Application of the *Fair Trade*-Caema CDM Model to the Fedepalma Umbrella Program

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KEYWORDS

Fair trade,
Oil palm Umbrella Project

First Latin American Meeting of the Roundtable on Sustainable Palm Oil, RSPO

Cartagena, October 16 -17, 2008.

Summary

The *Fair Trade* project began when the regulatory framework of the Clean Development Mechanism (CDM) was uncertain. It represents a typical example of how the traditional command-and-control system, which established disincentives, fines and penalties, rather than incentives, has been changed with relation to environmental issues. Currently, there are incentives, because good environmental behavior generates fairly significant profits. Moreover, in the case of the oil palm sector, the Fedepalma Umbrella Project has significant advantages in obtaining better prices through the sale of Certified Emission Reductions (CERs) and the economies of scale that are generated.

The *Fair Trade* model changed the history of CDM projects in developing countries. Before it existed, investors in the global North or those businesses and governments which had to fulfill greenhouse gas (GHG) emission targets sought countries where they could buy certificates for cents. Today, the same certificates cost 23 dollars.

This is something about which palm oil producers, as owners of CDM projects if they are part of Fedepalma's Umbrella CDM scheme, or as potential owners, should be clear. After all, the producers' duty is to charge a fair price for their certificates.

No one can come to Colombia any longer and buy a certificate for one, two or three dollars. To sell them at such a price would be to commit an offence against oneself and against the country, because it would make impossible effective transfer technology, which is one of the major intentions of the Kyoto Protocol.

In this model, which Fedepalma implemented through its CDM consultancy (Caema), the paradigm of certificates sold for cents has been broken. The prices of the CER, which was €18.77, rose to almost US$30, and all this amidst the most severe economic crisis that humanity has faced in recent decades. The explanation is that the price of the certificates is determined by a regulatory regime which insists that countries must obey some very strict goals for reducing GHG emissions, or else be fined €100 for each unmitigated ton of CO_2 equivalent.

The idea of the Fair Trade CDM model is to sell the emission reduction service (CERs), creating competition between the emitters and the governments of industrialized countries to maximize the price in the international markets.

As I have already said, one of the main objectives of the Kyoto Protocol, in addition to stabilizing GHG emissions and thereby solving the problem of climate change, is to generate effective technology transfer. Another objective is to allow these reductions to take place in developing countries, where the marginal costs of doing so are competitive compared to the highly developed countries which have historically produced more pollution.

For example, in Japan, avoiding emissions of one ton of CO_2 equivalent can cost between US$400 and US$500. Here we have managed to reduce the same emissions for as little as US$4, which makes our certificates truly competitive.

Nonetheless, although the core business is sound, it must be well focused. One of the main elements of this model is that one becomes tied to the fortunes of the owners of the projects. This stems from a contractual structure, in which the formulator is *not* the counterpart in the purchase of the certificates generated by the projects. Previously this was the arrangement, so that the formulators looked to buy from the project owner at a minimum price, if it was a company obliged to comply with emission reduction quotas or, if it was an intermediary, to buy cheaply here before selling in Europe.

The Fair Trade model breaks with this, because the project owner becomes partner of the formulator, who then tries to generate the greatest possible number of certificates and sell them at the best possible market price.

In the case of the Fedepalma Umbrella Project, this means favoring the interests of the participating production units, which total 32. Coincidentally, that atomizes the transaction costs associated with the project and reduces significantly what each company involved effectively has to pay. This is because it is not the same to sit down to negotiate with a technology provider who is going to sell a machine for one project as it is to sit down to negotiate with the same technology provider over 32 machines of the same type.

At the same time, the intention is to optimize the quantity of possible CERs within the productive model and to capture the emission increases and CERs associated with the expected growth of the sector.

Oil palm growers will soon have the biggest project in Latin America, exceeding one million certificates. The project is already in the registration process. Within 20 days, the period for international comments will close, leaving the administrative part of the process. As a result, the oil palm industry has assets that could represent marginal incomes of above US$20 million each year for 21 years.

Here it's necessary to reiterate that the future flow of CERs should be optimized by studying the market, adding CERs, and selling unilaterally to the highest bidder at market peaks.

All this refers fundamentally to making the big global buyers who have to carry out GHG emission reductions fight over their certificates. I repeat the current conditions are very different from previous conditions, when buyers practically did producers a favor by purchasing their titles at minimal prices. The logic has changed completely and now it is the buyers who have to come to buy at the price that the producers set.

In the Figure 1 shows the different moments at which the titles can be negotiated. It can be done as early as the identification itself, but the price paid will tend to zero. As the process advances, the price starts to rise. Currently, Fedepalma is at the point indicated by the arrow and is already being offered international market prices.

