

CDM-EB79-AA-A13

Draft Package of documents on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario

Version 01.0

DRAFT



United Nations
Framework Convention on
Climate Change

COVER NOTE

1. Procedural background

1. The Executive Board of the clean development mechanism (hereinafter referred to as the Board), at its seventy-second meeting, considered issues in relation to E+/E- policies with regard to additionality and mandated the secretariat to work on a technical and legal paper for the Board's consideration at its seventy-third meeting (EB 72 report, para. 41).
2. At its seventy-third meeting (EB 73 report, para. 70), the Board considered this policy issue and agreed to work further to develop a guideline in relation to the application of E-policy (or policies) for the demonstration of additionality through investment analysis.
3. Further, the Board agreed to pursue an approach by which, for the first seven years from the effective implementation date of the relevant E- policy, the benefit of that E- policy (or policies) does not need to be considered by project participants in the additionality demonstration through investment analysis. The Board also requested the secretariat to prepare guidelines on this approach and to assess the necessary revisions to the "Combined tool to identify the baseline scenario and demonstrate additionality", the "Tool for the demonstration and assessment of additionality" and any other decisions of the Board that would result from the adoption of the above approach.
4. At its seventy-fourth meeting (EB 74, para. 37), the Board considered the draft "Guideline on the application of E- policy for additionality demonstration through investment analysis" and the proposed revision of the Combined tool and Additionality tool". The Board requested the secretariat to revise the draft guideline and the tools taking into account the following issues, for further consideration by the Board at its seventy-fifth meeting:
 - (a) The voluntary nature of the approach;
 - (b) Various options should be analysed:
 - (i) On the effective date of implementation of the policy;
 - (ii) From and until when the benefit of the policy accruing to the project participants can be disregarded;
 - (c) The approach should be applied consistently to both the demonstration of additionality and the selection of the baseline scenario;
 - (d) The secretariat should conduct an analysis of the impact of the guideline on other existing regulations of the Board, including the Project standard, in order to propose any further revisions to the Board, if applicable.
5. At its seventy-eighth meeting (EB 78, para. 29), the Board considered the draft guideline on "Application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario" and amendments to the "Tool for the demonstration and assessment of additionality" and "Combined tool to identify the baseline scenario and demonstrate additionality". The Board agreed to narrow down the proposed options to

determine the E- policy benefit period and requested the secretariat to revise the draft guideline and the tools taking into account the following issues, for consideration by the Board at its seventy-ninth meeting:

- (a) Further analysis on the narrowed-down proposed options (2 & 4 and A & B) as per annex 16 to the annotated agenda of the seventy-fifth meeting of the Board;
- (b) Revisit the definition of policy implementation date.

2. Purpose

- 6. The objective of this set of documents is to respond to the Board's request as noted in paragraph 5 above, i.e. to present further analysis on the narrowed-down options and to revisit the definition of policy implementation date.
- 7. Appendix 1 contains the "Draft guideline on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario".
- 8. Appendix 2 contains the draft revision of the "Tool for the demonstration and assessment of additionality".
- 9. Appendix 3 contains the draft revision of the "Combined tool to identify the baseline scenario and demonstrate additionality".

3. Key issues and proposed solutions

- 10. This concept note has been prepared based on the assumption that:
 - (a) The Board wishes to implement new rules in relation to how national and/or sectoral policies or regulations that give comparative advantages to less emission-intensive technologies over more emission-intensive technologies (E-policies)¹ are to be treated in the investment analysis for demonstration of additionality and selection of baseline scenario;
 - (b) The approach adopted by the Board at its seventy-third meeting (EB 73 report, para. 70) in relation to the application of E- policy (-ies) to the demonstration of additionality through investment analysis does not need to be revisited.

3.1. Voluntary nature of the approach

- 11. The voluntary nature of the approach is clarified by adding relevant provisions in the draft guideline, where it is stated that the proposed guideline does not apply to a project activity when the project participants wish to consider all financial benefits associated with the proposed project activity and alternative baseline scenarios as then the investment analysis will be based on full costs and full revenues.

3.2. Consistent application to the demonstration of additionality and the selection of the baseline scenario

- 12. The approach is consistently applied to the investment analysis conducted to demonstrate additionality and/or to identify the baseline scenario. This is addressed by

¹ As defined in paragraph 44 of the CDM project standard (v.04.0)(CDM-EB65-A05-STAN).

revising the guideline to confirm that the application of E- policy in investment analysis will be consistently applied both to the demonstration of additionality and the selection of the baseline scenario. Further, this has been reflected through the revision to the Additionality tool and Combined tool to identify the baseline scenario and to demonstrate additionality.

3.3. Options to determine the “E- policy benefit period”

3.3.1. Definition of policy implementation date

13. The effective implementation date is defined as the date on which all necessary implementing regulations have entered into force and the E- policy is available to the project participants.
14. The discussion at the Board’s seventy-eighth meeting noted some advantages and disadvantages of Options 2 and 4, i.e. the seven-year benefit period starts when the policy enters into force in the host Party versus on the policy implementation date. The date when a policy enters into force can easily be deduced from the policy itself. Alternatively, legal systems have general applicable provisions for the entry into force of policies. It may be the case that even if the policy is formally in force, the authority in charge of its implementation may not have created the necessary mechanisms to make the comparative advantages available. In such a case, the policy is implemented sometime after it enters into force. However, it might not be easy to determine the policy implementation date in an objective and straightforward manner and therefore it could be difficult for the designated operational entity (DOE) to validate the policy implementation date.
15. One practical solution may be to require the host country designated national authority (DNA) to identify such dates for the E- policies and make them available to the validating DOEs.

3.3.2. Options considered according to the feedback received by the Board

16. The options considered in this analysis were discussed at the seventy-third meeting of the Board, further developed and discussed by the Board at its seventy-fourth meeting, and decided on based on inputs received at its seventy-eighth meeting.
17. The selected options identify the period during which the benefit due to application of E- policy may be disregarded for the identified period in the investment analysis. The investment analysis for the remaining period (if any) of the assessment period shall be based on full cost and full revenue.
18. The four options selected at the seventy-eighth meeting of the Board are explained as follows:
 - (a) Option 2A: The seven-year benefit period starts when the policy enters into force in the host Party or 1 January 2014, whichever is later. For each project, only the comparative advantages enjoyed during the defined seven-year benefit period can be disregarded;

- (b) Option 2B: The seven-year benefit period starts when the policy enters into force in the host Party or 1 January 2014, whichever is later. For each project submitted for registration during the defined seven-year benefit period, all the comparative advantages received by the project can be disregarded for the entire assessment period of the investment analysis (say, 21 years);
- (c) Option 4A: The seven-year benefit period starts on the policy implementation date or 1 January 2014, whichever is later. For each project, only the comparative advantages enjoyed during the defined seven-year benefit period can be disregarded;
- (d) Option 4B: The seven-year benefit period starts on the policy implementation date or 1 January 2014, whichever is later. For each project submitted for registration during the defined seven-year benefit period, all the comparative advantages received by the project can be disregarded for the entire assessment period of the investment analysis (say, 21 years).

3.3.3. Further analysis on application of four narrowed-down options

- 19. This analysis applied the four options (2A, 2B, 4A and 4B) to the actual financial information (including discount rates of 13–14%, capital cost, operation and maintenance cost, revenues, subsidies, taxes, etc.) submitted along with the request for registration for three renewable energy CDM project activities, two with long-term or recurring subsidies in the form of feed-in tariffs, renewable energy certificates, tax holidays, etc., and one with short-term or one-time subsidy for capital cost (seen in small hydro projects).
- 20. The analysis calculated the 72 net present values (NPVs) of the three CDM projects under four options (2A, 2B, 4A and 4B) and under six scenarios. The six scenarios assume three hypothetical project start dates/request for registration submission dates (2010, 2013 and 2016) in combination with two hypothetical policies (one which enters into force before or in 2014 and is implemented before or in 2014 and one which enters into force before or in 2014 and is implemented in 2016). The six scenarios are further explained below:
 - (a) S1: Policy effective before/in 2014 and implemented before/in 2014, project start date in 2010;
 - (b) S2: Policy effective before/in 2014 and implemented before/in 2014, project start date in 2013;
 - (c) S3: Policy effective before/in 2014 and implemented before/in 2014, project start date in 2016;
 - (d) S4: Policy effective before/in 2014 and implemented in 2016, project start date in 2010;
 - (e) S5: Policy effective before/in 2014 and implemented in 2016, project start date in 2013;
 - (f) S6: Policy effective before/in 2014 and implemented in 2016, project start date in 2016.

21. The following observations were made from the analysis:

- (a) Under all six scenarios, all options under consideration do not change the conclusion on additionality, i.e. the 72 NPVs are always below zero and three CDM projects remain additional;
- (b) Options 2B and 4B are in effect equivalent and they are referred to below as one option, Option B. Even if there is a gap between a policy's entry into force and its implementation, the seven-year benefit periods for two options (2B and 4B) do not exactly overlap as Option B is linked with the request for registration submission date of a CDM project. At the same time it is also observed that Option B has disadvantages as the project participant may choose to submit the request for registration for a CDM project, availing E- benefits, slightly earlier or later to fit into the defined seven-year period just to disregard the benefit of the E- policy during the entire assessment period of the investment analysis;
- (c) Option B always results in a lower NPV compared to Options 2A and 4A;
- (d) Late-mover projects with a start date after the implementation date of the E- policy enjoy a longer "E- policy benefit period" under Option 4A than Option 2A, with long-term subsidies;
- (e) Impacts on early-mover projects, with start date before the implementation date of the E- policy, are different with long-term subsidies. Under Options 2A and 4A and for most of the scenarios, the early-mover projects implemented around the same time as the E- policy implementation date have more impacts (more additional) from the "E- policy benefit period" than the projects implemented later (late-mover). However, for most of the scenarios, the impacts are also lower (less additional) for the early-mover projects implemented well before the E- policy implementation date. For Option B, meanwhile, it does not have much impact as the early-mover projects would have the same impact from the "E- policy benefit period" as the projects implemented later (late-mover);
- (f) For short-term subsidies, the NPV results are very likely to be the same for all options (2A, 4A and B). If the project activities start during the defined seven-year "E- policy benefit period", the subsidies would likely occur during the period rather than before or after the period; therefore the impacts from all options would be the same.

22. Keeping in mind the advantages and the disadvantages of the four options described above, the Board may wish to select one of the options.

23. Based on the above analysis, the secretariat has prepared the draft guideline on "Application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario" (Appendix 1). The Board may wish to either adopt this draft guideline, or request the secretariat to work further on a different guideline with another set of approaches/options to be analysed.

