

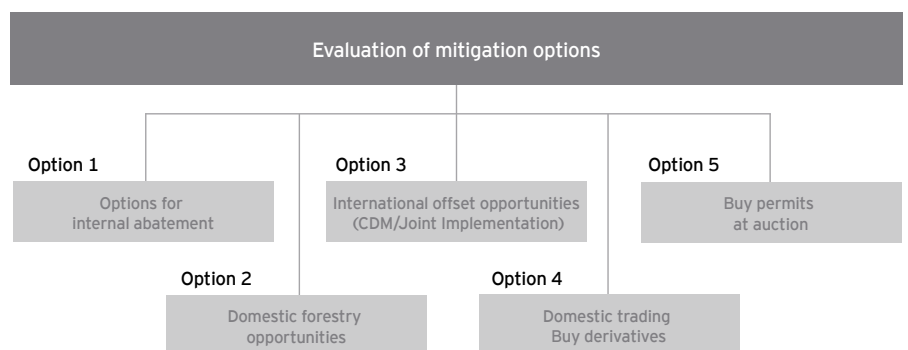


Opportunities in the Clean Development Mechanism

Role of the Clean Development Mechanism (CDM) in the carbon market

The carbon market in Australia is set to grow significantly under the Carbon Pollution Reduction Scheme (CPRS). Following on from the initial fixed price regulation proposed for 2011/12, liable entities will be able to use both primary and secondary carbon assets to meet compliance obligations from 2012/13. A key design feature of the CPRS is the access to unlimited eligible international units, including Certified Emission Reduction (CER) units from the Clean Development Mechanism (CDM), one of the Kyoto Protocol flexible mechanisms. The Australian Government has confirmed its intention that CERs issued in the first Kyoto Commitment Period (2008-12) will be recognised for compliance in the CPRS beyond 2012.

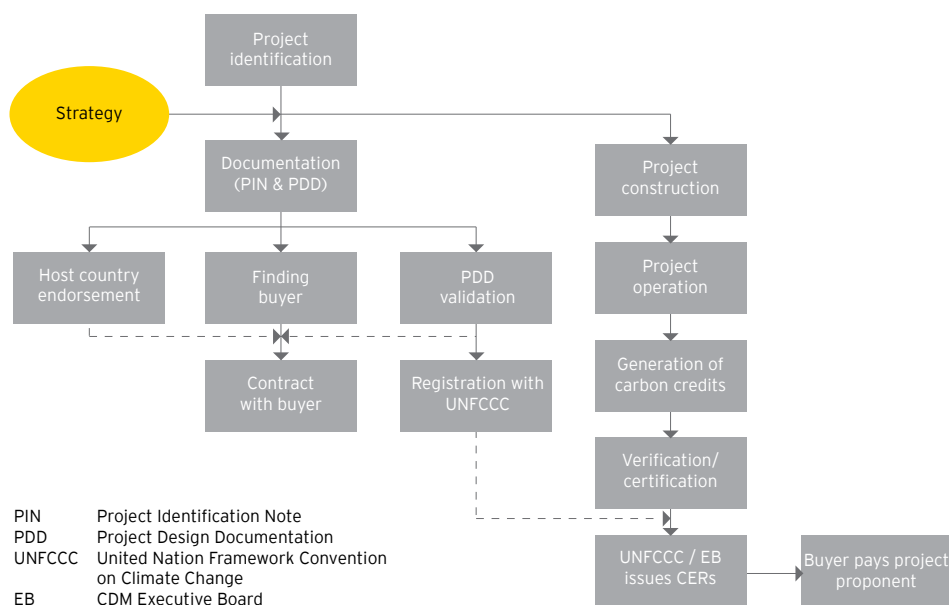
Figure 1: CPRS mitigation options



The CDM allows developed countries with a greenhouse gas (GHG) reduction target to invest in projects that reduce emissions in developing countries. CDM investments give rise to a project revenue stream via the sale or primary use of CERs. CDM can play a role in assisting developed countries meet their commitments while driving sustainable investment in developing countries and promoting technology transfer.

