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Re: EcoSecurities' response to the call for public inputs on CDM Programme of Activities

At its forty-first meeting, the CDM Executive Board agreed to launch a call for public inputs starting 06 August and ending 03 September 2008 24h00 GMT to seek comments on issues associated with the development of Clean Development Mechanism (CDM) Programme of Activities (PoA) and difficulties in the validation and submission for registration of a PoA. The Board agreed to consider the comments received at its next meeting.

EcoSecurities would like to take this opportunity to provide 5 key inputs based on its current CDM PoA development experience. Part I of this submission summarises the 5 key inputs. They are then discussed in Part II, where potential solutions are suggested.

PART I - SUMMARY OF KEY ISSUES:

1. **Methodological constraint: only one approved methodology allowed under a POA.** This significantly reduces the potential impact of carbon revenue, and hence the overall financial viability of the POA;
2. **Current procedural uncertainties,** especially regarding inclusion of a CPA under a POA;
3. **Regulatory uncertainty: identification of an error** that disqualify a CPA from inclusion in a POA left to the judgement of a single individual;
4. **DOE liability issues** for the potential wrongful inclusion of a CPA into a PoA; and
5. Institutional arrangements and **communication with the EB,** in particular regarding the designated focal point in the Modalities of Communication.

PART II - DETAILED DISCUSSION AND PROPOSED SOLUTIONS:

1. PoA methodological issue:

- **Only one approved methodology can be used under a PoA.** EB32
 Guidance on the registration of project activities under a programme of activities as a single CDM project activity¹ specifies that “All CPAs of a PoA shall apply the same approved baseline and monitoring methodology, involving one type of technology or set of interrelated measures in the same type of facility/installation/land”. This guidance has resulted in the exclusion of potential PoAs in which individual CPAs may include several technologies or sets of interrelated measures in the same type of facility/installation/land, since these PoAs require the application of several methodologies in order to cover all emissions reductions generated. An example of this would be a small-scale Housing Programme of Activities in which several devices (e.g. renewable energy technologies and energy efficiency technologies) eligible under different methodologies are installed in each household.
 → **We would propose** that each proposed CPA under the PoA be allowed to use several approved SSC methodologies as long as all CPAs individually do not exceed the SSC threshold when all methodologies applied are taken into account and the provisions for accounting leakage followed. Standard CDM projects are allowed to use several methodologies and there appears to be no reason to exclude PoAs from this rule.

2. Validation issues:

- **Addressing current procedural uncertainties.** As per the current rules, the DoE is required to confirm consistency and integrity of CPAs before including them under the registered PoA². Based on our experience and feedback from DoEs, the inclusion of a CPA to the registered PoA is estimated to be nearly as time consuming and expensive as a validation of a CDM project activity. This can be explained by the fact that the consistency and integrity check the DoE must perform specifically for CPAs is not well defined and that the DoE is fully liable for the outcome of this check (see below). This is most likely to result in increased transaction costs as CPAs can be added to a PoA during the entire lifetime of the PoA.
 → **We would propose** that the EB provides further guidance on what the consistency/integrity check for CPAs specifically should consist of, and that it clarifies the procedural and substantial differences between this check and the standard validation of a CDM project. Criteria, systems and procedures for

¹ EB 32, Annex 38, para. 7

² Para 11 of version 2 of the Procedures for registration of a PoA as a single CDM project activity and issuance of certified emission reductions for a PoA.

including CPAs are established at the PoA and the generic CPA levels and are validated by the DOE. As a result, we believe this consistency/integrity check and the subsequent inclusion of CPAs under a PoA should be a routine process (standardised assessment), without excessive DOE work involved (e.g. site visits should not be compulsory for each CPA to be included under the PoA).

3. Identification of erroneous inclusion of a CPA

- Paragraph 13 of version 2 of the procedures for registration of a POA adopted by EB35³, states the following:

13. If a DNA involved in the PoA or a Board member identifies any error that disqualifies a CPA from inclusion in the PoA, the Secretary of the Board shall be notified.

