CLIMATE FOCUS

Memo

To: CDM Executive Board and the Small Scale Working Group
From: Climate Focus
Subject: Response to the Call for Public Inputs on PoA
Date: 03 September 2008

Introduction

Climate Focus appreciates the invitation from the Executive Board to provide suggestions for further improvement of the Programme of Activities (PoA) concept. The market has so far been slow in applying the PoA concept and allowing it to grow to its full potential. Climate Focus has noticed that project developers are reluctant to engage in the development of PoA projects and that Designated Operational Entities (DOEs) face barriers that prevent them from entering the PoA market. This memo aims at providing suggestions to address typical PoA issues in a way that makes the concept more attractive for CDM project developers.

The PoA is a strong new concept under the CDM with the potential to literally bring the benefits of the CDM into the houses of people in developing and Least Developed Countries (LDC). PoA facilitates programs in numerous small applications to be developed and implemented over a longer period. Contrary to bundled CDM projects, PoA allows adding units to the project after its registration. Despite this clear advantage, no PoA project has been registered so far. This memo discusses four topics related to project timing and geographical or methodological limitations where PoA can be improved:

a) Validator liability
b) Constant adaptation to methodological changes
c) Starting date of a CPA, and
d) Expansion of the PoA to other countries

It also expresses concern over a recent revision to small scale methodology AMS-II.C.[1] in which the new concept of "baseline penetration" puts PoAs at a disadvantage.

By facilitating the development of programs rather than single or small bundles of projects, new issues arose, which the PoA guidance and procedures attempts to address. Some of the solutions implemented are obsolete and have already been sufficiently covered by the regular CDM procedures. Some elements in the PoA guidance documents and procedures also re-create the barriers that the PoA intends to overcome.

[1] AMS-II.C. Demand-side energy efficiency activities for specific technologies, version 10. This methodology applies to energy efficiency measures in appliances like lamps, motors, refrigerators and covers both existing installations and Greenfield projects.

CLIMATEFOCUS

Validator liability

The first barrier to the PoA is referred to as the validators' liability. If a DNA or EB member has found the inclusion of a CPA erroneous, the responsible DOE should transfer an amount of Certified Emission Reductions (CERs) to a cancellation account equal to the amount already issued under the CPA.[2] This is a serious liability which DOEs and project developers find difficult to deal with.

An erroneous CPA is defined as "any error that disqualifies a CPA from renewal", which includes violations of CDM guidance or the criteria defined in the POA. This definition is rather vague. According to our own interpretation, erroneous inclusions could occur in the following situations:

1. Applications listed in a CPA have not been implemented.
2. Applications listed in a CPA have been implemented later than indicated in the CPA.
3. Applications listed in a CPA do not meet the applicability requirements of the methodology.
4. Project participants wilfully provide misinformation to UNFCCC institutions to conceal non-compliance or inflate the amount of CERs the project can generate.

We assume that the liability on DOEs aims at avoiding these situations. Climate Focus recognises the concern that erroneous inclusions remain unnoticed by both the validator during CPA inclusion and the verifier. Since CPA inclusions are the core concept that creates advantages for the PoA above regular CDM, UNFCCC institutions face a trade-off. They need to find a balance between keeping CPA inclusions low-cost and time-efficient and ensuring that the integrity of the PoA is maintained and preventing gaming.

The current solution of creating a large liability for the DOE is ineffective. The liability should create an incentive for the validator to check the eligibility of each individual application thoroughly. It fails to do so since most DOEs transfer this liability to the project participants. Thereby it becomes a barrier for both project developers and DOEs. We see two fundamental problems with the current approach:

- The penalties imposed by the regulation can be very damaging to whichever entity bears the liability in the end. This is particularly true if a CPA consists of a large number of individual units and an error is discovered only after many years of CER issuance from the erroneous CPA. The liable entity will have to replace a large amount of CERs obtained at market price.
- In a program encompassing hundreds of thousands of units it can hardly be prevented that a small error fraction occurs. It seems unreasonable to punish the project for statistical outliers. Yet, the rules on liability do not differentiate between a small error rate that is naturally occurring and willful inflation of the program's emission reductions.