Table 1 corresponds to a page containing all the information up to October 14th, in which the negotiation of certifications by the brokers can be seen. With one exception, all are above €20 per certificate. Looking at the Reuters index, which is roughly the aggregate, all exceed €20, nearly US$30 dollars. Hence it is unacceptable that our projects continue to be sold at a lower price.

The results shown in Table 2 confirm the information further. They correspond to a survey performed by Caema a couple of months ago in an event on markets which it has long organized. 60% of those surveyed, qualified people who are active in this market, stated that CER prices for the first period of the Kyoto Protocol (2008 to 2012) will be between €15 and €22 by December 31st.

I should say that the Fedepalma project is a piece of work that has been well done: not just in terms of prices and negotiation, but also because it has achieved a greater quantity of CERs than was expected. The official DNV validation confirmed the project's potential to reduce emissions totaling 750,067 CERs a year (annual average over the first seven years, given that the project is correctly designed and implemented with Option 1). And the application of the AM0012 v4 methodology to the current processing plants' production conditions of fresh fruit bunch produced more than double the CER than were estimated in the BTG-Caema's CDM pre-feasibility study of 2004f (377,000)

When the project began, prices of US$6 USD per certificate were mentioned, due to the scenario of high asymmetry in terms of market knowledge between North and South, the big certificate buyers, the intermediaries and the project owners. Today, prices of US$30 USD are mentioned (Figure 2).

Offers to Fedepalma for its CERs

It is worth referring to a concrete case to show that all this doesn't correspond to desires or expectations, but rather to a palpable reality. Fedepalma, which still does not have issued certificates, is already receiving very interesting proposals from large companies and large government funds which have to fulfill greenhouse gas emission reductions.

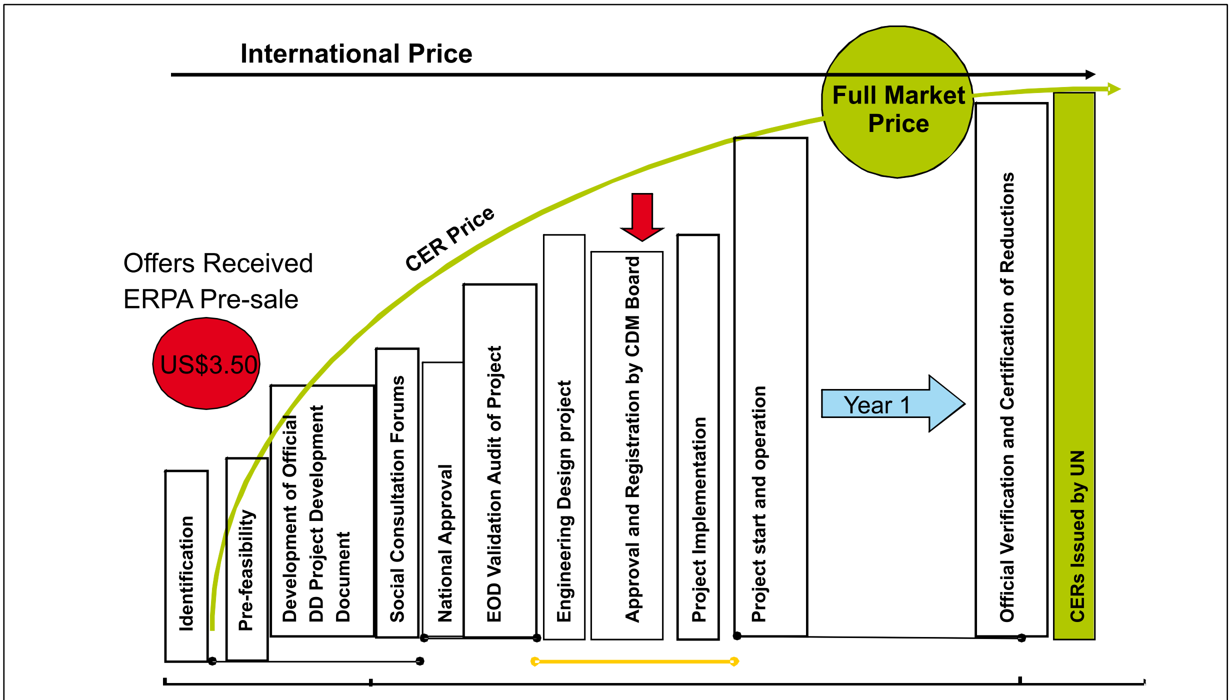

Figure 1. Relation between Project Stages and CER Value.