The consequence of such a statement about erroneous inclusion of a CPA under a PoA can be significant, as described in para 15 of the same procedures. However, the procedure to raise such a statement to the attention of the Board seems to be fairly weak since it can be based on the opinion of a single individual. This increases uncertainty and risks for project developers, as discussed in paragraph 4 below.

→ **We would propose** to align this rule with standard CDM rules for requests for review and to modify paragraph 13 as follows:

13. If a DNA involved in the PoA or **at least three** Board members identify any error that disqualifies a CPA from inclusion in the PoA, the Secretary of the Board shall be notified.

4. DOE liability issues for the wrongful inclusion of a CPA into a PoA:

- Paragraph 13 to 15 of version 2 of the procedures for registration of a POA adopted by EB35⁴, states the following:

13. If a DNA involved in the PoA or a Board member identifies any error that disqualifies a CPA from inclusion in the PoA, the Secretary of the Board shall be notified.

14. The Board shall decide whether to exclude the CPA from the PoA with immediate effect. [...]

15. The consequences of the exclusion are that:

- (a) The CPA that has been excluded shall not be re-included again in that or any other PoA, or qualify as a CDM project activity.
- (b) The DOE that included the CPA, shall acquire and transfer, within 30 days of the exclusion of the CPA, an amount of reduced tonnes of carbon dioxide equivalent to the amount of CERs issued to the PoA as a result of the CPA having been included, to a cancellation account maintained in the CDM registry by the Executive Board.

³ Registration of a programme of activities as a single CDM project activity and issuance of CERs for a programme of activities (Version 2), EB35.

⁴ Registration of a programme of activities as a single CDM project activity and issuance of CERs for a programme of activities (Version 2), EB35.

- (c) The further inclusion of new CPAs and issuance of CERs to that PoA shall be put on hold and all CPAs already submitted shall be reviewed to determine if any other CPA disqualifies.
- EcoSecurities feels that this is one of the most significant barriers PoAs that need to be addressed to enable a successful development of PoAs.
 → **We would propose** the following with regard to each letter of the bullet point included in para 15 above:
 - (a) The indefinite timeframe of the exclusion of the CPA from the POA does not appear to comply with any standard of equity or fairness applied by modern legal and regulatory systems. A *proportionate approach* should be applied, and the re-inclusion of the CPA in which the disqualifying error was found should be allowed at a later stage, provided that the error is removed and the CPA re-validated.
 - (b) To mitigate the risks and liabilities connected with the inclusion of CPAs within the PoA, which are currently borne by the validating DOE, we propose that an **“Insurance Carbon Pool”** be created and managed by the secretariat of the UNFCCC. The funding collection system would work in a similar fashion as the Share of Proceedings (SOP) collected for adaptation purposes: a share of the CERs to be issued for emission reductions generated by a PoA are set aside to provide for compensation in case a ‘wrongful inclusion’ of a CPA under the PoA were to be discovered in the future. The liability of the DOEs should be reduced in parallel. As in any insurance type approach, a *wilful misconduct* and/or *fraudulent conduct* resulting in the inclusion of an unsuitable CPA in the PoA should not be covered by the carbon pool and instead should result in the liability to replace CERs by the project participants (PP) and/or the DOE and pay a fine. This would avoid the impact of free-riding on the Insurance Carbon Pool. This would go a long way in fostering investors and project developers’ confidence, thus promoting the deployment of start-up capital necessary to fund the design and implementation of PoAs. It would, nonetheless, ensure that environmental integrity and conservativeness are safeguarded too, and that adequate guarantees exist to provide for a replacement of CERs issued to CPAs wrongfully included in the registered PoA.
 A ‘maximum time frame’ could also be set (e.g. [7] years), after which a CPA included in the PoA should be considered legitimately included. This would safeguard the certainty and stability of the system, as *Usucaption*⁵ does in many property law systems.
 - (c) The automatic review of all CPAs included in the PoA on the basis of the discovery of only one error appears to be greatly disproportionate and has the potential of rendering the system not practically workable. A *proportionate, tiered approach* appears to be more suitable.
 An example of such a system would be a three stages system, designed as follow:

⁵ “Usucaption” is a legal principle used by civil law systems by which ownership of property can be gained by lapse of time (acquiescence).

