



Private Sector Investment in REDD: Minimum Conditions and Risks

EPRI Greenhouse Gas Emissions Offset Policy Dialogue

Workshop 5

Reducing Emissions from Deforestation and Degradation,

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REDD in the Waxman-Markey draft

The original Waxman draft legislation describes REDD initiatives as “part of a global effort” to combat climate change, and states that EPA, US State Department and USDA will serve as the U.S. federal entities overseeing international REDD activities. The draft includes international REDD activities in three areas:

SUPPLEMENTAL REDUCTIONS

- A funding mechanism
- The Waxman draft sets aside 5% of the total emissions cap through 2025 (decreasing to 2% by 2050) for international REDD activities
- Only countries with whom the US has a bi- or multi-lateral agreement
- Funding for REDD activities at national and sub-national level
- The draft aims to reduce 10% of the US’s 2005 emissions through this mechanism

STRATEGIC AUCTION

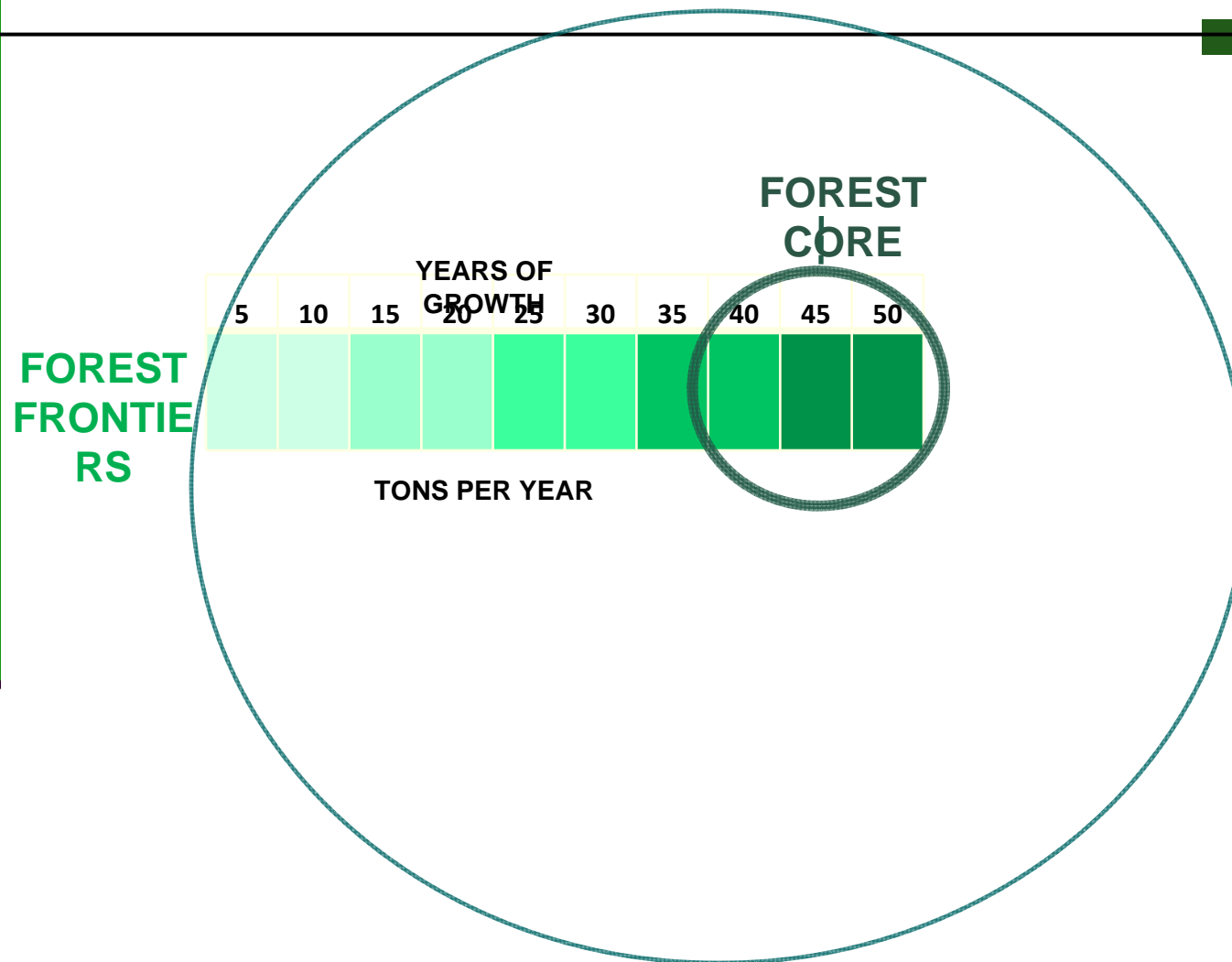
- The draft’s “Strategic Reserve Auction” is designed as a price control measure
- Funds generated through the auction will be used to purchase international offset credits from selective REDD activities
- The majority of these credits – 80% – will be converted to allowances
- These allowances will then be used in the Strategic Reserve Auction
- The remaining REDD credits will be retired

