European Investment Bank

European Investment Bank (EIB)

Guidelines for the Climate Change Technical Assistance Facility (CCTAF) Operations

March 2006

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INTRODUCTION

In response to EU Climate Change policy, the EIB (the Bank) has launched several initiatives aimed at promoting investment in projects that reduce greenhouse gas emissions and supporting the development of the emerging carbon market. The Climate Change Technical Assistance Facility (CCTAF) provides advance conditional funding for activities associated with the development of project-based carbon assets (credits) under the Clean Development Mechanism (CDM) and Joint Implementation (JI) instruments of the Kyoto Protocol.

A number of activities are needed for a project to be registered for carbon credits, such as determination of a baseline scenario, establishment of a baseline methodology, calculation of projected emission reductions and development of a monitoring plan for assessment of resulting emission reductions all of, which involve complicated technical and methodological issues. In addition, in order to be entitled to carbon credits, the project has to take a number of steps (e.g. a carbon feasibility study), which incur considerable up-front costs. The CCTAF is designed to facilitate development of CDM and JI projects by providing technical assistance for project promoters to get them through the main stages of the CDM/JI project cycle till credit registration.

The necessary studies and processing work are outsourced to private sector consultants. By combining the specific expertise of the consultants with the project development expertise of the EIB, the CCTAF ensures quality in the selection and preparation of CDM/JI projects.

The CCTAF takes the form of conditional funding that would be reimbursed by the promoter if the project were successfully registered by the relevant CDM/JI authority. Should the carbon asset development fail, the Bank would assume the CCTAF costs. By taking this risk, the Facility aims to help develop projects that otherwise would not be implemented.

The establishment of the CCTAF of EUR 10 million was agreed by the EIB Board of Directors in 2004; of this, EUR 5 million would be provided by the EIB, matched by EUR 5 million from external sources. In July 2005, the Board agreed to de-link the EIB contribution to the CCTAF of EUR 5 million from the identification of co-financing in order to “kick-start” the Facility. In June 2005, the Board approved the funding modalities for the Facility.

1 BACKGROUND

1.1 The concept of CDM and JI

CDM and JI are project-based mechanisms, established by the Kyoto Protocol to facilitate countries with an obligation to reduce or limit their greenhouse gas emissions (so-called Annex I countries (Annex 1)) to meet their targets in a cost effective way. Under these mechanisms, an Annex I country (investor party) invests in an emission reduction project in another country (host party) (a non-Annex I country for CDM, or another Annex I country for JI), and in turn may receive carbon credits, which then are counted towards the investor party's emission reductions. Companies with obligations to reduce emissions under the EU Emissions Trading Scheme (ETS) can also use such crediting mechanisms[1].

For project promoters, CDM and JI provide a mechanism to realise a market value from the carbon mitigation resulting from the project activity. Additional cash flow resulting from the sale of carbon credits may strengthen the financial viability of a project, reduce its financial risk or help to develop a financially marginal activity.

Eligible project activity sectors include energy (except for nuclear and with extra requirements for large-scale hydro), transport, industry, waste, agriculture and land use, land use change and forestry (LULUCF). The latter are known as "sink" projects, as they remove CO_2 emissions through carbon sequestration.

CDM	JI
Host country is non-Annex I country	Host country is Annex I country
Generated carbon credits are called Certified Emission Reductions (CERs)	Generated carbon credits are called Emission Reduction Units (ERUs)
There is no limitation on the crediting period, i.e. CERs can be obtained for emission reductions even before the first commitment period under the Kyoto Protocol, which is 2008-2012	Generally, the crediting period starts from 2008, i.e. ERUs can be issued only for emission reductions from 2008 on. But some early crediting may be possible
The CDM Executive Board issues CERs	The host country issues the ERUs

However, not all projects that reduce emissions are eligible for CDM/JI. For a project to be eligible it has to provide emission reductions or removals that are "additional" to any that would otherwise occur, in other words, that reduce GHG emissions from the projected baseline level.

[1] EU Emissions Trading Scheme; Directive 2003/87/EC and the Linking Directive; Directive 2004/101/EC

1.2 CDM/JI project preparation and project cycle

A CDM or JI project is first and foremost a capital investment in one of the following sectors: industry, energy, waste, transport, forestry and agriculture. A CDM or JI project has the additional aspect of trying to create another asset – carbon credits. In some cases, the decision to do a CDM/JI project alters the technical choice of an underlying investment project. There is no good CDM/JI project in itself, without a sound underlying investment project. In this note, however, where the term 'CDM/JI project' is used, it denotes activities related to the carbon crediting aspects of the project.