4. Impacts

24. The option agreed by the Board will help project participants and DOEs by providing them with uniform and clear Board rules on the application of E- policies in investment analysis for the additionality demonstration and selection of baseline scenario.

5. Subsequent work and timelines

25. If the appendices are adopted by the Board, the secretariat will conduct an impact analysis of the approved guideline on other existing regulations of the Board, including the CDM project standard, in order to propose any further revisions to the Board, if applicable.

6. Recommendations to the Board

The secretariat recommends that the Board adopt the draft guideline on “Application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario” based on further analysis on the application of four narrowed-down options presented to the Board.

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Appendix 1. Draft guideline on “Application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario”

1. Introduction

1.1. Background

2. The Executive Board of the clean development mechanism (hereinafter referred to as the Board) has taken a number of decisions in relation to national and/or sectoral policies or regulations that give comparative advantages to less emission-intensive technologies over more emission-intensive technologies.¹ These policies are also referred to in the “Tool for the demonstration and assessment of additionality” (version 07.0) and the “Combined tool to identify the baseline scenario and demonstrate additionality” (version 05.0). At its seventy-third meeting, the Board considered the policy issue on the application of E- policy (or policies) to the demonstration of additionality through investment analysis and agreed to work further to develop a guideline in relation to the application of E- policy (or policies) in this context (EB 73 meeting report, para. 70).
3. At its seventy-fourth meeting, the Board considered this policy issue and agreed to further revise the draft guideline and the tools taking into account the following issues, for further consideration by the Board at its seventy-fifth meeting:
 - (a) The voluntary nature of the approach;
 - (b) Various options should be analysed:
 - (i) On the effective date of implementation of the policy;
 - (ii) From and until when the benefit of the policy accruing to the project participants can be disregarded;
 - (c) The approach should be applied consistently to both the demonstration of additionality and the selection of the baseline scenario.
4. At its seventy-eighth meeting (EB 78 report, para. 29), the Board considered the draft guideline on “Application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario” and amendments to the “Tool for the demonstration and assessment of additionality” and “Combined tool to identify the baseline scenario and demonstrate additionality”. The Board agreed to narrow down the proposed options to determine the E- policy benefit period and requested the secretariat to revise the draft guideline and the tools taking into account the following issues, for consideration by the Board at its seventy-ninth meeting:

¹ See EB 16 (annex 3) and EB 22 (annex 3) (both annexes now included in the “Clean development mechanism project standard” (CDM-EB65-A05-Stan, version 03.0 at paragraphs 44 and 45) and, in relation to certain requests for registration only – EB 53, annex 32 and EB 55, paragraph 27.

- (a) Further analysis on the narrowed-down proposed options (2 & 4 and A & B) as per annex 16 to the annotated agenda of the seventy-fifth meeting of the Board;
- (b) Revisit the definition of policy implementation date.

1.2. Objectives

- 5. This guideline sets out how project participants (PPs) and designated operational entities (DOEs) should treat the impact of national/local/sectoral policies that give comparative financial advantages to less emission-intensive technologies over more emission-intensive technologies (E- policy/policies) in the investment analysis for demonstration of additionality and the selection of the baseline scenario.

2. Scope, applicability, and entry into force

2.1. Scope

- 6. The scope of this guideline is to provide rules for the consideration of local/national sectoral policies that give comparative financial advantages to less emission-intensive technologies over more emission-intensive technologies (E- policy/policies) in the investment analysis for demonstration of additionality and the selection of the baseline scenario.

2.2. Applicability

- 7. This guideline is applicable for PPs when developing project activities that could be affected by E- policy (or policies) in the host Parties and for DOEs when validating those project activities.
- 8. This guideline does not apply to national/local/sectoral policies that give comparative advantages to more emission-intensive technologies or fuels over less emission-intensive technologies or fuels ("E+ policies").
- 9. This guideline does not apply when the project participants wish to consider all financial benefits associated with the proposed project activity and alternative baseline scenarios as then the investment analysis will be based on full costs and full revenues. This information will be reported in the project design document (PDD).

2.3. Entry into force

- 10. This guideline will be effective from its date of adoption at the seventy-ninth meeting of the Board.

3. Definitions

- 11. The definitions contained in the Glossary of CDM terms shall apply.
- 12. The definitions that apply for this guideline are:
 - (a) "Assessment period": the period for which the investment analysis is conducted;
 - (b) "E- policy (or policies)": national and/or sectoral policies or regulations that give comparative advantages to less emissions-intensive technologies over more

emissions-intensive technologies (e.g. public subsidies to promote the diffusion of renewable energy or to finance energy efficiency programs);

- (c) “Effective”: means that the E- policy is legally in force in the host Party;
- (d) “Implementation” means that for the E- policy all necessary implementing regulations have entered into force in the host Party and the E- policy is available to project participants;
- (e) “E- policy expiry date”: the date on which the financial benefit from the policy or regulation ends due to either the termination of the policy or regulation by the public authority or due to the termination of the financial benefits from the policy or regulation for the project activity or baseline scenario assessed;
- (f) “E- policy benefit period”: the period during which the financial benefits of an E- policy may be disregarded in the investment analysis. The E- policy benefit period shall start at the date when the E- policy is [effective or 1 January 2014, whichever is later (options 2A / 2B)] [implemented or 1 January 2014, whichever is later (options 4A / 4B)]. The E- policy benefit period shall end either: (a) at the E- policy expiry date or (b) seven years after the E- policy is [effective or 1 January 2014, whichever is later] [implemented or 1 January 2014, whichever is later], whichever is earlier;
- (g) “Relevant”: means that the E- policy has an impact on the investment analysis of the project activity.

4. Stepwise approach for the application of the Board rule on E- policy (-ies) for the demonstration of additionality through investment analysis

4.1. Step 0:

13. Indicate in the PDD whether all financial benefits associated with the proposed project activity and alternative baseline scenarios are considered while identifying the baseline scenario and demonstrating additionality.² If yes, the PPs can skip/avoid applying this guideline altogether (step 1-5 of this guideline). If not, the PPs can follow steps 1–5 of this guideline.

4.2. Step 1:

14. Identify and list in the PDD all effective and/or relevant E- policy (or policies) for the project activity and any alternative baseline scenario assessed in the investment analysis.

4.3. Step 2:

15. Provide all relevant information on each identified E- policy, including and not limited to: title of policy, reference to relevant legislation/regulation/guidance, the effective date of E- policy and other information on the status of policy, and geographical coverage of the policy in the host Party.

² As then the investment analysis will be based on full costs and full revenues

4.4. Step 3:

16. Determine, for each E- policy identified in step 1 above, the E- policy benefit period, in accordance with paragraph 11(f) above.

4.5. Step 4:

17. Quantify, for each E- policy identified in step 1 above and for each baseline scenario assessed in the investment analysis, the financial benefits for each year of the assessment period. Document the results and the underlying assumptions used to quantify the financial benefits transparently in the PDD.

4.6. Step 5:

18. Conduct the investment analysis disregarding the financial benefits from each identified E- policy during the applicable “E- policy benefit period”. Consider all financial benefits during the remaining time of the assessment period, where applicable.

5. Examples

19. Where (Option 2 with Option A):
- (a) A policy becomes effective in 2008;
 - (b) E- policy expiry date is in 2011; and
 - (c) The assessment period starts in 2013;
 - (d) In this case, the E- policy is not relevant as the E- policy expires before starting the assessment period of the project activity;
 - (e) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy during the entire assessment period.
20. Where (Option 2 with Option A):
- (a) A policy becomes effective in 2008;
 - (b) E- policy expiry date is in 2016; and
 - (c) The assessment period starts in 2013;
 - (d) In this case, the E- policy benefit period starts in 2014 and ends in 2016 (at the E- policy expiry date);
 - (e) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2016, and considering all relevant financial benefits during the remaining assessment period.
21. Where (Option 2 with Option A):
- (a) A policy becomes effective in 2008;
 - (b) E- policy expiry date is in 2026; and
 - (c) The assessment period starts in 2013;

- (d) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after 1 January 2014);
 - (e) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2020, and considering all relevant financial benefits during the remaining assessment period.
22. Where (Option 2 with Option A):
- (a) A policy becomes effective in 2014;
 - (b) E- policy expiry date is in 2017; and
 - (c) The assessment period starts in 2008;
 - (d) In this case, the E- policy benefit period starts in 2014 and ends in 2017 (at the E- policy expiry date);
 - (e) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2017, and considering all relevant financial benefits during the remaining assessment period.
23. Where (Option 2 with Option A):
- (a) A policy becomes effective in 2014;
 - (b) E- policy expiry date is in 2027; and
 - (c) The assessment period starts in 2008;
 - (d) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after the E- policy is effective);
 - (e) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2020, and considering all relevant financial benefits during the remaining assessment period.
24. Where (Option 2 with Option B):
- (a) A policy becomes effective in 2008;
 - (b) E- policy expiry date is in 2026; and
 - (c) The assessment period starts in 2013;
 - (d) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after 1 January 2014);
 - (e) Therefore, if the project is submitted for registration during the defined seven-year benefit period (2014–2020), conduct the investment analysis disregarding the financial benefits during the entire assessment period.
25. Where (Option 2 with Option B):
- (a) A policy becomes effective in 2014;
 - (b) E- policy expiry date is in 2027; and

- (c) The assessment period starts in 2008;
 - (d) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after the E- policy is effective);
 - (e) Therefore, if the project is submitted for registration during the defined seven-year benefit period (2014–2020), conduct the investment analysis disregarding the financial benefits during the entire assessment period.
26. Where (Option 4 with Option A):
- (a) A policy becomes effective in 2006;
 - (b) A policy is implemented in 2008;
 - (c) E- policy expiry date is in 2026; and
 - (d) The assessment period starts in 2013;
 - (e) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after 1 January 2014);
 - (f) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2020, and considering all relevant financial benefits during the remaining assessment period.
27. Where (Option 4 with Option A):
- (a) A policy becomes effective in 2010;
 - (b) A policy is implemented in 2014;
 - (c) E- policy expiry date is in 2027; and
 - (d) The assessment period starts in 2008;
 - (e) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after the E- policy is implemented);
 - (f) Therefore, conduct the investment analysis disregarding the financial benefits from this E- policy from 2014 to 2020, and considering all relevant financial benefits during the remaining assessment period.
28. Where (Option 4 with Option B):
- (a) A policy becomes effective in 2006;
 - (b) A policy is implemented in 2008;
 - (c) E- policy expiry date is in 2026; and
 - (d) The assessment period starts in 2013;
 - (e) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after 1 January 2014);

- (f) Therefore, if the project is submitted for registration during the defined seven-year benefit period (2014–2020), conduct the investment analysis disregarding the financial benefits during the entire assessment period.

