System
Reductions
5 tons @ $2.50/t
payment
credits
On System
Reductions
100 tons
50 tons
payment
credits
Firm 1
50 tons/yr
Firm 2
100 tons/yr 60 tons/yr
$5/t
Total: -45 tons/yr @ cost $212.50
$87.50 savings for = reductions
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The CDM is created from whole cloth

- Possibly the first regulatory system that **creates value**, rather than intermediating value that already exists
- An enormous task—potentially unlimited number of project types, locations, counterparty types, emission reduction methodologies
- System bridges multiple countries and the UN
- Enforcement largely managed by private sector, media, civil society
- Imperative need for independent, third party accountability

Creating CERs is *not* a zero-sum transaction

- The concept of "**additionality**" is plausible on the surface, but ranges in qualitative interpretation among different observers

The Positive and the Negative

- Complex system up and running
- >950 projects UN registered
- >3000 more in the pipeline
- Current projection: from 2008-2012 these projects will reduce **2.5 billion tonnes** of developing country emissions

- Successful early projects are extraordinarily concentrated
- 16 of 950 projects are generating 75% of total credits to date (95M out of 130M tonnes)
- System is overly complicated and is becoming almost impossible for small projects to gain access

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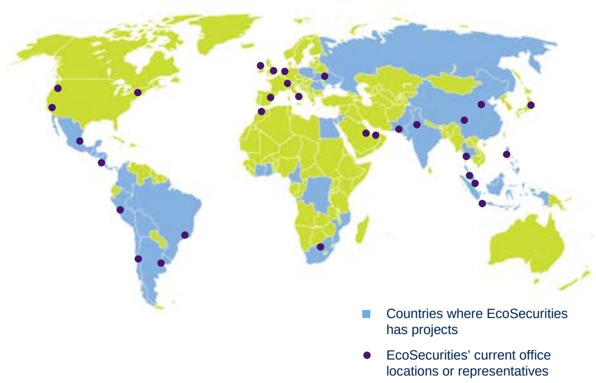
- The hardest part is over
- “Learning by doing” has created significant CDM expertise base
- Many failures can be attributed to “over-success”
- Solid proof that markets can indeed achieve social objectives

- High value, immediate return projects are done
- Dwindling Kyoto timeframe = little incentive to invest in next set of projects
- Great uncertainty today about what happens after 2012
- Current additionality construct makes many CER projects highly unpredictable
- **All this constrains investment flows dramatically**

Example: The Dispersion Effect

Buenos Aires
Bankok
Beijing
Bern
Casablanca
Chengdu
Delhi
Dubai
Dublin
Jakarta
Johannesburg
Karachi
Kiev
Kuala Lumpur
Lima



Los Angeles
Madrid
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Manama
Mexico City
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Oxford
Portland
Rio de Janeiro
Rome
San Jose
Santiago
Singapore
The Hague
Tokyo

EcoSecurities Overview

EcoSecurities is a leading originator of carbon credits in the global carbon market

Carbon Credit portfolio at of March 2008 comprised of:

- 400+ CDM projects using 18 technologies in 36 countries
- 105 projects registered with the CDM Executive Board (largest portfolio in the world)
- Projects have the potential to generate 150 m CERs to 2012

A history of “market firsts”:

- First emission reduction project to be registered by the UN under the Kyoto Protocol
- First project to receive Certified Emission Reductions (CERs) under the Kyoto Protocol

Strategic association with Credit Suisse via an acquisition in June 2007 of 9.9% of issued share capital.

EcoSecurities is listed on the London Stock Exchange AIM (ticker “ECO), with a market capitalisation of approximately US$300 m.

We are an Industry Based on Policy

- Today, policies are extremely unpredictable/disappointing
  - The ongoing delays in linking the EU to the CDM via the International Transaction Log has *real* impacts on cash flows
  - No certainty of post-2012 in the UNFCCC
  - EU’s proposed severe limitations on the CDM post-2012 are already negatively impacting the industry
  - “Fortress California” a surprising vanguard of climate protectionism
  - Most US legislation largely devoid of international linkages

Fool Me Once, Shame on You…

- To those in the industry, policy shifts are bewildering and disturbing
- Capital markets have provided €billions to funds, companies and technologies based on the assumption of stable policy
- Won't easily get another bite at the financial apple if capital markets believe that climate policies are too malleable and unpredictable
    - Many of us remember when the i-banks were *not* at the table

Capital markets are not "optional" in a global transition that will require the mobilization of €trillions

Fool Me Twice, Shame on Me

- Innovation and determination must be rewarded
- Important that early adopters and risk takers not have the rug pulled out from under them by arbitrary policy shifts
- Risk pulling a "bait and switch" on a key climate change/sustainable development tool that has engaged the developing world
- This could have profoundly negative impacts on future negotiations between the OECD and G-77 on these issues

Why the Shift?

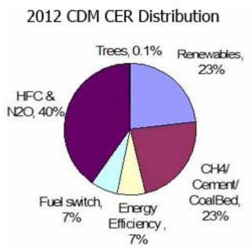
Some negative interpretations:

1. **CDM is nothing more than a subsidy for China**

Response:
- China is 40% of the developing world's emissions
- It makes sense that many CDM projects were sourced there
- China has also created a stable CDM regulatory environment
  - Not the case in many other countries (Brazil, Thailand, etc.)

2. **CDM has proven a boon to one class of assets alone**

Response:
- Only partially true, plus, markets by nature first seek out highest return assets
- There may have been more effective/ efficient means of reducing emissions from these highly concentrated sources
- In the absence of such means, the markets proved able to provide effective incentives and find least cost reductions



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3. The voluntary carbon market is rife with charlatans

Response:

- Important differences between voluntary and compliance markets
- Not entirely untrue (or true), but saying so would be like condemning the Internet in 1998 because of **Pets.com**

4. Phase 1 of EU ETS was a fiasco

Response:

- It is not the fault of the CDM that the EU ETS was over-allocated

5. Many non-chemical projects (EE/RE) are not additional

Response:

- Some truth: these projects allow greater emissions in EU/Japan possibly without clear 1:1 reductions in LDCs
- However, we also need to appreciate the benefits of scaling up RE technology into new markets
- Bottom-up additionally is a challenge to implement effectively
- Challenge is a function of the ratio of conventional to carbon value, which ranges from 4:1 to 10:1
- **We probably need to re-conceive this part of the CDM**

Long Term Goals of Climate Policy?

How about…

- **"Developing an effective, global, low-carbon infrastructure across all economic sectors & stages of country development, driven by scientifically established emission reduction targets"**
- Accelerating development and diffusion of technologies that can achieve this goal should be paramount
- Emission reduction tonnes provides a good but imperfect indicator that helps focus developers by providing direct financial incentives
- Ultimately, we need to influence broad trends, not haggle over a few tonnes—but every game needs a scorekeeper

Points to Take Away

1. MARKETS WORK – but designing them to fit the specific policy goal is critical
   - Markets are not the only solution, but an in=important arrow in the policy quiver
2. We need **long-term (20++ years) commitments** to policy that reward/penalize relative GHG performance
   - **Kyoto period of five (5) years is *way* too short**
3. Simplification of process—**conservative** can be a substitute for **exact**
   - Cannot account for every tonne; but *can* create a positive atmosphere for accelerating the trend to a low-carbon econom
4. We only achieve "learning by doing" if we keep doing!!

a1

Slide 20

a1 Not sure what this means and also not sure whether this is the right point to end on when you have so many other strong and important points to make

abarnes, 25/03/2008

Thank You

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