The combination of both has a paralysing effect on PoAs.

---

[2] Procedures for registration of a programme of activities as a single CDM project activity and issuance of certified emission reductions for a programme of activities, (Version 02), CDM Executive Board, paragraph 15.

Recommendation
We recommend deleting the validator's liability from the PoA guidelines and mitigate the risk of erroneous inclusion of CPAs or individual units within CPAs through the following measures:

Rely on existing PoA guidance to avoid erroneous inclusions: project owner should furnish proof of CPA existence and time of implementation to the validator
The PoA validation process in the current PoA guidelines already provides a solution. Upon PoA validation, the validator should asses the quality assurance and quality control mechanisms that the project has in place.[3] If such mechanisms can not provide sufficient guarantee, validators may require evidence that each individual application in a CPA is eligible and operational at the moment of CPA inclusion. Examples of such proof could be pictures and sales contracts which can be reviewed during inclusion, either with or without sampling. Validators may choose to perform eligibility checks on a sample of all applications before including a CPA, only in cases where satisfactory evidence is unavailable,.

Don't punish a complete CPA but correct for erroneous units or non-performance of units during verification
PoAs should allow for the statistical variance that is an inevitable element of using sampling methods and statistics. With programs involving hundreds of thousands of units scattered over countries the size of Nepal, Vietnam or Kenya, it is often impossible to ensure that each and every individual application is indeed implemented, operational and eligible under the CDM. By allowing project participants to provide solutions and by focusing on the quality assurance and quality control mechanisms they propose, the validation and verification procedures can allow for statistical variance within reasonable limits.

Treat wilful attempts to inflate POAS in the same manner as fraud is addressed under regular CDM
If erroneous inclusions have been the result of wilful misconduct, the project owner should be held responsible. This can be dealt with in a manner similar to regular CDM where such "fraud" is dealt with under the review procedure upon issuance of CERs.[4] A request for issuance can be subject to review for "issues of fraud, malfeasance or incompetence" of the DOE.

Constantly adapting a PoA to methodological changes

The PoA procedures require that if the methodology used for the PoA is revised or merged into a consolidated methodology after registration of the PoA, the PoA has to be adjusted accordingly. All changes made to the PoA require reassessment and validation by the DOE and approval from the EB.

---

[3] See for example, Procedures for registration of a programme of activities as a single CDM project activity and issuance of certified emission reductions for a programme of activities, (Version 02), CDM Executive Board, paragraph 2 sub (g), (i), (k), but also the CDM-SSC-POA-DD, section
A.4.2.2. Eligibility criteria for inclusion of a SSC-CPA in the PoA,
A.4.4.1. Operational and management plan.
[4] FCCC/KP/CMP/2005/8/Add.1, Modalities and procedures for a clean development mechanism, paragraph 65.

Since methodologies are constantly evolving and developing, this creates a potentially significant workload for PoA project participants. Suspension of a methodology may lead to unwarrented losses of credits. In addition, it creates short-term uncertainty on the amount of CERs a PoA project will generate and thereby makes future CDM revenues uncertain. Predictability and reliability of future CER revenues are important criteria for CDM project developers.

Recommendation
To avoid endless revision of a PoA, re-validation and renewal of EB approval, we recommend relying on the quality of approved methodologies and avoid PoA revisions during the crediting period of the PoA or at least during a fixed number of years.

Starting date of a CPA

According to the Glossary of CDM Terms[5] the starting date of a CPA can only be after the registration of the PoA. Starting date is defined as "the earliest date at which either the implementation or construction or real action of a programme activity begins". This implies that project participants will lose the reductions from all installations implemented before PoA registration. The PoA deviates from regular CDM here as well.

Under regular CDM procedures, project activities can start before registration if the CDM is seriously taken into consideration before registration or the UNFCCC or DNA have been notified at an early stage.[6] Under PoA rules the absence of this option creates a risk for project developers. Without PoA precedents there is no indication whatsoever on the time it will take to register a project. Project developers may therefore be forced to wait for months or years before they can start their project and benefit from the CDM.

Recommendation
In line with regular CDM, allow project developers to start their program before the PoA has been registered.