29. Where (Option 4 with Option B):

- (a) A policy becomes effective in 2010;
- (b) A policy is implemented in 2014;
- (c) E- policy expiry date is in 2027; and
- (d) The assessment period starts in 2008;
- (e) In this case, the E- policy benefit period starts in 2014 and ends in 2020 (seven years after the E- policy is implemented);
- (f) Therefore, if the project is submitted for registration during the defined seven-year benefit period (2014–2020), conduct the investment analysis disregarding the financial benefits during the entire assessment period.

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Document information

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Decision Class: Regulatory Document Type: Guideline Business Function: Methodology Keywords: additionality, barrier analysis, E- policy, investment aspects		

Appendix 2. Draft methodological tool “Tool for the demonstration and assessment of additionality”

1. Introduction

1. The tool provides a stepwise approach to demonstrate and assess the additionality of a clean development mechanism (CDM) project. These steps are:
 - (a) Step 0 – Demonstration whether the proposed project activity is the first of its kind;
 - (b) Step 1 – Identification of alternatives to the project activity;
 - (c) Step 2 – Investment analysis;
 - (d) Step 3 – Barriers analysis;
 - (e) Step 4 – Common practice analysis.

2. Scope, applicability, and entry into force

2.1 Scope

2. This tool provides for a stepwise approach to demonstrate and assess additionality. These steps include:
 - (a) Demonstration whether the proposed project activity is the first of its kind;
 - (b) Identification of alternatives to the project activity;
 - (c) Investment analysis to determine that the proposed project activity is either: 1) not the most economically or financially attractive, or 2) not economically or financially feasible;
 - (d) Barriers analysis; and
 - (e) Common practice analysis.
3. Based on the information about activities similar to the proposed project activity, the common practice analysis is to complement and reinforce the investment and/or barriers analysis.¹ The steps are summarized in figure 1.
4. The document provides a general framework for demonstrating and assessing additionality and is applicable to a wide range of project types. Some project types may require adjustments to this general framework.
5. This tool does not replace the need for the baseline methodology to provide a stepwise approach to identify the baseline scenario. Project participants that propose new

¹ Project participants can use either the investment analysis or barrier analysis step. They may, if they so wish, use both the investment and barrier analysis step.

baseline methodologies shall ensure consistency between the determination of additionality of a project activity and the determination of a baseline scenario. Project participants can also use the “Combined tool to identify the baseline scenario and demonstrate additionality”, which provides a procedure for baseline scenario identification as well as additionality demonstration.

6. In validating the application of this tool, designated operation entities (DOEs) shall carefully assess and verify the reliability and creditability of all data, rationales, assumptions, justifications and documentation provided by project participants to support the demonstration of additionality. The elements checked during this assessment and the conclusions shall be documented transparently in the validation report.
7. Project activities with a start date before the date of validation shall specifically take into account the guidance provided in the “Guidelines for completing the Project Design Document”, Chapter V “Specific guidelines” Section B, sub-section B-5. The “start date of a project activity” is as defined in paragraph 76 of the report of the thirty-third meeting of the CDM Executive Board (the Board).²
8. Project activities that apply this tool in the context of approved consolidated methodology ACM0002, need only identify that there is at least one credible and feasible alternative that would be more attractive than the proposed project activity.

2.2 Applicability

9. The use of the “Tool for the demonstration and assessment of additionality” is not mandatory for project participants when proposing new methodologies. Project participants may propose alternative methods to demonstrate additionality for consideration by the Board. They may also submit revisions to approved methodologies using the additionality tool.
10. Once the additionally tool is included in an approved methodology, its application by project participants using this methodology is mandatory.

2.3 Entry into force

11. Immediately upon adoption of the tool at the seventy-ninth meeting of the Board (1 June 2014). The grace period of eight months is applicable to version 8.0.0 of the “Tool for the demonstration and assessment of additionality”.

3. Definitions

12. The definitions contained in the “Glossary of CDM terms” shall apply.
13. For the purpose of this tool, the following definitions apply:
 - (a) **Applicable geographical area** should be the entire host country. If the project participants opt to limit the applicable geographical area to a specific

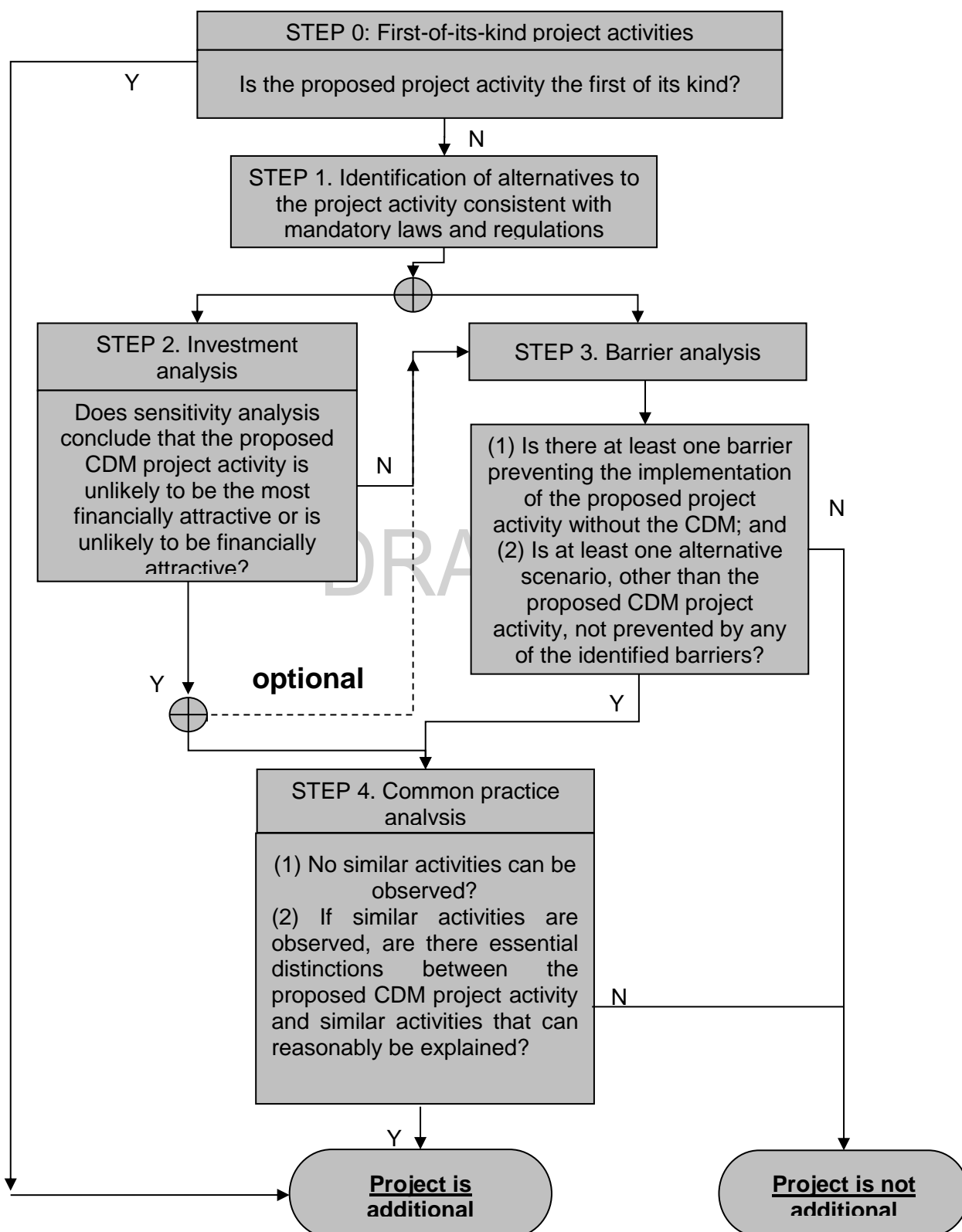
² The Board agreed to clarify that the primary purpose of defining the start date of a project activity is to ensure that project activities submitted for registration comply with the requirements of paragraph 13 of Decision 17/CP.7. In this context, it has always been the Board’s view that the start date of a CDM project activity is the earliest of the dates at which the implementation or construction or real action of the project activity begins.

geographical area (such as province, region, etc.) within the host country, then they shall provide justification on the essential distinction between the identified specific geographical area and the rest of the host country;

- (b) **Measure**³ (for emission reduction activities) is a broad class of greenhouse gas emission reduction activities possessing common features. Four types of measures are currently covered in the framework:
- (i) Fuel and feedstock switch (example: switch from naphtha to natural gas for energy generation, or switch from limestone to gypsum in cement clinker production);
 - (ii) Switch of technology with or without change of energy source including energy efficiency improvement as well as use of renewable energies (example: energy efficiency improvements, power generation based on renewable energy);
 - (iii) Methane destruction (example: landfill gas flaring);
 - (iv) Methane formation avoidance (example: use of biomass that would have been left to decay in a solid waste disposal site resulting in the formation and emission of methane, for energy generation);
- (c) **Output** is goods/services produced by the project activity including, among other things, heat steam, electricity, methane, and biogas unless otherwise specified in the applied methodology.

³ Identified measures do not cover industrial gases, transport and afforestation/reforestation projects.

Figure 1. Flowchart of the stepwise approach



4. Methodology procedure

4.1 Step 0: Demonstration of whether the proposed project activity is the first of its kind

14. This step is optional. If it is not applied it shall be considered that the proposed project activity is not the first of its kind.
15. This step serves for the demonstration of additionality by means of the first of its kind.
16. If the proposed CDM project activity (-ies) apply measure(s) that are listed in the definitions section above, the latest version of the “Guidelines on additionality of first-of-its-kind project activities” available on the UNFCCC website shall be applied to demonstrate that the project activity is the first of its kind.
17. If the proposed CDM project activity (-ies) apply other measure(s) than those identified in the definitions section above, the project proponents shall propose an approach for demonstrating that a project is a “first of its kind”.
18. **Outcome of Step 0:** If the proposed project is the first of its kind, its additionality is demonstrated; otherwise, proceed to Step 1.

