IETA
INTERNATIONAL EMISSIONS TRADING ASSOCIATION

September 3, 2008

CDM Executive Board
UNFCCC Secretariat
Martin Luther King Strasse 8
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Dear Mr. Sethi,

I write to you on behalf of the International Emission Trading Association (IETA) and in response to the invitation by the Executive Board at EB 41 to share our comments regarding issues associated with the development of a **Programme of Activities (PoA) as a CDM Project Activity and difficulties in the validation and submission for registration of a PoA.**

DOE Liability Issue

I would like to begin by reviewing an issue that has already been explained to the EB regarding the liability for DOEs when validating CPAs.

The current approach regarding the liability of the validating DOE for erroneous inclusion of CPAs in a PoA is not aligned with the idea of a simplified validation of CPAs, the intention of which was to reduce transaction costs.

Version 2 of the procedures for registration of a PoA state that 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 and the Board shall decide whether to exclude the CPA from the PoA with immediate effect. The consequences of an exclusion are that:

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(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 an equivalent 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, within 30 days of the exclusion of the CPA;

(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** (emphasis added) to determine if any other CPA disqualifies. A DOE that has not performed validation, registration, inclusion or verification functions with regard to this PoA shall conduct the review and submit a review report to the Board.

Clearly, DOEs cannot be requested to perform a simplified approach to validate the inclusion of a CPA in a PoA, while at the same time being subject to a significantly greater degree of liability. The EB suggested as a solution to this problem that the DOEs pass this liability on to the entity coordinating/managing the PoA through its contractual arrangements with that entity. Three limitations arise:

1) the ability of the financial entity to take up this liability

2) the unpredictability of whether the entity will still be in operation at the time the default is discovered

3) the first and ultimate liability will always remain with the DOE

An entity created only for the development of a PoA, as is often the case for CDM projects, will often not be able to take up this liability and/or no longer be in operation at the time the liability is discovered. Indeed, only large multinational companies and governments could be considered dependable in that regard. Either way, DOEs would remain liable in the first case to the EB, with only having a *secondary* recourse against the PoA entity. This recourse accessed only following a lengthy court procedure— a costly, time-consuming process with an uncertain outcome that is in direct contrast to the

swift decision made by the EB (and triggered by only one EB member) that carries with it no room for appeal or review.

Solution to DOE Liability Issue

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. A *proportionate, tiered approach* would be more suitable. Indeed, IETA believes that the three-tiered approach, described below, would provide an excellent replacement for the current practice:

1. 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.

2. 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.

3. If further errors are found in the [25]% sample, then 100% of the CPA is 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.

To mitigate the risks and liabilities that would remain with the DOEs if the third tier were to be reached, IETA proposes that an "***Insurance Carbon Pool***" be created and managed by the secretariat of the UNFCCC. The funding collection system could work in a

similar fashion to the Share of Proceeds (SOP) collected for adaptation purposes: a share of the CERs to be issued for emission reductions generated by a PoA would be set aside to provide for compensation in cases where a 'wrongful inclusion' of a CPA under the PoA was discovered in the future. The liability of the DOEs should be reduced in parallel. As in any insurance type approach, a *willful 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 PP and/or the DOE. This would avoid the impact of free-riding on the Insurance Carbon Pool.

IETA believes that this approach would go a long way towards fostering investor and project developer confidence, thus promoting the deployment of start-up capital necessary to fund the design and implementation of PoAs. It would also ensure that environmental integrity and conservativeness are safeguarded, and that adequate guarantees exist to provide for a replacement of CERs issued to CPAs wrongfully included in the registered PoA.

As a final observation in this section, IETA would like to note that the constraining effect of the current liability rules are exacerbated by the rule requiring different DOEs for validation and verification, making it necessary to have two DOEs willing to take on PoAs. Only in some cases, upon request, the Board *may* allow a DOE to perform all these functions within a single PoA, but agreement is not guaranteed. What is more, this constraining requirement applies to small scale PoAs as well, unlike individual CDM. IETA believes that, until the DOE liability problem has been adequately addressed, i.e. the carbon insurance pool enacted, the Board should agree to exempt all PoAs from this rule, and that this requirement is permanently removed for small-scale PoAs.

Other Important Issues

In addition to re-iterating the liability issue above, IETA would also like to point out a number of other issues holding back the development of PoAs.

Developing a Programme of Activities represents a very different approach from single CDM projects since it entails the aggregation of dispersed mitigation activities over large geographical areas and long periods of time. Such activity is obviously more complex than for single CDM projects and carries a higher risk that something could go wrong as well as higher costs for project owners, project developers, and DOEs alike.