CDM has been a success to date. As at October 2009, there were 1,854 projects registered with the United Nations Framework Convention on Climate Change (UNFCCC) Executive Board and 335 million CERs had been issued. The projection is that registered projects will deliver 1.66 billion CERs in the period to the end of 2012. There is much uncertainty as to the framework for a post-2012 international regime and domestic legislation is still under development in a range of major economies, however it is clear that the demand for international credits is expected to rise steeply.

Figure 2: The CDM project cycle

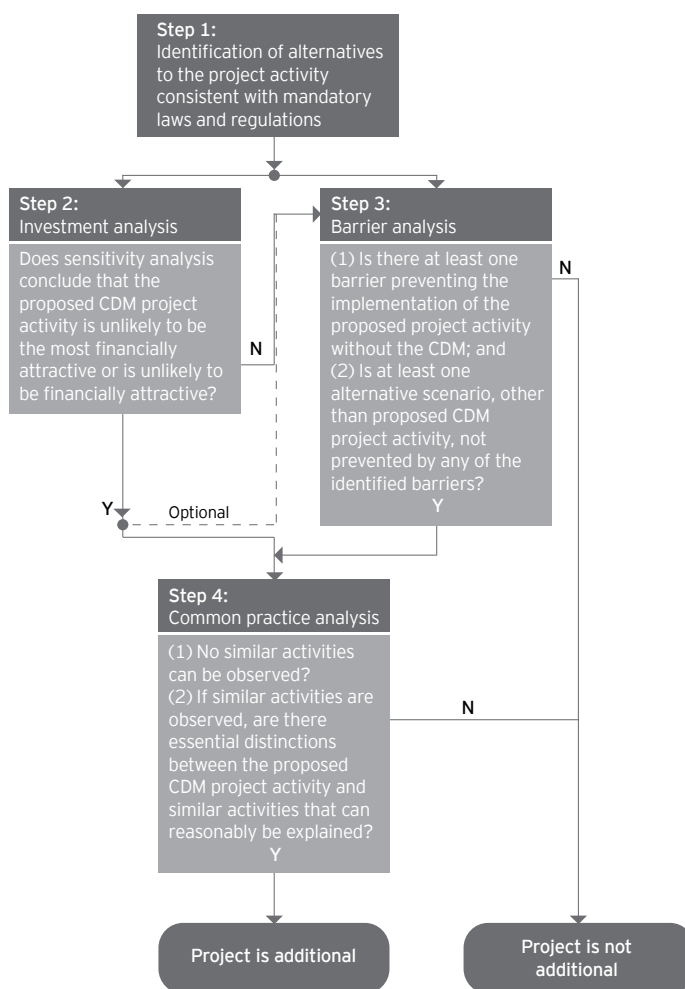


Developing a CDM project requires a clear understanding of the rules and processes, as well as interaction with a range of stakeholders, for example, the CDM Executive Board (EB), the Designated National Authority (DNA), Designated Operational Entity (DOE), CER buyers, community representatives and technology providers.

Australian companies can invest directly in CDM projects or purchase CERs in the market. All CERs can be held in an account with the Australian National Registry of Emissions Units (ANREU)¹ which links with the international carbon market through the International Transaction Log (ITL). The ITL is managed by the UNFCCC Secretariat. It verifies the validity of transactions of Kyoto units, including issuance, transfer and acquisition between registries.

The concept of additionality is critical to CER determination. The CDM EB deems a project additional if the project goes beyond business-as-usual in terms of regulatory compliance, technology choice and meeting sustainability criteria or, alternatively, it reduces investment barriers directly via CDM revenue. Figure 3 outlines the decision path.