4.2 Step 1: Identification of alternatives to the project activity consistent with current laws and regulations

19. Define realistic and credible alternatives⁴ to the project activity (-ies) through the following sub-steps:

4.2.1 Sub-step 1a: Define alternatives to the project activity

20. Identify realistic and credible alternative(s) available to the project participants or similar project developers⁵ that provide outputs or services comparable with the proposed CDM project activity.⁶ These alternatives are to include:
 - (a) The proposed project activity undertaken without being registered as a CDM project activity;

⁴ Reference to “alternatives” throughout this document denotes “alternative scenarios”.

⁵ For example, a coal-fired power station or hydropower may not be an alternative for an independent power producer investing in wind energy or for a sugar factory owner investing in a co-generation, but may be an alternative for a public utility. Alternatives are, therefore, related to technology and circumstances as well as to the investor.

⁶ For example:

- In the case of a project reducing emissions in the aluminum or cement production, the output provided by the alternative scenarios should be the production of the same quality of aluminum or the production of a cement type that can be used in the same applications as the cement type produced by the project activity;
- In the case of a project improving the energy efficiency of motors in a facility, the service provided is mechanical energy. Different scenarios to produce the same quantity of mechanical energy should be considered;
- In the case of a landfill gas capture project, the service provided by the project includes operation of a landfill. Alternative scenarios to the project could include different ways to operate the landfill, such as no capture of methane, capture and flaring of the methane or capture and combustion of the methane for energy generation.

- (b) Other realistic and credible alternative scenario(s) to the proposed CDM project activity scenario that deliver outputs services (e.g. cement) or services (e.g. electricity, heat) with comparable quality, properties and application areas, taking into account, where relevant, examples of scenarios identified in the underlying methodology;
 - (c) If applicable, continuation of the current situation (no project activity or other alternatives undertaken).
21. If the proposed CDM project activity includes several different facilities, technologies, outputs or services, alternative scenarios for each of them should be identified separately. Realistic combinations of these should be considered as possible alternative scenarios to the proposed project activity.⁷
 22. For the purpose of identifying relevant alternative scenarios, the project participant should include the technologies or practices that provide outputs (e.g. cement) or services (e.g. electricity, heat) with comparable quality, properties and application areas as the proposed CDM project activity and that have been implemented previously or are currently being introduced in the relevant country/region.
 23. **Outcome of sub-step 1a:** Identified realistic and credible alternative scenario(s) to the project activity

4.2.2 Sub-step 1b: Consistency with mandatory laws and regulations

24. The alternative(s) shall be in compliance with all mandatory applicable legal and regulatory requirements, even if these laws and regulations have objectives other than greenhouse gas (GHG) reductions, e.g. to mitigate local air pollution. (This sub-step does not consider national and local policies that do not have legally-binding status.)
25. If an alternative does not comply with all mandatory applicable legislation and regulations, then show that, based on an examination of current practice in the country or region in which the law or regulation applies, those applicable legal or regulatory requirements are systematically not enforced and that non-compliance with those requirements is widespread in the country. If this cannot be shown, then eliminate the alternative from further consideration.
26. If the proposed project activity is the only alternative amongst the ones considered by the project participants that is in compliance with mandatory regulations with which there is general compliance, then the proposed CDM project activity is not additional.
27. **Outcome of sub-step 1b:** Identified realistic and credible alternative scenario(s) to the project activity that are in compliance with mandatory legislation and regulations taking into account the enforcement in the region or country and Board decisions on national and/or sectoral policies and regulations.

⁷ For example:

- In case of a cogeneration project activity, alternative scenarios for heat and electricity generation should be established separately;
- In case of a project that improves energy efficiency in several boilers with rather different characteristics (e.g. size, technology, age, etc.), alternative scenarios should be established for each boiler or for types of boilers with broadly similar characteristics.

28. Proceed to step 2 (investment analysis) or step 3 (barrier analysis). (Project participants may also choose to complete both steps 2 and 3.)

4.3 Step 2: Investment analysis

29. Determine whether the proposed project activity is not:
- (a) The most economically or financially attractive; or
 - (b) Economically or financially feasible, without the revenue from the sale of certified emission reductions (CERs).
30. Please note that the latest version of the “Guidelines on the assessment of investment analysis”, available on the UNFCCC website, shall be taken into account when applying this step.
31. To conduct the investment analysis, use the following sub-steps:

4.3.1 Sub-step 2a: Determine appropriate analysis method

32. Determine whether to apply simple cost analysis, investment comparison analysis or benchmark analysis (sub-step 2b). If the CDM project activity and the alternatives identified in step 1 generate no financial or economic benefits other than CDM-related income, then apply the simple cost analysis (option I). Otherwise, use the investment comparison analysis (option II) or the benchmark analysis (option III).

4.3.2 Sub-step 2b: Option I. Apply simple cost analysis

33. Document the costs associated with the CDM project activity and the alternatives identified in step 1 and demonstrate that there is at least one alternative which is less costly than the project activity.
34. If it is concluded that the proposed CDM project activity is more costly than at least one alternative then proceed to step 4 (common practice analysis).

4.3.3 Sub-step 2b: Option II. Apply investment comparison analysis

35. Identify the financial indicator, such as internal rate of return (IRR), net present value (NPV), cost-benefit ratio, or unit cost of service (e.g. levelized cost of electricity production in \$/kWh or levelized cost of delivered heat in \$/GJ) most suitable for the project type and decision-making context.

4.3.4 Sub-step 2b: Option III. Apply benchmark analysis

36. Identify the financial/economic indicator, such as IRR, most suitable for the project type and decision context.
37. When applying option II or option III, the financial/economic analysis shall be based on parameters that are standard in the market, considering the specific characteristics of the project type, but not linked to the subjective profitability expectation or risk profile of a particular project developer. Only in the particular case where the project activity can be

implemented by the project participant, the specific financial/economic situation of the company undertaking the project activity can be considered.⁸

38. Discount rates and benchmarks shall be derived from:

- (a) Government bond rates, increased by a suitable risk premium to reflect private investment and/or the project type, as substantiated by an independent (financial) expert or documented by official publicly available financial data;
- (b) Estimates of the cost of financing and required return on capital (e.g. commercial lending rates and guarantees required for the country and the type of project activity concerned), based on bankers views and private equity investors/funds' required return on comparable projects;
- (c) A company internal benchmark (weighted average capital cost of the company), only in the particular case referred to above in paragraph 5. The project developers shall demonstrate that this benchmark has been consistently used in the past, i.e. that project activities under similar conditions developed by the same company used the same benchmark;
- (d) Government/official approved benchmark where such benchmarks are used for investment decisions;
- (e) Any other indicators, if the project participants can demonstrate that the above options are not applicable and their indicator is appropriately justified.

4.3.5 Sub-step 2c: Calculation and comparison of financial indicators (only applicable to options II and III):

39. Calculate the suitable financial indicator for the proposed CDM project activity and, in the case of option II above, for the other alternatives. Include all relevant costs (including, for example, the investment cost, the operations and maintenance costs), and revenues (excluding CER revenues, but possibly including ~~inter alia subsidies/fiscal incentives,~~⁹ official development assistance (ODA), etc., where applicable, and undertaking the analysis in accordance with the "Guideline on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario"), and, as appropriate, non-market cost and benefits in the case of public investors if this is standard practice for the selection of public investments in the host country.
40. Present the investment analysis in a transparent manner and provide all the relevant assumptions, preferably in the PDD, or in separate annexes to the PDD, so that a reader can reproduce the analysis and obtain the same results. Refer to all critical techno-economic parameters and assumptions (such as capital costs, fuel prices, lifetimes, and discount rate or cost of capital). Justify and/or cite assumptions in a manner that can be validated by the DOE. In calculating the financial/economic indicator, the project's risks can be included through the cash flow pattern, subject to project-specific expectations

⁸ For example, when the project activity upgrades an existing process or uses a resource (i.e. some waste) available on the project site and that is not traded.

⁹ See EB guidance on the consideration of national/local/sectoral policies and measures for the baseline setting.

and assumptions (e.g. insurance premiums can be used in the calculation to reflect specific risk equivalents).

41. Assumptions and input data for the investment analysis shall not differ across the project activity and its alternatives, unless differences can be well substantiated.
42. Present in the PDD submitted for validation a clear comparison of the financial indicator for the proposed CDM activity and:
 - (a) The alternatives, if option II (investment comparison analysis) is used. If one of the other alternatives has the best indicator (e.g. highest IRR), then the CDM project activity cannot be considered the most financially attractive;
 - (b) The financial benchmark, if Option III (benchmark analysis) is used. If the CDM project activity has a less favourable indicator (e.g. lower IRR) than the benchmark, then the CDM project activity cannot be considered financially attractive.

4.3.6 Sub-step 2d: Sensitivity analysis (only applicable to options II and III)

43. Include a sensitivity analysis that shows whether the conclusion regarding the financial/economic attractiveness is robust to reasonable variations in the critical assumptions. The investment analysis provides a valid argument in favour of additionality only if it consistently supports (for a realistic range of assumptions) the conclusion that the project activity is unlikely to be the most financially/economically attractive (as per sub-step 2c) or is unlikely to be financially/economically attractive (as per sub-step 2c).
44. **Outcome of step 2:** If after the sensitivity analysis it is concluded that: (1) the proposed CDM project activity is unlikely to be the most financially/economically attractive (as per sub-step 2c) or is unlikely to be financially/economically attractive (as per sub-step 2c), then proceed to step 4 (common practice analysis).¹⁰
45. Otherwise, unless barrier analysis below is undertaken and indicates that the proposed project activity faces barriers that do not prevent at least one alternative from occurring, the project activity is considered not additional.

4.4 Step 3: Barrier analysis

46. This step serves to identify barriers and to assess which alternatives are prevented by these barriers. Please note that the latest approved version of the “Guidelines for objective demonstration and assessment of barriers”, available on the UNFCCC website, shall be taken into account when applying this step.
47. If this step is used, determine whether the proposed project activity faces barriers that:
 - (a) Prevent the implementation of this type of proposed project activity; and
 - (b) Do not prevent the implementation of at least one of the alternatives.

¹⁰ If the project participants so wish, they may apply step 3 (barrier analysis) as well.