While IETA agrees that ensuring the environmental integrity of PoAs is essential, the current rules, particularly the amount of upfront work necessary and the monitoring and review requirements, are resulting in very high transaction costs which are preventing the development of PoAs and represent a risk to the overall success of Programmatic CDM. IETA has identified a number of specific areas where the current rules are failing to reduce transaction costs and we have suggested the solutions we propose.

(1) **Limit to One Methodology and One Technology**: As now stipulated, a PoA may use only one methodology and one technology. While this approach aims to preserve simplicity in project development, it should be noted that many registered projects already make use of multiple methodologies in practice, e.g. methane capture + electricity generation, and there seems to be no reason to limit PoAs more than regular CDM projects. In addition, this stipulation precludes, for example, developing a PoA out of a buildings energy efficiency policy or standard. If a project developer wanted to develop a PoA in a building that employed efficient heating/cooling, lighting, water heating, improved insulation in walls, and double-paned windows, that entity would need to develop multiple PoAs in the same building to capture all the emission reductions from all EE applications. Allowing multiple methodologies and technologies would enable a developer to benefit from a single, if more expensive, validation and verification. What is more, if monitoring is done by survey, surveys for multiple elements could be carried out at once, thereby cutting costs substantially.

Proposed Solution: IETA urges the Board to decide *immediately* to allow multiple methodologies and technologies for the same PoA. IETA cannot emphasize enough how important this simple change will be to the development of PoAs.

(2) **Upfront Work to Guarantee High CER volume**: PoAs require much more work to be completed before project registration when compared with a normal CDM project. At the time of registration, project participants must submit a PoA-Design Document and a generic CPA-Design Document, however, they effectively must also have completed a number of specific CPA-design documents. It is necessary to complete multiple CPA-design documents *before* registration because the decision to invest time and effort into developing a PoA will only be taken *after* the project participants are sure that a significant number of CPAs will be able to be included in the PoA. Only by ensuring the generation of high CER volume through the inclusion of a large number of CPAs will the project participants realize a benefit from the flexibility that a PoA allows. (The necessity of having a large number of CPAs, however, also increases the risk that one CPA will be found to be erroneous, therefore requiring all CPAs for that PoA to be reviewed and leading to the DOE liability issue outlined above.)

Proposed Solution: To ease the burden on PoA developers that results from the preparatory work described above, IETA suggests that the Board instruct the Secretariat to expedite requests for clarification submitted by PoA developers in order to reduce uncertainty in project implementation. While this request seems like a small issue, it will make a great amount of difference to PoA developers.

(3) **Indefinite Exclusion of a CPA with an Error:** Currently, any CPA found to have been erroneously included in a PoA is indefinitely excluded from re-registration of a CPA as well as an individual CDM project activity. This rule

does not appear to comply with any standard of equity or fairness applied by modern legal and regulatory systems.

Proposed Solution: IETA proposes that the re-inclusion of an erroneous CPA should be allowed at a later stage, provided that the error is removed and the CPA re-validated. Likewise, project developers/owners should be allowed to submit that CPA as an individual CDM project activity if they so choose.

(4) **Crediting Period Liability:** The PoA's crediting period and baseline must undergo re-approval every seven years (although each CPA within the Programme shall be revised only when it requests renewal of its own crediting period). This rule is more stringent than for regular CDM.

Proposed Solution: IETA suggests that the re-approval process for PoAs be brought in line with regular CDM. The crediting period of PoA's, therefore, should require re-approval only when it expires, i.e. a 10 year crediting period should be renewed at the end of 10 years instead at the end of 7 years.

(5) **Requests for review:** Only one EB member is required to identify any error that disqualifies a CPA from inclusion – not three, which means this rule is more stringent than for individual CDM projects. It increases delivery risk for investors, thereby threatening PoA viability.

Proposed Solution: IETA proposes that this rule be amended so that the same review process applies for PoAs as for regular CDM projects. In other words, three EB members should be required to identify errors that disqualify a CPA from inclusion, after which the Board should consider the issue at the EB meeting, decide whether or not a review is required or simply changes to be made, and engage with the DOE and PPs as needed during this process.

(6) **Starting Date of CPA:** In the glossary of the CDM terms (v4) it states that "*The starting date of the CPA cannot be before the date of registration of the PoA.*" This stipulation is more strict than with regular CDM and could result in a substantial loss of CER revenue due to the significant delays that have and will likely continue to plague the registration of PoAs in the future.

Proposed Solution: IETA would like to suggest that this definition be changed to read, "*The starting date of a CPA cannot be before the starting date of the PoA.*" IETA would also like to request that the Board provide clarification about what constitutes the starting date of the PoA.

Though we have noted many issues above, it is IETA's firm belief that all of those issues require the attention of the Board and the Secretariat. We appreciate the chance to share our comments and hope that our suggestions provide a firm base upon which you may continue your discussions.

Henry Derwent
President