- Following the discovery of a disqualifying error in a CPA, a randomly selected [5]% of all CPAs is to be reviewed. If no further errors are found, then only the CPA containing the mistake is put on hold until the disqualifying error is corrected and the CPA re-validated. The issuance of CERs shall be put on hold until the review of the [5]% of CPAs is completed.
- If further errors are found, a randomly selected [25]% of all CPAs are reviewed. If no further errors are found, then only the CPAs containing the disqualifying errors are put on hold until the mistakes are corrected and the CPAs re-validated. The issuance of CERs shall be put on hold until the review of the [25]% of CPAs is completed.
- If further errors are found in the [25]% sample, then the 100% of the CPAs are reviewed. As the [25]% sample of all CPAs is a statistically significant sample of the PoA, the amount of CERs to be issued, which are put on hold, should in this case only be limited to a share of the overall CERs to be issued corresponding to the % of the wrongfully included CPAs within the [25]% sample that has been reviewed.

5. Institutional arrangements and communication with the EB:

- **Modalities of Communication (MoC):** According to Paragraph 4 of Annex 38 of EB 32⁶ the coordinating/managing entity of a PoA is the entity responsible for coordinating with the EB. It is not clear if a project participant other than the coordinating/managing entity can be declared focal point in the Modalities of Communication (MoC) of a PoA. This uncertainty affects all non unilateral projects and is a barrier for third party (i.e. other than the coordinating/managing entity) investments into PoAs.
 → **We would suggest** that, as for standard CDM project activities, it should be up to the project participants to decide who the focal point should be for any relevant communication and CERs' forwarding instruction to be submitted to the EB. We would propose the following changes to Paragraph 4 of Annex 38 of EB 32:

A PoA shall be proposed by the coordinating /managing entity **or by any project participant listed in the PDD**, which shall be **a project participant** authorized by all participating host country DNAs involved. The same project participant should also be identified in the modalities of communication as the entity which communicates with the Board, including on matters relating to the distribution of CERs.

We understand that other developers (and DOEs) are facing issues similar to the one summarised above, and that these are preventing project developers from moving ahead under the PoA framework (to date only 4 PoAs have been submitted for validation and none has been

⁶ "A PoA shall be proposed by the coordinating or managing entity which shall be a project participant authorized by all participating host country DNAs involved and identified in the modalities of communication as the entity which communicates with the Board, including on matters relating to the distribution of CERs."

submitted for registration⁷). If we are to operationalise the programmatic approach we will need collaboration, and effective learning-by-doing. For project developers (and DOEs) to be able to embark in PoAs and to expand the scope of the CDM, it is crucial that clear guidance and a strong signal from the EB are sent preferably before the upcoming COP/MOP. This would show that a PoA is recognised as a suitable scheme to support private/public emission reduction programs enhancing the existing project-by-project CDM approach without increasing the risk, complexity and most importantly transaction cost for the parties involved.

→ **Communication:** To this end, we would like to further propose the establishment of a **PoA “task force”** which, headed by an EB member and/or nominated expert, would allow informal and on-going collaboration of different stakeholders such as the Secretariat, representative project developers, DOEs and others to fast track the development of PoAs. Such a group of people could also work on further clarifications and amendment of the procedures and guidance. The mandate of such a task force could be limited to the first 5-10 PoAs to be registered, in order to facilitate an effective learning-by-doing approach. This would especially help to understand the dynamics that will emerge due to the multiplicity of stakeholders involved in achieving emissions reductions within PoAs and to define clear roles and responsibilities under the PoA framework.

Thank you for considering the inputs provided; we hope that they will help you to best address the problems identified in the paragraphs above, promoting the long-term success and sustainability of the programmatic CDM approach.

Kind regards,



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⁷ UNEP Risoe CDM/JI Pipeline Analysis and Database, September 1st 2008