48. The identified barriers are only sufficient grounds for demonstration of additionality if they would prevent potential project proponents from carrying out the proposed project activity undertaken without being registered as a CDM project activity.
49. If the CDM does not alleviate the identified barriers that prevent the proposed project activity from occurring, then the project activity is not additional.
50. Use the following sub-steps:

4.4.1 Sub-step 3a: Identify barriers that would prevent the implementation of the proposed CDM project activity

51. Establish that there are realistic and credible barriers that would prevent the implementation of the proposed project activity from being carried out if the project activity was not registered as a CDM activity. Such realistic and credible barriers may include, among others:
 - (a) Investment barriers, other than the economic/financial barriers in step 2 above, inter alia:
 - (i) For alternatives undertaken and operated by private entities: Similar activities have only been implemented with grants or other non-commercial finance terms. Similar activities are defined as activities that rely on a broadly similar technology or practices, are of a similar scale, take place in a comparable environment with respect to regulatory framework and are undertaken in the relevant country/region;
 - (ii) No private capital is available from domestic or international capital markets due to real or perceived risks associated with investment in the country where the proposed CDM project activity is to be implemented, as demonstrated by the credit rating of the country or other country investments reports of reputed origin;
 - (b) Technological barriers, inter alia:
 - (i) Skilled and/or properly trained labour to operate and maintain the technology is not available in the relevant country/region, which leads to an unacceptably high risk of equipment disrepair and malfunctioning or other underperformance;
 - (ii) Lack of infrastructure for implementation and logistics for maintenance of the technology (e.g. natural gas cannot be used because of the lack of a gas transmission and distribution network);
 - (iii) Risk of technological failure: the process/technology failure risk in the local circumstances is significantly greater than for other technologies that provide services or outputs comparable to those of the proposed CDM project activity, as demonstrated by relevant scientific literature or technology manufacturer information;
 - (iv) The particular technology used in the proposed project activity is not available in the relevant region;
 - (c) Other barriers, preferably specified in the underlying methodology as examples.

52. **Outcome of sub-step 3a:** Identified barriers that may prevent one or more alternative scenarios from occurring or the conclusion that the project is additional.

4.4.2 Sub-step 3b: Show that the identified barriers would not prevent the implementation of at least one of the alternatives (except the proposed project activity)

53. If the identified barriers also affect other alternatives, explain how they are affected less strongly than they affect the proposed CDM project activity. In other words, demonstrate that the identified barriers do not prevent the implementation of at least one of the alternatives. Any alternative that would be prevented by the barriers identified in sub-step 3a is not a viable alternative, and shall be eliminated from consideration.
54. In applying sub-steps 3a and 3b, provide transparent and documented evidence, and offer conservative interpretations of this documented evidence, as to how it demonstrates the existence and significance of the identified barriers and whether alternatives are prevented by these barriers. Anecdotal evidence can be included, but alone is not sufficient proof of barriers. The type of evidence to be provided should include at least one of the following:
- (a) Relevant legislation, regulatory information or industry norms;
 - (b) Relevant (sectoral) studies or surveys (e.g. market surveys, technology studies, etc.) undertaken by universities, research institutions, industry associations, companies, bilateral/multilateral institutions, etc.;
 - (c) Relevant statistical data from national or international statistics;
 - (d) Documentation of relevant market data (e.g. market prices, tariffs, rules);
 - (e) Written documentation of independent expert judgments from industry, educational institutions (e.g. universities, technical schools, training centres), industry associations and others.
55. **Outcome of step 3:** If both sub-steps 3a and 3b are satisfied, proceed to step 4 (common practice analysis).
56. If one of the sub-steps 3a or 3b is not satisfied, the project activity is not additional.

4.5 Step 4: Common practice analysis

57. The above generic additionality tests shall be complemented with an analysis of the extent to which the proposed project type (e.g. technology or practice) has already diffused in the relevant sector and region. This test is a **credibility check** to complement the investment analysis (step 2) or barrier analysis (step 3). Identify and discuss the existing common practice through the following sub-steps. If the proposed CDM project activity (-ies) applies measure(s) that are listed in the definitions section above proceed to sub-step 4a; otherwise, proceed to sub-step 4b.

4.5.1 Sub-step 4a: The proposed CDM project activity (-ies) applies measure(s) that are listed in the definitions section above

58. The latest version of the “Guidelines on common practice” available on the UNFCCC website shall be applied.

59. Proceed directly to the outcome of step 4.

4.5.2 Sub-step 4b: The proposed CDM project activity (-ies) does not apply any of the measures that are listed in the definitions section above

60. Provide an analysis of the extent to which similar activities to the proposed CDM project activity have been implemented previously or are currently underway. Similar activities are defined as activities (i.e. technologies or practices) that are of similar scale, take place in a comparable environment, inter alia, with respect to the regulatory framework and are undertaken in the applicable geographical area, as defined above. Other CDM project activities (registered project activities and project activities which have been published on the UNFCCC website for global stakeholder consultation as part of the validation process) are not to be included in this analysis. Provide documented evidence and, where relevant, quantitative information. On the basis of that analysis, describe whether and to what extent similar activities have already diffused in the applicable geographical area.
61. If similar activities to the proposed project activity are identified, then compare the proposed project activity to the other similar activities and assess whether there are essential distinctions between the proposed project activity and the similar activities. If this is the case, point out and explain the essential distinctions between the proposed project activity and the similar activities and explain why the similar activities enjoyed certain benefits that rendered them financially attractive (e.g., subsidies or other financial flows) and which the proposed project activity cannot use or why the similar activities did not face barriers to which the proposed project activity is subject.
62. Essential distinctions may include a serious change in circumstances under which the proposed CDM project activity will be implemented when compared to circumstances under which similar projects were carried out. For example, new barriers may have arisen, or promotional policies may have ended, leading to a situation in which the proposed CDM project activity would not be implemented without the incentive provided by the CDM. The change must be fundamental and verifiable.
63. The proposed project activity is regarded as “common practice” if similar activities can be observed and essential distinctions between the proposed CDM project activity and similar activities cannot be identified.
64. **Outcome of Step 4:** If the outcome of step 4 is that the proposed project activity is not regarded as “common practice”, then the proposed project activity is additional.
65. If the outcome of step 4 is that the proposed project activity is regarded as “common practice” then the proposed CDM project activity is not additional.

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Document information

<i>Version</i>	<i>Date</i>	<i>Description</i>
09.0	14 May 2014	Published within annex 13 to the annotated agenda of EB 79. Revision to include the reference to the draft “Guidelines on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario”.
08.0.0	16 September 2013	Published within annex 16 to the annotated agenda of EB 75. Revision to include the reference to the draft “Guidelines on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario”.
07.0.0	23 November 2012	EB 70, Annex 8 <ul style="list-style-type: none"> • Inclusion of reference to the latest approved “Guidelines on additionality of first-of-its-kind project activities” and the “Guidelines on common practice”.
06.1.0	13 September 2012	EB 69, Annex 20 Amendment to: <ul style="list-style-type: none"> • Allow the use of other sources of information to assess the common practice of a project activity.
06.0.0	25 November 2011	EB 65, Annex 21 Inclusion of requirements from the guidelines on additionality of Foik projects activities and the guidelines on common practice.
05.2.1	27 June 2011	Editorial amendment to: <ul style="list-style-type: none"> • Remove the "Guidelines on the assessment of investment analysis" as an annex within this document and instead add it as a reference; • Add reference to the “Guidelines for objective demonstration and assessment of barriers”; • Implement other minor editorial improvements.
05.2	26 August 2008	Updated with version 2 of the annex “Guidance on the assessment of investment analysis”.
05.1	25 July 2008	Addition of the “Guidance on the assessment of investment analysis” as an annex to the Additionality Tool.
05	16 May 2008	EB 39, Annex 10 <ul style="list-style-type: none"> • Changes in scope and applicability; • Clarity in the conditions under which different approaches, provided in Step 2: Investment analysis can be applied; • Clarity in the appropriate choice of the benchmark for the assessment of additionality when using benchmark analysis; • Footnote 6 deleted.

<i>Version</i>	<i>Date</i>	<i>Description</i>
04	30 November 2007	EB 36, Annex 16 Footnote 7 revised.
03	16 February 2007	EB 29, Annex 05 <ul style="list-style-type: none">• Removed Step-0 and Step-5 from Tool and other small changes done;• The tool is aligned with the Combined Tool.
02	25 November 2005	EB 22, Annex 08 Footnote 2 added providing clarity on evidence for the incentive from CDM to be submitted by project proponents as per Step-0 1b).
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Appendix 3. Draft methodological tool “Combined tool to identify the baseline scenario and demonstrate additionality”

1. Introduction

1. This tool provides a stepwise approach to identify the baseline scenario and simultaneously demonstrate additionality. These steps are:
 - (a) Step 0 – Demonstration of whether the proposed project activity is the first of its kind;
 - (b) Step 1 – Identification of alternative scenarios;
 - (c) Step 2 – Barrier analysis;
 - (d) Step 3 – Investment analysis;
 - (e) Step 4 – Common practice analysis.

2. Scope, applicability, and entry into force

2.1. Scope

2. Project participants shall apply the following five steps:
 - (a) Step 0 – Demonstration that a proposed project activity is the first of its kind
 - (b) Step 1 – Identification of alternative scenarios;
 - (c) Step 2 – Barrier analysis;
 - (d) Step 3 – Investment analysis (if applicable);
 - (e) Step 4 – Common practice analysis.
3. The procedure is summarized in figures 1 and 2 below. For more specific detail regarding the flowcharts please refer to the text.
4. In validating the application of this tool, designated operational entities (DOEs) should carefully assess and verify the reliability and credibility of all data, rationales, assumptions, justifications and documentation provided by project participants to support the selection of the baseline and demonstration of additionality. The elements checked during this assessment and the consequent conclusions should be documented transparently in the validation report.

2.2. Applicability

5. This tool is only applicable to methodologies for which the potential alternative scenarios to the proposed project activity available to project participants cannot be implemented in parallel to the proposed project activity.¹¹
6. In some cases, methodologies referring to this tool may require adjustments or additional explanations. This could include, inter alia, a listing of relevant alternative scenarios that should be considered in Step 1, any relevant types of barriers other than those presented in this tool and guidance on how common practice should be established.

2.3. Entry into force

7. Immediately upon adoption of the tool at the seventy-ninth meeting of the Executive Board of the clean development mechanism (the Board) (1 June 2014). The grace period of eight months is applicable to version 6.0.0 of the “Combined tool to identify the baseline scenario and demonstrate additionality”.