Table 1. Negotiation of certificates by brokers

EUA Prices (EU-ETS)	Date	Dec 08	Dec 09	Dec 10	Dec 11	Dec 12	Dec 13
FUTURES (ECX)	14-oct	€ 23,29	€ 23,80	€ 24,42	€ 25,29	€ 26,34	€ 26,91
SPOT (BlueNext)	13-oct	€ 23,14					
CER Prices (CDM)		Dec 08		Dec 09		08-12 Strip	
Broker							
TFS Energy	14-oct	€ 19,90	€ 20,10	€ 19,95	€ 20,15	€ 20,12	€ 20,32
Evolution Markers	14-oct	€ 20,20	€ 20,30	€ 19,95	€ 20,15	€ 20,20	€ 20,40
CantorCO2e	14-oct	€ 20,20	€ 20,30	€ 20,05	€ 20,15	€ 20,25	€ 20,35
Tullet Prebon	14-oct	€ 20,15	€ 20,25	€ 20,05	€ 20,15	€ 20,15	€ 20,40
ICAP	14-oct	€ 20,15	€ 20,35	€ 19,90	€ 20,10	€ 20,18	€ 20,38
MF Global Energy	14-oct	€ 20,10	€ 20,30	€ 19,95	€ 20,15	€ 20,15	€ 20,35
Spectron	14-oct	€ 20,20	€ 20,30	€ 20,07	€ 20,17	€ 20,11	€ 20,32
GFI Group	14-oct	€ 20,08	€ 28,30	€ 19,95	€ 20,15	€ 20,20	€ 20,40
		Dec 08		Dec 09		Strip	
*Reuters CER Index	14-oct	€ 20,20		€ 20,07		€ 20,27	
Net Chg/	%Chg	€ 0,44	2,23%	€ 0,45	2,29%	€ 0,41	2,05%
Implied Percentage/	€ Spread	86,72%	€ 3,09	84,31%	€ 3,74	83,02%	€ 4,15
Exchange		Dec 08	Net Chg	Volume	Dec 09	Net Chg	Volume
ECX CERs	14-oct	€ 20,20	€ 0,49	187	€ 20,06	€ 0,46	155
Nord Pool CERs	14-oct	€ 20,20	€ 0,65	0	€ 20,15	€ 0,60	0
Green Exchange CERs	13-oct	€ 19,05	€ 0.00	0			
		Close	Net Chg	Volume			
BlueNext (SPOT) CERs	13-oct	20,26€	€ 0,00	0			
		nov-08	Net Chg	Volume			
India's MCX (INR)	14-oct	1.319,00	54,00	3			
VER Prices (Voluntary)		2005	2006	2007	2008	2009	2010
CCX Vintages (USA)	13-oct	$ 1,85	$ 1,80	$ 1,75	$ 1,75	$ 1,80	$ 1,85

Table 2. Range of expected prices for the first commitment period (2008-2012)

Range	Probability (%)	Estimated price (per CER issued)
High	25	Between €22.88 and €29
Probable	60	Between €15 and €22.88
Low	15	Between €12.60 and €15

Note: Without the United States in the international carbon market

Fedepalma has received proposals from, amongst many others, Natixis, JP Morgan, France Energy, BNP Paribas, Colibri Capital, the European Carbon Fund and the Austrian Government's Carbon Fund.

And for an international buyer it is much more important to come and buy 750,000 or a million certificates than 20,000. So the Umbrella Project was strategically thought out by Fedepalma and managed to be even more successful than expected.

In conclusion, the global CDM reality has changed. Developing countries and project owners like yourselves have the right to receive fair prices for their certificates.

- At the value of the CERs issued up to the date of this Act € (20), the annual value of CERs is € 15 billion a year.

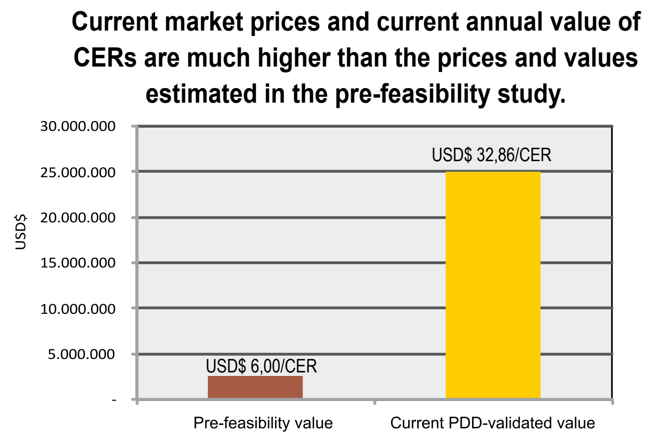

Figure 2. Much better prices per CER and much better annual value of incomes than was expected.