The main difference between the set-up of a CDM/JI project and a standard project arises from the involvement of the host country's authorities or a third party, according to the eligibility conditions set out in the Marrakesh Accords, and development of additional carbon crediting-related documentation.

The document used as the framework for project development under the project-based mechanisms of the Kyoto Protocol is the Project Design Document (PDD). The specific aim of the PDD is the project's official registration with appropriate authorities. This registration will ensure for buyers that the carbon assets created by a project will be acceptable for Kyoto Protocol compliance purposes.

For up to date information on CDM or JI rules and procedures, please visit the UNFCCC CDM and JI websites at: http://cdm.unfccc.int and http://ji.unfccc.int/.

The steps that should be undertaken by a project developer are summarised as follows:

- Initial assessment (carbon feasibility study): Before developing a project as a CDM or JI activity, project developers are advised to conduct a preliminary assessment to ensure that the project being considered would be eligible under international guidelines, that it meets conventional project development and implementation criteria and that the amount of carbon credits likely to be generated would be sufficient to cover CDM/JI related costs.
- Prepare documentation: Project developers need to prepare a PDD, which in some cases includes development of new baseline and/or monitoring methodology. This generally represents the largest upfront cost item due to the detailed analyses required and the fact that the PDD needs to contain all of the information that will be used to evaluate the project.
- Obtain host government approval: Once the PDD is complete, the project promoter will need a Letter of Approval from the host country for the transfer of the carbon credits and confirmation that the project would contribute to the host country's sustainable development. The relevant host country authority should issue this letter of approval. In the case of the CDM this is the Designated National Authority (DNA) or CDM Office, whilst for JI it is the JI Focal Point.
- Validate project design: The PDD needs to be reviewed and validated by an independent third party accredited by the appropriate authorities. A Designated Operational Entity

(DOE) validates CDM projects; an Independent Entity (IE) validates Track 2[2] JI projects; the relevant host country sets its own approval procedures for Track 1 JI projects. For further information visit a relevant UNFCCC website (http://cdm.unfccc.int and http://ji.unfccc.int/). DOEs and IEs are often referred to as validators.

- Prepare a carbon credits sales agreement: The project promoter or other entity entitled to sell the carbon credits develops an agreement between the carbon credit buyer and seller, called the Emission Reduction Purchase Agreement (ERPA). The terms of the ERPA and timing of its signing may vary considerably. Preparation of the ERPA involves legal and contractual costs related to drafting of the contract, risk management and negotiations.
- Registration: CDM projects need to be registered by the CDM Executive Board. Registration is the formal acceptance by the Executive Board (EB) of a validated project activity as a CDM project activity. The EB will charge a registration fee, which depends on the volume of emission reductions. So far there are no registration fees for JI projects. The share of proceeds is intended to cover administrative expenses related to the work of the EB. The possibility of future national registration fees, levied in host and/or investor countries, cannot be ruled out. A JI project once approved is registered with the host government.
- Monitoring and verification of emission reductions: Once the project is operational, the project developer needs to monitor the emissions following the plan laid out in the Project Design Document. The project developer should hire an independent auditor to verify the emission reductions that have been generated.

For small-scale projects, where scale is defined in terms of amount of emissions reduced by the project, requirements and procedures are simplified, in order to reduce their transaction costs.

With the JI Supervisory Committee just having been established, detailed JI procedures and requirements are in the process of being developed though they are very similar to the CDM requirements. For the latest information on JI please visit the UNFCCC JI website at http://ji.unfccc.int/.

[2] The Kyoto Protocol provides two sets of JI procedures. Track 1 procedures apply when a host Party meets certain eligibility criteria. Such host Parties are allowed to apply their own procedures for assessing additionality and are able to issue and transfer ERUs to the investing Party, without recourse to any international body for approval. Under Track 2 procedures, the project cycle is very similar to the CDM cycle, with the JI Supervisory Committee having a role similar to the CDM Executive Board.

2 SCOPE AND FORM OF THE CCTAF

2.1 Scope of funding

The purpose of the CCTAF is to assist projects expected to be financed by the EIB, which are seeking to secure sources of carbon finance under the CDM and JI instruments of the Kyoto Protocol, to develop their carbon asset potential, through to project registration as a CDM/JI project.