3. Definitions

8. The definitions contained in the “Glossary of CDM terms” shall apply.
9. For the purpose of this tool, the following definitions apply:
 - (a) **Applicable geographical area** should be the entire host country. If the project participants opt to limit the applicable geographical area to a specific geographical area (such as province, region, etc.) within the host country, then they shall provide justification on the essential distinction between the identified specific geographical area and the rest of the host country;
 - (b) **Measure**¹² (for emission reduction activities) is a broad class of greenhouse gas (GHG) emission reduction activities possessing common features. Four types of measures are currently covered in the framework:
 - (i) Fuel and feedstock switch (example: switch from naphtha to natural gas for energy generation, or switch from limestone to gypsum in cement clinker production);

¹¹ For example, in the following situations a methodology could refer to this tool:

- For an energy efficiency CDM project where the identified potential alternative scenarios are: (a) retrofit of an existing equipment, or (b) replacement of the existing equipment by new equipment, or (c) the continued use of the existing equipment without any retrofits;
- For a CDM project activity related to the destruction of a greenhouse gas in one site where the identified potential alternative scenarios are: (a) installation of a thermal destruction unit, or (b) installation of a catalytic destruction system, or (c) no abatement of the greenhouse gas.

In these cases, the project proponents could not implement the three alternatives in parallel but they could only implement one of them.

However, the tool is, for example, not applicable in the following situation: the CDM project activity is the installation of a Greenfield facility that provides a product to a market (i.e. electricity, cement, etc.) where the output could be provided by other existing facilities or new facilities that could be implemented in parallel with the CDM project activity.

¹² Identified measures do not cover industrial gases, transport and afforestation/reforestation projects.

- (ii) Switch of technology with or without change of energy source including energy efficiency improvement as well as use of renewable energies (example: energy efficiency improvements, power generation based on renewable energy);
 - (iii) Methane destruction (example: landfill gas flaring);
 - (iv) Methane formation avoidance (example: use of biomass that would have been left to decay in a solid waste disposal site resulting in the formation and emission of methane, for energy generation);
- (c) **Output** is goods/services produced by the project activity including, among other things, heat steam, electricity, methane, and biogas unless otherwise specified in the applied methodology.

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4. Methodology procedure

Figure 1. Flowchart of the stepwise approach (case 1)

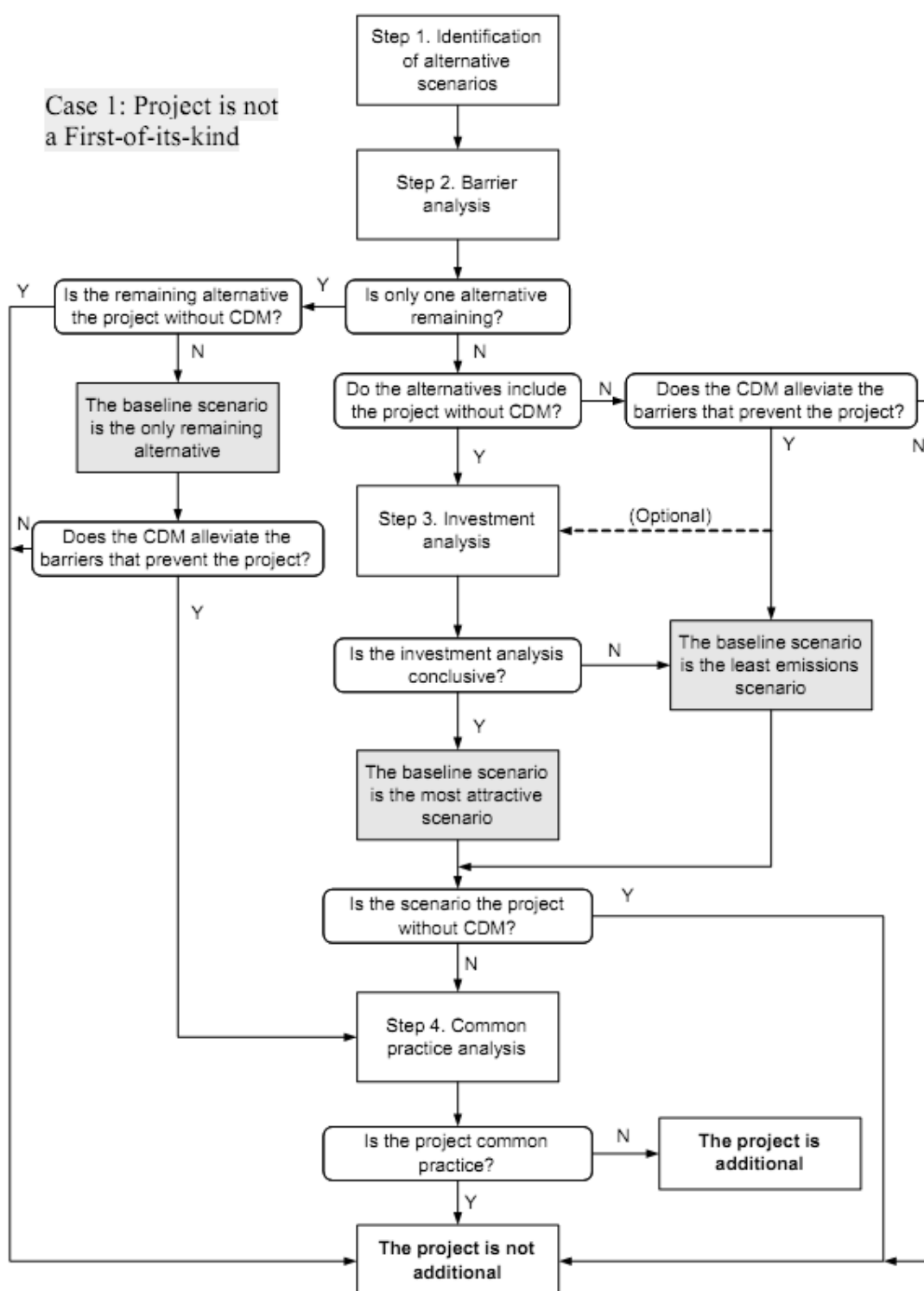
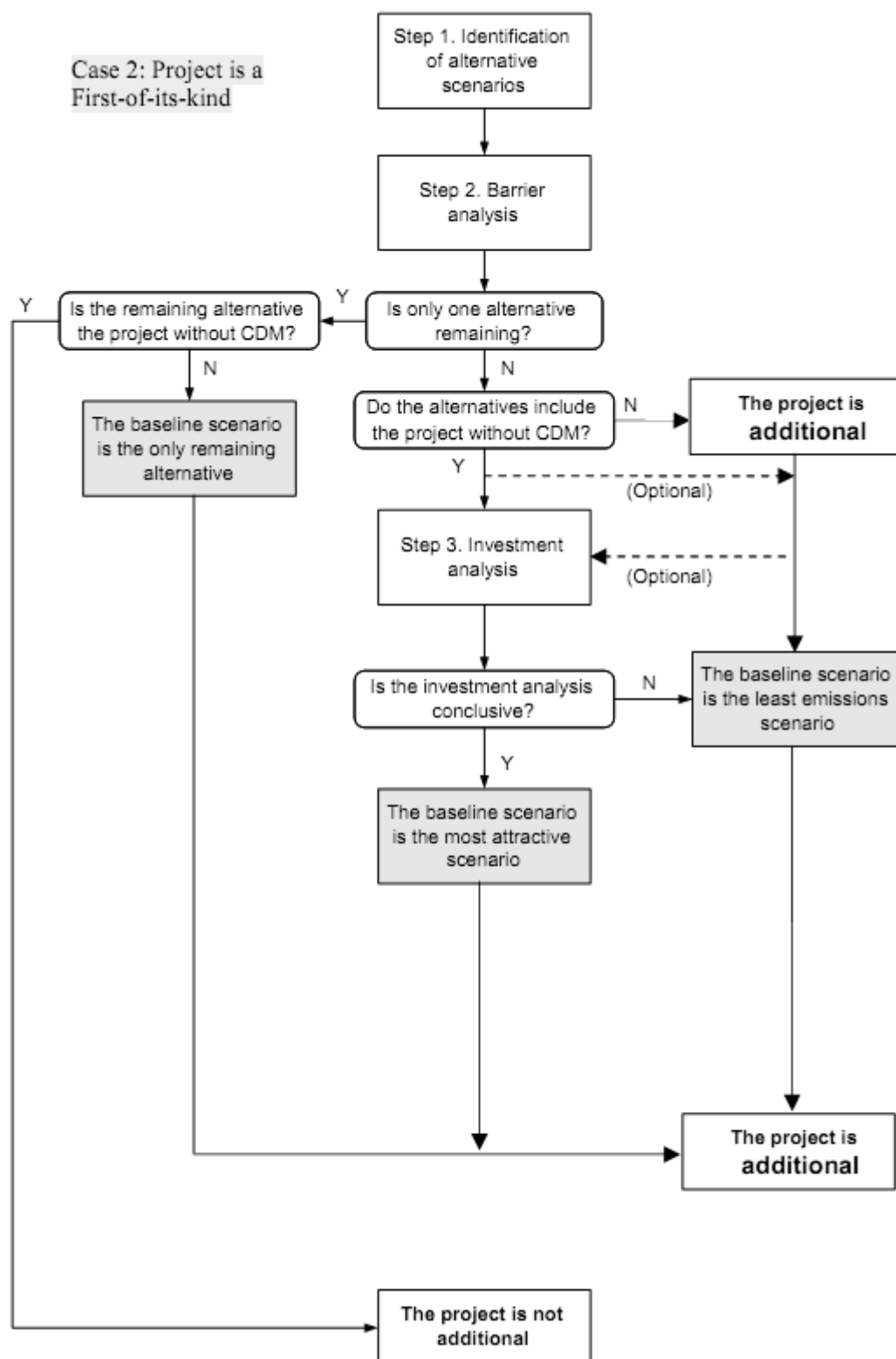


Figure 2. Flowchart of the stepwise approach (case 2)



4.1. Step 0: Demonstration of whether the proposed project activity is the first of its kind

10. This step is optional. If it is not applied it shall be considered that the proposed project activity is not the first of its kind.
11. This step serves for the demonstration of additionality by means of the first-of-its-kind approach.
12. If the proposed CDM project activity (-ies) apply measure(s) that are listed in the definitions section above, the latest version of the “Guidelines on additionality of first-of-its-kind project activities” available on the UNFCCC website shall be applied to demonstrate that the project activity is the first of its kind.
13. If the proposed CDM project activity (-ies) apply other measure(s) than those identified in the definitions section above, the project proponents shall propose an approach for demonstrating that a project is a “first of its kind”.

Outcome of step 0:

Conclusion I: The proposed project activity is the first of its kind.

Conclusion II: The proposed project activity is not the first of its kind.

In both cases, proceed to step 1.