Figure 3: The decision path to determine additionality



Source: "Tool for the demonstration and assessment of additionality" Version 05.2, United Nations Framework Convention on Climate Change CDM - Executive Board, EB 39 Report, Annex 10, Page 3, 26 August 2008

¹ <http://www.climatechange.gov.au/en/government/initiatives/anreu.aspx>



How Ernst & Young can support CDM investments

Ernst & Young is well placed to assist you in developing your carbon strategy. We are one of the leading private developers of CDM projects in the world. Globally, the firm has executed more than 550 projects across a range of sectors, including:

- ▶ Coal-fired power generation
- ▶ Coal bed methane capture
- ▶ Renewable energy
- ▶ Oil and gas
- ▶ Iron and steel
- ▶ Pulp and paper
- ▶ Cement

Ernst & Young has completed Project Design Documentation (PDD) for more than 300 projects and facilitated more than 200 host country approvals. In total, we have had 148 projects registered with the CDM Executive Board to date and 58 of these have been issued CERs. The firm has assisted CDM project proponents in India, South Africa, China, Sri Lanka and Indonesia. In addition, we have developed ten new methodologies which have been approved by the CDM Executive Board.

Examples of the types of projects that Ernst & Young has supported

Industry	Project
Energy supply - power generation - oil & gas	<ul style="list-style-type: none"> ▶ coal/gas/renewable power generation ▶ fuel switching ▶ co-generation
Mining	<ul style="list-style-type: none"> ▶ industrial energy efficiency ▶ abatement of fugitive emissions from coal mines
Manufacturing - iron and steel - cement - paper and pulp	<ul style="list-style-type: none"> ▶ fuel switching ▶ waste heat recovery ▶ industrial energy efficiency
Agriculture and forestry	<ul style="list-style-type: none"> ▶ afforestation and reforestation ▶ improved management of natural woodlands
Transport and communications	<ul style="list-style-type: none"> ▶ improved public transport and traffic management ▶ improved urban planning ▶ vehicle fuel switching and improved vehicle efficiency
Built environment	<ul style="list-style-type: none"> ▶ energy efficiency in building design ▶ solar water heating and energy-efficient appliances ▶ fuel switching

Carbon markets are still relatively immature and they have demonstrated high levels of volatility. In our view, buyers are looking for:

- ▶ Fair price and terms
- ▶ A strong counterparty
- ▶ Solid underlying fundamentals such as land rights, legal title to the CERs, well-defined and transparent structure, clear project documentation, and robust monitoring procedures and plans
- ▶ A solid institutional framework in the host country
- ▶ Low transaction costs
- ▶ An appropriate risk-reward spectrum

In seeking to maximise value, we advise sellers of CERs to be aware of:

- ▶ The pricing and structure of deals
- ▶ Volumes offered and option deals
- ▶ Guarantees and penalties for delivery
- ▶ Buyer counterparty risk
- ▶ Timing of deliveries and communication requirements of buyers

CDM and your carbon strategy

Ernst & Young offers advice on the development of carbon strategies to meet local and international operations and requirements. In order to assess your investment options, we will develop carbon scenarios which cover Australian and international regulations.

CDM investments need to be analysed against other mitigation options. We can work with you to build internal abatement cost curves to rank projects within your own international operations or at third party locations. We can also take the analysis further by applying our Ernst & Young Carbon Offset Strategic Analysis (COSA) methodology to optimise your carbon asset portfolio on a risk-weighted basis.

Ernst & Young will help you in the identification of potential CDM projects and in the preparation of key documents. We have experience in assisting with host country endorsement and we will support you in completing documentation for your Letter of Approval from the Australian DNA².

Once the project and technology is identified, we can work with you to secure project finance and analyse options for distribution of the CERs. We can support you in carbon transacting, including advice on accounting and tax treatment of the carbon assets. Finally, we can assist you in developing a decision tool to determine your strategy for purchasing CERs by examining a range of risk factors.

² <http://www.climatechange.gov.au/government/initiatives/national-authority-cdm-ji.aspx>

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