INTERNATIONAL OFFSET CREDITS

- The draft allows for offset credits from international reduced deforestation activities that are distinct from credits issued by an international body (i.e. CDM)
- Such REDD activities must originate in a developing country with a bi- or multi-lateral agreement with the US
- Project countries must have a national baseline. This excludes sub-national activities
- Dependent on EPA discretion, avoided degradation for forests, forested wetland and peatlands could be eligible

The next ten days will be a crucial time in the House of Representatives, with a revised Waxman draft forthcoming.

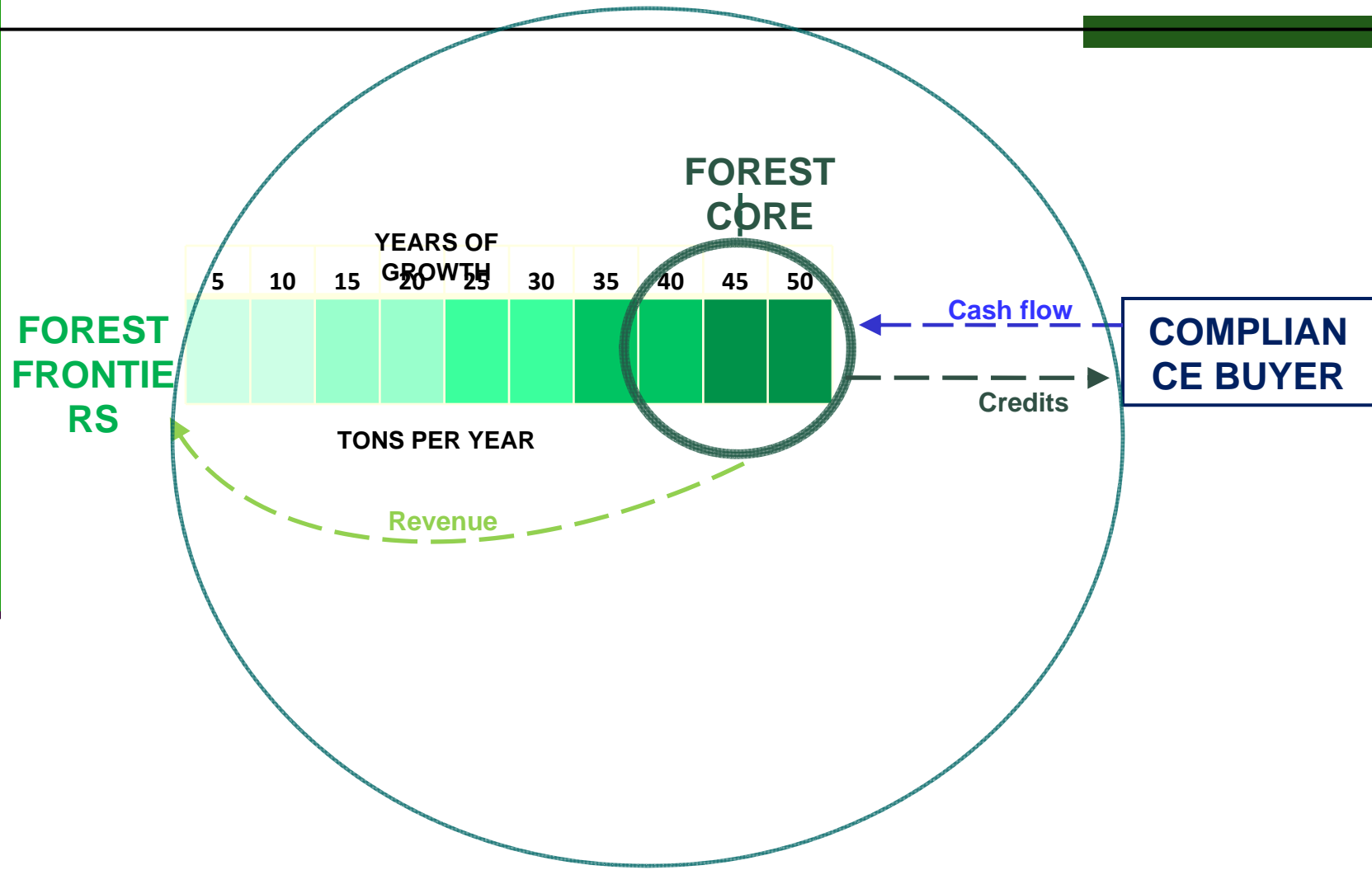
REDD Asset Valuation Risk: Test of “Credible Risk of Deforestation”