4.2. Step 1: Identification of alternative scenarios

14. This step serves to identify all alternative scenarios to the proposed CDM project activity (-ies) which can be the baseline scenario:

4.2.1. Step 1a: Define alternative scenarios to the proposed CDM project activity

15. Identify all alternative scenarios that: (a) are available to the project participants; (b) cannot be implemented in parallel to the proposed project activity; and (c) provide the same output as the proposed CDM project activity.¹³ These alternative scenarios shall include:
 - (a) S1: The proposed project activity undertaken without being registered as a CDM project activity;

¹³ For example:

- In the case of a project reducing emissions in the aluminium or cement production, the output provided by the alternative scenarios should be the production of the same quality of aluminium or the production of a cement type that can be used in the same applications as the cement type produced by the project activity;
- In the case of a project improving the energy efficiency of motors in a facility, the service provided is mechanical energy. Different scenarios to produce the same quantity of mechanical energy should be considered;
- In the case of a landfill gas capture project, the service provided by the project includes operation of a landfill. Alternative scenarios to the project could include different ways to operate the landfill, such as no capture of methane, capture and flaring of the methane or capture and combustion of the methane for energy generation.

- (b) S2: Where applicable, no investment is undertaken by the project participants but third party (-ies) undertake(s) investments or actions which provide the same output to users of the project activity, for example:
 - (i) In the case of a Greenfield power project, an alternative scenario may be that the project participants would not invest in another power plant but that power would be generated in existing and/or new power plants in the electricity grid;
 - (c) S3: Where applicable, the continuation of the current situation, *not* requiring any investment or expenses to maintain the current situation, such as:
 - (i) The continued venting of methane from a landfill;
 - (ii) The continued release of N₂O from adipic or nitric acid production;
 - (d) S4: Where applicable, the continuation of the current situation, requiring an investment or expenses to maintain the current situation, such as:
 - (i) The continued use of an existing boiler involving expenses for operation and maintenance;
 - (ii) The continued use of a specific fuel mix for power generation in an existing power plant;
 - (e) S5: Other plausible and credible alternative scenarios to the project activity scenario, including the common practices in the relevant sector, that deliver the same output, taking into account, where relevant, examples of scenarios identified in the underlying methodology;
 - (f) S6: Where applicable, the “proposed project activity undertaken without being registered as a CDM project activity” to be implemented at a later point in time (e.g. due to existing regulations, end of life of existing equipment, financing aspects).
16. If the proposed CDM project activity includes several different facilities, technologies or outputs, alternative scenarios for each of them should be identified separately. Realistic combinations of these should be considered as possible alternative scenarios to the proposed project activity.¹⁴
17. For the purpose of identifying relevant alternative scenarios, provide an overview of other technologies or practices that provide the same output as the proposed CDM project activity and that have been implemented previously or are currently underway in the applicable geographical area. The applicable geographical area should preferably include 10 facilities (or projects) that provide the same output as the proposed CDM project activity. If fewer than 10 facilities (or projects) that provide the same output as the proposed CDM project activity are found in the applicable geographical area, the

¹⁴ For example:

- In case of a cogeneration project activity, alternative scenarios for heat and electricity generation should be established separately;
- In case of a project that improves energy efficiency in several boilers with specific different characteristics (e.g. size, technology, age, etc.), alternative scenarios should be established for each boiler or for types of boilers with broadly similar characteristics.

applicable geographical area may be expanded to an area that covers if possible, 10 such facilities (or projects). Other registered CDM project activities are not to be included in this analysis. Provide relevant documentation to support the results of the analysis.

Outcome of step 1a: List of plausible alternative scenarios to the project activity.

4.2.2. Step 1b: Consistency with mandatory applicable laws and regulations

18. The alternative scenario(s) shall be in compliance with all mandatory applicable legal and regulatory requirements, even if these laws and regulations have objectives other than GHG reductions, e.g. to mitigate local air pollution.¹⁵ (This step does not consider national and local policies that do not have legally-binding status).
19. If an alternative scenario does not comply with all mandatory applicable legislation and regulations, then show that, based on an examination of current practice in the country or region in which the mandatory law or regulation applies, those applicable mandatory legal or regulatory requirements are systematically not enforced and that non-compliance with those requirements is widespread in the country. If this cannot be shown, then eliminate the alternative scenario from further consideration.
20. If the proposed project activity is the only alternative scenario amongst the ones considered by the project participants that is in compliance with all mandatory regulations with which there is general compliance, then the proposed CDM project activity is not additional.

Outcome of step 1b: List of alternative scenarios to the project activity that are in compliance with mandatory legislation and regulations taking into account the enforcement in the region or country and Board decisions on national and/or sectoral policies and regulations.

If the above-mentioned list contains only one scenario, namely: S1 – the proposed project activity undertaken without being registered as a CDM project activity, then the proposed project activity is not additional and any remaining procedures of this tool are not applicable.

Otherwise, proceed to step 2 (barrier analysis).

4.3. Step 2: Barrier analysis

21. This step serves to identify barriers and to assess which alternative scenarios are prevented by these barriers. Please note that the latest approved version of the “Guidelines for objective demonstration and assessment of barriers”, available on the UNFCCC website, shall be taken into account when applying this step.

¹⁵For example, an alternative consisting of an open, uncapped landfill would be non-complying in a country where this scenario would imply violations of safety or environmental regulations pertaining to landfills.

4.3.1. Step 2a: Identify barriers that would prevent the implementation of alternative scenarios

22. Establish a complete list of realistic and credible barriers that may prevent alternative scenarios from occurring. Such realistic and credible barriers may include:

- (a) Investment barriers, other than insufficient financial returns as analysed in step 3, inter alia:
 - (i) For alternatives undertaken and operated by private entities: similar activities have only been implemented with grants or other non-commercial finance terms. Similar activities are defined as activities that rely on a broadly similar technology or practices, are of a similar scale, take place in a comparable environment with respect to regulatory framework and are undertaken in the applicable geographical area, as defined in step 1a above;
 - (ii) No private capital is available from domestic or international capital markets due to real or perceived risks associated with investments in the country where the project activity is to be implemented, as demonstrated by the credit rating of the country or other country investment reports of reputed origin;
- (b) Technological barriers, inter alia:
 - (i) Skilled and/or properly trained personnel to operate and maintain the technology are not available in the applicable geographical area, which leads to an unacceptably high risk of equipment disrepair, malfunctioning or other underperformance;
 - (ii) Lack of infrastructure for implementation and logistics for maintenance of the technology (e.g. natural gas cannot be used because of the lack of a gas transmission and distribution network);
 - (iii) Risk of technological failure: the process/technology failure risk in the local circumstances is significantly greater than for other technologies that provide services or outputs comparable to those of the proposed CDM project activity, as demonstrated by relevant scientific literature or technology manufacturer information;
 - (iv) The particular technology used in the proposed project activity is not available in the applicable geographical area;
- (c) Other barriers, preferably specified in the underlying methodology as examples.

Outcome of step 2a: List of barriers that may prevent one or more alternative scenarios from occurring.

4.3.2. Step 2b: Eliminate alternative scenarios which are prevented by the identified barriers

23. Identify which alternative scenarios are prevented by at least one of the barriers listed in step 2a, and eliminate those alternative scenarios from further consideration. All alternative scenarios shall be compared to the same set of barriers. The assessment of

the significance of barriers should take into account the level of access to and availability of information, technologies and skilled labour in the specific context of the industry where the project type is located. For example, projects located in sectors with small and medium sized enterprises may not have the same means to overcome technological barriers as projects in a sector where typically large or international companies operate.

Outcome of step 2b: List of alternative scenarios to the project activity that are not prevented by any barrier.

24. In applying steps 2a and 2b, provide transparent and documented evidence, and offer conservative interpretations of this evidence, as to how it demonstrates the existence and significance of the identified barriers and whether alternative scenarios are prevented by these barriers. The type of evidence to be provided should include at least one of the following:

- (a) Relevant legislation, regulatory information or industry norms;
- (b) Relevant (sectoral) studies or surveys (e.g. market surveys, technology studies, etc.) undertaken by universities, research institutions, industry associations, companies, bilateral/multilateral institutions, etc.;
- (c) Relevant statistical data from national or international statistics;
- (d) Documentation of relevant market data (e.g. market prices, tariffs, rules);
- (e) Written documentation from the company or institution developing or implementing the CDM project activity or the CDM project developer, such as minutes from Board meetings, correspondence, feasibility studies, financial or budgetary information, etc.;
- (f) Documents prepared by the project developer, contractors or project partners in the context of the proposed project activity or similar previous project implementations;
- (g) Written documentation of independent expert judgements from industry, educational institutions (e.g. universities, technical schools, training centres), industry associations and others.

Outcome of step 2:

1. If there is only one alternative scenario that is not prevented by any barrier, then the following applies:
 - (a) If this alternative scenario is the proposed project activity undertaken without being registered as a CDM project activity, then the project activity is not additional. In such a case any remaining procedures of this tool are not applicable;
 - (b) If this alternative scenario is not the proposed project activity without being registered as a CDM project activity, then this alternative is identified as the baseline scenario;

- (i) If the proposed project activity is the first of its kind then it is additional, and the remaining procedures of this tool are not applicable;
 - (ii) Otherwise, the following applies: explain – using qualitative or quantitative arguments – how the registration of the CDM project activity will alleviate the barriers that prevent the proposed project activity from occurring in the absence of the CDM. If the CDM alleviates the identified barriers that prevent the proposed project activity from occurring, proceed to step 4, otherwise the project activity is not additional.
- 2. If there is more than one alternative scenario that is not prevented by any barrier, then the following applies:
 - (a) If the alternative scenarios include the proposed project activity undertaken without being registered as a CDM project activity, then the following applies:
 - (i) If the proposed project activity is the first of its kind then it is additional and for the baseline scenario identification the project participants may choose either:
Option 1: go to step 3 (investment analysis); or
Option 2: exclude the proposed project activity undertaken without being registered as a CDM project activity from the set of the alternative scenarios. For option 2, from among the remaining scenarios identify the one with the lowest emissions¹⁶ (i.e. the most conservative) as the baseline scenario and any remaining procedures of this tool are not applicable;
 - (b) If the proposed project activity is not the first of its kind, then directly proceed to step 3 (investment analysis).
- 3. If the alternative scenarios do not include the proposed project activity undertaken without being registered as a CDM project activity, then the following applies:
 - (a) If the proposed project activity is the first of its kind then it is additional. For identification of baseline scenario project participants may choose either:
Option 1: go to step 3 (investment analysis); or
Option 2: identify the alternative scenario with the lowest emissions¹⁷ (i.e. the most conservative) as the baseline scenario. In such a case any remaining procedures of this tool are not applicable;
 - (b) If the proposed project activity is not the first of its kind, then:
explain – using qualitative or quantitative arguments – how the registration of the CDM project activity will alleviate the barriers that prevent the proposed project activity from occurring in the absence of the CDM. If the CDM alleviates the identified barriers that prevent the proposed project activity from occurring, project participants may choose either:
Option 1: go to step 3 (investment analysis); or
Option 2: identify the alternative scenario with the lowest emissions¹⁸ (i.e. the most conservative) as the baseline scenario, and proceed to step 4.
If the CDM does not alleviate the identified barriers that prevent the proposed project activity from occurring, then the project activity is not additional.