The carbon crediting activities, for which the CCTAF can provide funding, include:

- Carbon credit feasibility study;
- Preparation of carbon credit documentation (PDD), including preparation of new baseline and/or monitoring methodology if needed;
- Validation of the PDD; and
- Registration of the project.

2.2 Form of funding and repayment conditions

CCTAF provides conditional funding in the form of a loan that would be reimbursed by a project promoter only if the project is successfully registered as a CDM/JI project.

The loan covers 100 % of the costs of carbon crediting activities under the scope of the CCTAF. The development costs include consultancy and validation services and a project registration fee. An administrative fee of 20 % of these costs is charged to cover the costs to the EIB of operating the Facility.

If the development of the carbon crediting aspects of the project results in the successful registration with a relevant CDM/JI authority, the project promoter is required to repay the loan to the EIB as follows:

- Under normal circumstances, the EIB will be a lender to the underlying investment project. The CCTAF costs and the administrative fee will form part of the project costs and will be repaid to the EIB in full out of the proceeds of the first disbursement made under the EIB finance contract for the project;
- If the EIB is not ultimately a lender to the project, the project promoter will be required to reimburse the loan and pay the administrative fee in full at the time of financial close of the project.

If, however, the project does not receive registration with the relevant CDM/JI authority, the project promoter will be released from the obligation to repay the loan. Project risks and risks of failure of repayment of the CCTAF on the part of the promoter are covered in the contract.

3 CCTAF PROJECT CYCLE AND OPERATIONS

3.1 Phases of technical assistance

In order to identify projects suitable for CCTAF financing, candidate projects should be identified early in the EIB project cycle, i.e. ideally at pre-PIN stage. Periodically the project pipeline will be reviewed as a whole to ensure CCTAF opportunities have not been overlooked. The promoter's agreement to the terms of the conditional funding and commitment to the project is essential.

After the decision to provide the CCTAF for the project is made, the promoter is asked to send a letter to the EIB agreeing in principle with the conditions for funding under the CCTAF.

The contract between the EIB and the project promoter setting out terms of CCTAF financing should be signed ideally before launching the initial tender process; in any case, it must be signed before awarding the first service contract for a consultant to work on that project.

The full CCTAF cycle for a project involves the following steps:

- Phase I – Carbon Feasibility Study: under this phase, a consultant is hired to prepare a carbon feasibility study. The objective of Phase I is to assist the project promoter and the EIB to assess whether the carbon finance case is sufficient enough to proceed with the CDM/JI project development phase and the elaboration of the Project Design Documentation (PDD).
- Phase II – carbon credit documentation preparation and assisting with CDM/JI procedural issues: under this phase, a consultant is hired to prepare the PDD, assist the project promoter with procedural steps required along the CDM/JI project cycle, carbon credit commercialisation and managing other carbon credit-related aspects of the project. The objective of Phase II is to ensure the project's successful registration by the relevant CDM/JI authority.
- Phase III – CDM/JI project validation: under this phase, a Designated Operational Entity (DOE) (for CDM projects) or Independent Entity (IE) (for JI projects) is hired to undertake project validation.

The cycle is split into these phases for reasons of tendering and contracting. Any phase may be omitted and its scope modified if a project promoter or another body assumes responsibility for undertaking some tasks in the CDM/JI project cycle without the assistance of the Bank. The EIB in turn may stop consultancy services or providing assistance at any stage of the CCTAF if it considers that further development of the CDM/JI aspects of the project bears an unacceptable level of risk.

3.2 Financial administration

Consultants and validators are paid upon submission of invoices in the following instalments:

Phase I: At least 30 % of the costs are paid after contract signature and the rest is paid upon receipt of invoices sent to the EIB and after submission to the EIB of the completed report to the satisfaction of the Bank.

Phase II: At least 30 % of the costs are paid after contract signature. Other payments are phased according to the work required. Possible points of payment could be at the end of the following stages or deliverables completed to the satisfaction of the Bank:

- Approval of new methodology;
- PDD (for submission to the validator);
- After the first attempt of registration;
- Deliverables for carbon credit marketing and sales activities;
- At the completion of the assignment: successful registration or cancellation of the contract by the EIB.

Phase III: At least 30 % of the costs are paid after contract signature and the rest is paid upon receipt of invoices sent to the EIB and after submission to the EIB of the validation report.

Once, and if all phases are successfully completed, the project gets registered by the relevant CDM/JI authority **and** it reaches financial close, all costs of the CCTAF and administrative fee are repaid to the EIB by the promoter, according to the requirements specified above.