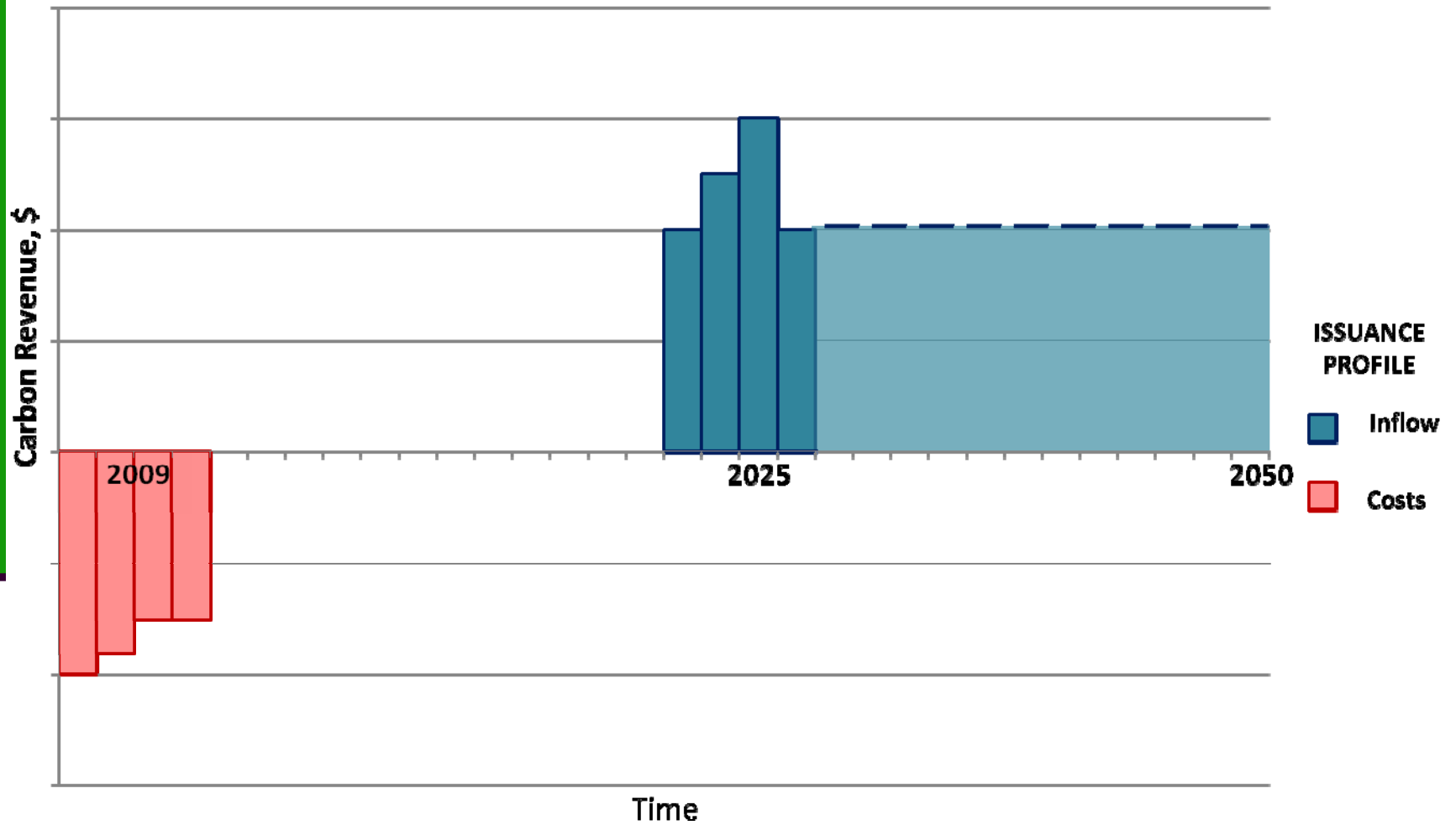
REDD Asset Economics

- Avoiding deforestation at forest frontiers is complex, costly and risky
- McKinsey and NGO examples suggest \$10-30/tCO₂e to achieve real reductions
- Controlling and offering forest core assets not under imminent threat is cheap but should be viewed with caution as a tradable asset
- Sovereigns will require real a verifiable emissions from private sector investment and trade