¹⁶ For alternative scenarios where the project participants do not undertake investments (i.e. scenarios as described in S2 or S3), the respective emissions should be determined in accordance with the underlying methodology.

¹⁷ For alternative scenarios where the project participants do not undertake investments (i.e. scenarios as described in S2 or S3), the respective emissions should be determined in accordance with the underlying methodology.

4.4. Step 3: Investment analysis

25. The objective of step 3 is to compare the economic or financial attractiveness of the alternative scenarios remaining after step 2 by conducting an investment analysis. The analysis should include all alternative scenarios remaining after step 2, including scenarios where the project participants do not undertake an investment (S2 or S3).
26. Please note that the latest approved version of the “Guidelines on the assessment of investment analysis”, available on the UNFCCC website, shall be taken into account when applying this step.
27. Identify the financial indicator, such as internal rate of return (IRR), net present value (NPV), cost-benefit ratio, or unit cost of service (e.g. levelized cost of electricity production in \$/kWh or levelized cost of delivered heat in \$/GJ) most suitable for the project type and decision-making context. If one of the alternative scenarios remaining after step 2 corresponds to the situation described in S2 or S3, then use either the NPV or the IRR as financial indicator in the analysis.
28. Calculate the suitable financial indicator for all alternative scenarios remaining after step 2. Include all relevant costs (including, for example, **the investment cost**, investment operations and maintenance costs), and revenues (including **subsidies/fiscal incentives**,¹⁹ official development assistance (ODA), etc. where applicable, and **undertaking the analysis in accordance with the “Guideline on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario”**), and, as appropriate, non-market costs and benefits in the case of public investors if this is standard practice for the selection of public investments in the host country.
29. For alternative scenarios that correspond to the situation described in S2 or S3 and that do not involve any investment costs, operational costs or revenues, use the following values for the financial indicator to reflect such a situation:
 - (a) If the financial indicator is the NPV: Assume a value of NPV equal to zero;
 - (b) If the financial indicator is the IRR: Use as the IRR the financial benchmark, as determined through options (a) to (e) below.
30. The financial/economic analysis shall be based on parameters that are standard in the market, considering the specific characteristics of the project type, but not linked to the subjective profitability expectation or risk profile of a particular project developer. In the particular case where the project activity can only be implemented by the project participant, the specific financial/economic situation of the company undertaking the project activity can be considered.²⁰

¹⁸ For alternative scenarios where the project participants do not undertake investments (i.e. scenarios as described in S2 or S3), the respective emissions should be determined in accordance with the underlying methodology.

¹⁹ ~~Note that according to guidance by the EB (EB 22, Annex 3), subsidies and incentives may be excluded from consideration in certain cases.~~

²⁰ For example, when the project activity upgrades an existing process or uses a resource (i.e. some waste) available on the project site and that is not traded.

31. The discount rate (in the case of the NPV) or the financial benchmark (in the case of the IRR) shall be derived from:
- (a) Government bond rates, increased by a suitable risk premium to reflect private investment and/or the project type, as substantiated by an independent (financial) expert or documented by official publicly available financial data;
 - (b) Estimates of the cost of financing and required return on capital (e.g. commercial lending rates and guarantees required for the country and the type of project activity concerned), based on banker's views and private equity investors/funds' required return on comparable projects;
 - (c) A company internal financial benchmark (weighted average cost of capital of the company), only in the particular case that the project activity can only be implemented by the project participant. The project developers shall demonstrate that this financial benchmark has been consistently used in the past, i.e. that project activities under similar conditions developed by the same company used the same financial benchmark;
 - (d) A government/officially approved financial benchmark where it can be demonstrated that such financial benchmarks are used for investment decisions;
 - (e) Any other indicators if the project participants can demonstrate that the above options are not applicable and their indicator is appropriately justified.
32. Present the investment analysis in a transparent manner and provide all the relevant assumptions, preferably in the PDD, or in separate annexes to the PDD, so that a reader can reproduce the analysis and obtain the same results. Refer to critical techno-economic parameters and assumptions (such as capital costs, fuel prices, lifetimes, and discount rate or cost of capital). Justify and/or cite assumptions in a manner that can be validated by the DOE. In calculating the financial indicator, the risks of the alternative scenarios can be included through the cash flow pattern, subject to project-specific expectations and assumptions (e.g. insurance premiums can be used in the calculation to reflect specific risk equivalents). Assumptions and input data for the investment analysis shall not differ across alternative scenarios, unless differences can be well substantiated.
33. Present in the PDD submitted for validation a clear comparison of the financial indicators for all alternative scenarios and rank the alternative scenarios according to the financial indicators.
34. Include a sensitivity analysis to assess whether the conclusion regarding the financial attractiveness is robust to reasonable variations in the critical assumptions. The investment comparison analysis provides a valid argument in identifying the baseline scenario only if it consistently supports (for a realistic range of assumptions) the conclusion that one alternative scenario is the most economically and/or financially attractive.

Outcome of step 3: Ranking of the short list of alternative scenarios according to the most suitable financial indicator, taking into account the results of the sensitivity analysis.

If the sensitivity analysis is not conclusive, then the alternative scenario to the project activity with least emissions among the alternative scenarios is considered the baseline scenario. If the sensitivity analysis confirms the result of the investment comparison analysis, then the most economically or financially attractive alternative scenario is considered the baseline scenario.

If the alternative considered the baseline scenario is the “proposed project activity undertaken without being registered as a CDM project activity”, then the project activity is not additional. Otherwise, proceed to step 4.

4.5. Step 4: Common practice analysis

35. If the proposed project activity is the first of its kind then this step is not applicable. Otherwise, the previous steps shall be complemented with an analysis of the extent to which the proposed project type (e.g. technology or practice) has already diffused in the relevant sector and applicable geographical area. This test is a **credibility check** to demonstrate additionality and complements the barrier analysis (step 2) and, where applicable, the investment analysis (step 3).
36. If the proposed CDM project activity (-ies) applies measure(s) that are listed in the definitions section above, proceed to step 4 a, otherwise, proceed to step 4 b.

4.5.1. Step 4a: The proposed CDM project activity (-ies) applies measure(s) that are listed in the definitions section above

37. The latest version of the “Guidelines on common practice” available on the UNFCCC website shall be applied.
38. Proceed directly to the box “Outcome of step 4”.

4.5.2. Step 4b: The proposed CDM project activity (-ies) does not apply any of the measures that are listed in the definitions section above

39. Provide an analysis of the extent to which similar activities to the proposed CDM project activity have been implemented previously or are currently underway. Similar activities are defined as activities (i.e. technologies or practices) that are of similar scale, take place in a comparable environment, inter alia, with respect to the regulatory framework and are undertaken in the applicable geographical area, as defined in step 1a above. Other CDM project activities (registered project activities and project activities which have been published on the UNFCCC website for global stakeholder consultation as part of the validation process) are not to be included in this analysis. Provide documented evidence and, where relevant, quantitative information. On the basis of that analysis, describe whether and to what extent similar activities have already diffused in the applicable geographical area.
40. If similar activities to the proposed project activity are identified, then compare the proposed project activity to the other similar activities and assess whether there are essential distinctions between the proposed project activity and the similar activities. If this is the case, point out and explain the essential distinctions between the proposed

project activity and the similar activities and explain why the similar activities enjoyed certain benefits that rendered them financially attractive (e.g. subsidies or other financial flows) and which the proposed project activity cannot use or why the similar activities did not face barriers to which the proposed project activity is subject.

41. Essential distinctions may include a serious change in circumstances under which the proposed CDM project activity will be implemented when compared to circumstances under which similar projects were carried out. For example, new barriers may have arisen, or promotional policies may have ended, leading to a situation in which the proposed CDM project activity would not be implemented without the incentive provided by the CDM. The change must be fundamental and verifiable.
42. The proposed project activity is regarded as “common practice” if similar activities can be observed and essential distinctions between the proposed CDM project activity and similar activities cannot be identified.

Outcome of step 4: If the outcome of step 4 is that the proposed project activity is not regarded as “common practice”, then the proposed project activity is additional.
If the outcome of step 4 is that the proposed project activity is regarded as “common practice” then the proposed CDM project activity is not additional.

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Document information

<i>Version</i>	<i>Date</i>	<i>Description</i>
07.0	14 May 2014	Published within annex 13 to the annotated agenda of EB 79. Revision to include the reference to the draft “Guidelines on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario”.
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05.0.0	23 November 2012	EB 70, Annex 8 Inclusion of reference to the latest approved “Guidelines on additionality of first-of-its-kind project activities” and the “Guidelines on common practice”.

<i>Version</i>	<i>Date</i>	<i>Description</i>
04.0.0	2 March 2012	EB 66, Annex 48 Revision to: <ul style="list-style-type: none"> • Apply request contained in EB 65, para 87 to incorporate all provisions included in the “Guidelines on additionality of first-of-its-kind project activities” (version 01.0) and the “Guidelines on common practice” (version 01.0) in the “Combined tool to identify the baseline scenario and demonstrate additionality”.
03.0.1	11 August 2011	Editorial amendment to: <ul style="list-style-type: none"> • Remove the "Guidelines on the assessment of investment analysis" as an annex within this document and instead add it as a reference; • Add reference to the “Guidelines for objective demonstration and assessment of barriers”.
03.0.0	15 April 2011	EB 60, Annex 7 Revision to: <ul style="list-style-type: none"> • Include situations in which not all potential alternative scenarios to the proposed project activity are available options to the project participants. To that end, Sub-step 1a was revised with the inclusion of scenarios S2, S3 and S4. And, Step 3 was revised with the inclusion of procedures to assess scenarios S2 and S3 through a benchmark analysis; • Broaden applicability; • Further ensure consistency with the “Tool for the demonstration and assessment of additionality”; • Include editorial improvements; • Update the annex “Guidance on the assessment of investment analysis”, to the latest approved version of 03.1. • Format changes.
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02.1	21 February 2007	The revision was made to version 2 to clarify the flow diagram of the tool.
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Draft Package of documents on application of E- policy in investment analysis for additionality demonstration and selection of baseline scenario

Version 01.0

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