Expansion to other countries

PoA projects can be applied to different countries.[7] That is an interesting advantage for programs. Similar to regular CDM, current PoA guidance requires that all host countries are listed when submitting the PoA for registration. However, at the inception of a program there is generally little information on the potential to export the concept to other countries.

---

[5] Glossary of CDM terms, Version 04.
[6] EB41, Annex 46: Guidance on the demonstration and assessment of prior consideration of the CDM.
[7] Procedures for registration of a programme of activities as a single CDM project activity and issuance of certified emission reductions for a programme of activities, (Version 02), CDM Executive Board, paragraph 2.

Recommendation
To reap the benefits from PoA projects in different countries, it should be made possible to expand the PoA to other countries without registering a new PoA, but simply by furnishing a Letter of Approval from a new host country at the time the program expands.

Baseline Penetration Factor

At its 39th meeting the Executive Board requested the Small Scale Working Group (SSC WG) to propose revisions to AMS-II.C "Demand-side energy efficiency activities for specific technologies", aimed at expanding its scope to Greenfield projects. In addition to responding to that request, the SSC WG introduced a new CDM feature: the Baseline Penetration Factor (BP), with the objective "to consider the penetration of the project activity technology in the baseline"[8] of PoAs.

The BP is applied when calculating the emission reduction:

ER=(BE-PE)*BP)-LE.[9]

The BP is calculated by dividing the total amount of project units already implemented by the total potential in a country. By multiplying the difference between the baseline and project emissions with the BP, the emission reduction is reduced by a percentage equal to the "market share" that the project technology already has before the CDM project started.

The revision seems an attempt to introduce a "common practice correction factor" that reduces the CER potential of projects that are not completely new to a region. This is not justified for three reasons. The first is that investment conditions may change over time. Take for example a program under which the dissemination of a technology has been stalled since the price of raw materials went up and potential users can no longer afford the investment.[10] CDM revenues can bring the investment costs down and bring the investment back in reach of future users. In that case all new units are fully additional and there is no reason to correct the emission reduction estimates for similar units implemented in the past.

Apart from the investment conditions there are two other reasons why the early movers in a market do not always face the highest barriers. Technologies may be more or less profitable in different locations. For instance, wind projects are very attractive at locations with high wind speed. However, once these locations are taken, investors have to move to less favourable locations where the returns are lower. A third argument is that the CDM as a mechanism is not suitable to promote pilot projects. The strength of the mechanism lies in promoting the dissemination of existing technologies. The baseline penetration factor threatens this key strength of the CDM.

In addition to arguments for why the BP is counter effective, there are three reasons why the BP concept goes against basic principles of the CDM. Under the CDM, project features like additionality, baseline scenario, project scenario, and emission reductions are well defined. The

[8] Report of the sixteenth meeting of the Small-Scale Working Group, 30 June – 2 July 2008, Sweden, page 2.
[9] ER=emission reduction, BE= baseline emissions, PE= project emissions, LE= leakage
[10] This is not an unlikely scenario in many CDM host countries.

BP mixes up the different CDM features and does not belong to any of the existing CDM concepts. In addition, correcting the emission reduction with the BP is a violation of the requirement that emission reductions under the CDM should be accurate.[11]

The third reason is that the introduction of the BP concept in an energy efficiency methodology seems to confuse energy efficiency projects with grid connected renewable energy projects. If a power grid has significant renewable energy capacity already, additional renewable energy units will indeed avoid fewer emissions. That is taken into account in the grid emission factor. That is not the case for energy efficiency projects; the reduction potential of an energy efficient light bulb does not change if one's neighbour already has one.

Recommendation
Remove the Baseline Penetration factor from AMS-II.C., thereby avoiding an unjustified reduction of the CER potential of PoA projects by penalising them for the market share that a technology already has. Technologies that are not new to a region may still face serious barriers since investment conditions change over time. PoA project developers that succeed in overcoming these barriers should be entitled to receive the same amount of CERs as regular CDM projects.

[11] FCCC/KP/CMP/2005/8/Add.1, Appendix C: Terms of reference for establishing guidelines on baselines and monitoring methodologies.