REDD Asset Valuation Risk: Test of “Credible Risk of Deforestation”



Crediting Period for Forest Core Protection



Conditions for Private Sector Investment

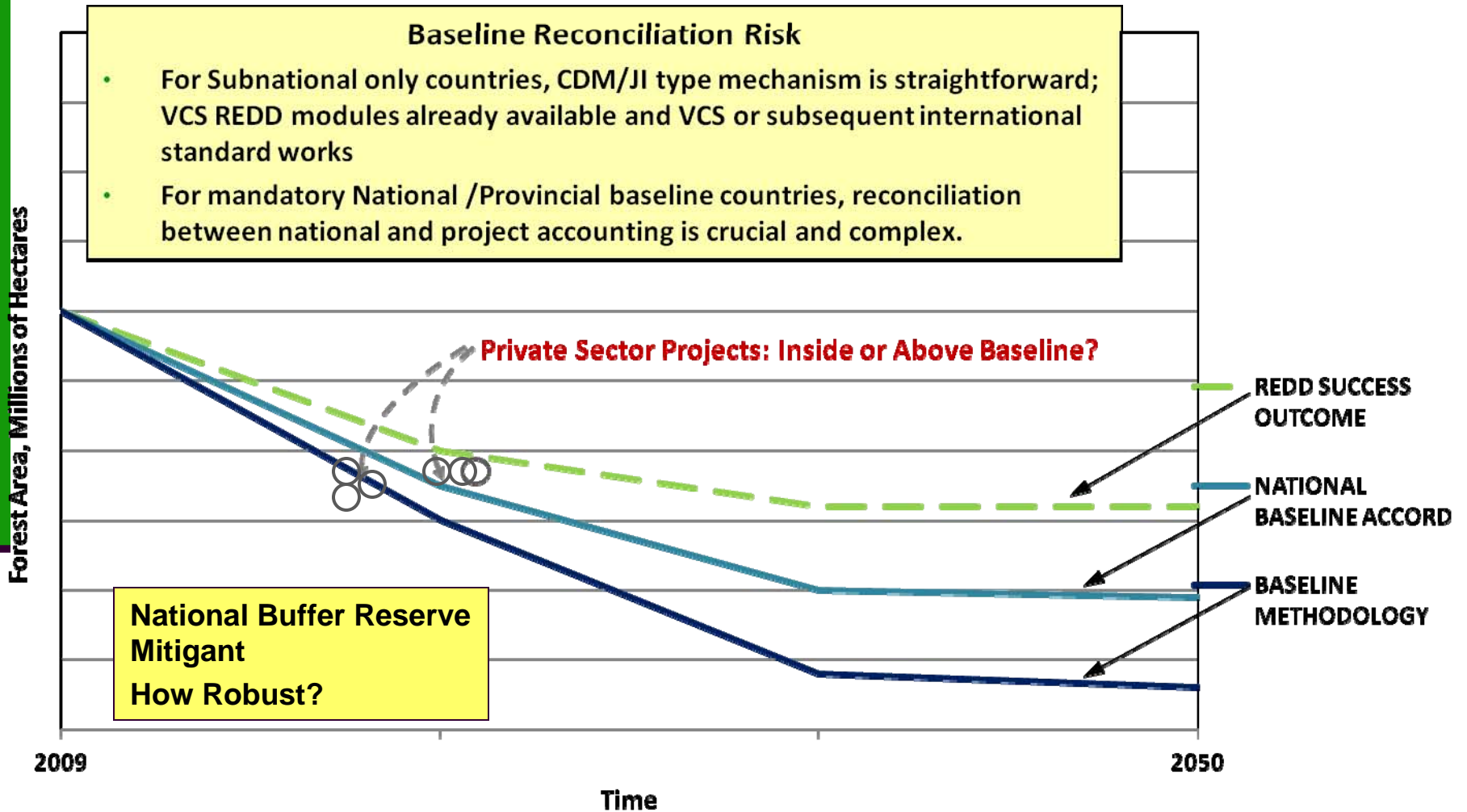
■ Private Sector Investor Needs:

- **Property Rights: Clear /Irrevocable Title to Carbon Asset**
 - Seller Liability, clear title to underlying land/forest, or to unbundled carbon rights (Independent registry of international body; units deducted from National level accounts)
- **Enforceable Contracts: Easily enforceable purchase contracts (ERPAs or equivalent):** UK, US or third country law for arbitration
- **Project Level Crediting**
 - Regardless of existence of national baselines, REDD assets are credited from, and associated with specific projects for monitoring and verification (JI first track, or CDM model) against approved reference baselines
- **High and Universal Standard for REDD project offsets**
 - rules for subnational/projects that buyers and Seller Sovereigns agree
 - Performance-based crediting instead of project based additionality to lower risk of advanced payment (VCS REDD Modules under review)
- **Independent third party verification:** to ensure environmental integrity

Conditions for Private Sector Investment

- **Effective institutions and transparent, reliable and workable approval procedures in seller Sovereign for REDD asset purchases**
 - Well defined procedures for submission and approval of REDD projects integrating local and state/provincial level procedures and national approval and registration
 - **Consistency with Buyer Sovereign regime requirements!**
- **Effective Monitoring of REDD asset production (National Baseline case)**
 - National level monitoring and reporting of avoided deforestation within a national accounting framework to avoid double counting or exclusion of project-based credits
- **A market: long term stable demand for REDD assets in OECD-based compliance regimes**
 - US, Australia, UNFCCC-driven acceptance of REDD carbon offsets arising from private sector investment. Fungibility between regimes.
- **Acceptable Country Risk**
 - That Sovereign will establish and respect laws and regulations establishing production and trade of REDD assets and remain in compliance with international/Buyer Sovereign requirements

Sovereign Performance Risk



The real world of REDD: the case of Indonesia

■ Context

- Deforestation accounts for 84% of national emissions: ~ 1mm ha/year
- 20 REDD projects: NGOs, Investment Banks, Governments
- REDD voluntary market revenue estimated at \$500mm-\$2bn/year
- Donor commitment to “REDD readiness” in Indonesia: >\$200 mm

■ Government Commitment

- Committed to balanced approach through mix of national and subnational, market and find-based, and regulatory-driven and voluntary actions
- Wants reductions in emissions to be real, measurable and verifiable
- Insists that REDD is responsibility of national government through Ministry of Forestry thought fate of revenues from REDD will be determined by Ministry of Finance
- Ministry of Forestry has issued regulations on implementation of REDD projects and established a Ministry Working Group on Climate Change to asses each REDD proposal and advise Minister on approval. National carbon accounting system is anticipated.
- Established a Forest Resource Information System to support development of a National Carbon Accounting System

The real world of REDD: the case of Indonesia

■ Issues

- **Lack of capacity** in Government – obvious to participants, acknowledged by Government
- **High risk** of REDD projects due to complexity of social and economic drivers of deforestation at forest frontiers where projects will be focused.
- **Uncertainty in national rules** until international agreement on REDD in Post-Kyoto negotiations. Government focused on Post-Kyoto, not US compliance market.
- **Private Partnership?** Government views private sector with suspicion
- **Implicit Tax:** Government proposal to set aside 30% of verified emissions for a national reserve, above any project level buffer is economically punitive
- **Jurisdictional Conflict:** Ministry of Forests does not own all forest. Most pilot projects are in forests owned at the State level. Federal/State coordination and authorization requirements for project approval and REDD asset sale is unclear

■ Outcomes to date

- Not a single REDD offset has been sold despite years of project preparation and independent verification
- Uncertainty about authorization and issuance procedures for REDD offsets remains a barrier to market development

Way Forward: Parallels with Prototype Carbon Fund(PCF)?

- PCF was a public-private partnership to pioneer rules for carbon asset creation and trade through learning by doing in course of rule-making (before Marrakesh Accord)
- Most carbon offset contract, process and documentation requirements stem from PCF preparation and implementation

Recommendation

- US Government through USAID/EPA/DoA sponsors public-private partnerships in REDD asset creation in several forest nations
- Drives a learning by doing process that defines and demonstrates requirements for private sector investment in REDD for **US compliance markets** including
 - tests of environmental integrity of REDD assets
 - Processes for project approval, REDD asset authorization, registration and issuance arrangements with and without national baselines
 - Systems and institutional requirements for reconciliation between project level and national level carbon accounting
- Engage with the World Bank's Forest Carbon Partnership Facility on readiness TA to develop this framework of essential market infrastructure