

**RESPONSE TO CALL FOR PUBLIC INPUT
BY THE EXECUTIVE BOARD OF THE CLEAN DEVELOPMENT MECHANISM**

REGARDING DESIGN OF AN APPEALS PROCESS FOR THE CLEAN DEVELOPMENT MECHANISM

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I. INTRODUCTION

Chairman Mahlung and members of the Executive Board, I am grateful to have the opportunity to submit my views regarding the design of an appellate procedure for the Clean Development Mechanism (CDM) as requested by the Conference of the Parties (COP/MOP) at its 15th meeting. The comments below reflect my own views and not those of my employer, Stanford University. Overall, I applaud the prompt attention being paid to revision of the registration and issuance procedures and to the development of an appeals process for the CDM. These actions by the CDM Executive Board (EB) have the potential to significantly increase both public confidence in the CDM process and its product, Certified Emissions Reductions (CERs), and to lay the groundwork for greater future investment in emissions reductions in developing countries, a crucial objective of both the Convention and the Kyoto Protocol.

An appeal process, along with associated changes to the validation, registration, and issuance processes, has the potential to substantially increase public confidence in the operation and environmental integrity of the CDM while at the same time reducing the perceived regulatory risks that may discourage investment in the system. A well-designed CDM registration and issuance process must not only be fair, transparent, and predictable, but also be perceived to be so. The current process has created deep suspicion on the part of environmental non-governmental organizations (NGOs) as to the stringency of its environmental integrity while at the same time generating the belief on the part of project developers that EB and Secretariat practice may change in an instant for reasons that are unpredictable and non-transparent. Neither result is acceptable if the CDM is to continue to grow and flourish as it should and can.

Moreover, neither result is likely to encourage other countries, most notably the United States, to enter the market as a buyer in the post-2012 environment. These perceptions will also encourage other major sources of demand, such as the European Union Emissions Trading Scheme, to limit use of CERs for covered sources. In the end, the CDM is a political market – demand and supply of CERs depends on the outcome of domestic political discussions as to the advisability of government investment, or discussion on the level of allowed investment for regulated firms within cap-and-trade markets.

An appeals process for the CDM thus needs to encourage confidence on the part of all stakeholders in the fairness and integrity of the offsets created. It can do this by allowing broad for involved stakeholders, by limiting the issues that may be appealed as described below, and by creating a body of binding precedent that will guide future decisions by project developers, Designated Operational Entities (DOEs), and the EB itself. Both are essential if the incentives that have led both to doubts regarding environmental integrity and the wisdom of investment in the CDM are to be resolved.

II. STAKEHOLDERS DIRECTLY INVOLVED IN THE REGISTRATION AND ISSUANCE PROCESS, DEFINED IN A CONSERVATIVE MANNER, INCLUDES BOTH PROJECT PARTICIPANTS AND STAKEHOLDERS SUBMITTING PUBLIC COMMENTS DURING VALIDATION

Paragraph 42 of the CDM Decision from COP-15 (Decision 2/CMP.5) calls upon the CDM EB to design a procedure that includes “stakeholders directly involved, defined in a conservative manner.” In order to give full meaning to this charge, the procedure should include Project Participants, as defined on the Project Design Document (PDD) and stakeholders that submit public comments at the validation stage of a project. Appeals should not be permitted for the Designated National Authorities (DNAs) that approve a project, for Designated Operational Entities that validate a project or for local stakeholders that submit comments during the host-country government environmental impact assessment. This strikes a balance between inclusiveness aimed at ensuring due process and environmental integrity for parties that participate in the project registration process while also limiting the universe of appeals to those parties that have made their views known earlier in the process and to those perspectives that are appropriately considered at the EB level rather than at the host-country level.

The COP used the term “stakeholders” rather than “project participants” or other more narrowly defined terms within the CDM lexicon in its COP-15 decision. At the same time, the COP felt it necessary to limit participation in an appeals procedure to a conservative definition of this term. In giving full meaning to this choice of language, the CDM EB is thus required to expand access to the appeals process beyond merely project participants, and to consider a broader universe of those who are impacted by its decisions. At the same time, given that the potential universe of stakeholders includes all people, or at least all citizens of nation states that have ratified the Kyoto Protocol, the EB should take care to insure that only those individuals or entities with a real stake in the outcome and who have exhausted other attempts to express their views have access to the procedure.

Project participants have a clear financial stake in the outcome of CDM decisions and should have the opportunity to appeal unfavorable decisions. Entities listed on a CDM PDD are either the intended creator or beneficiary of CERs created by a project. Because they are investors in the project, they have an interest in seeing that it is treated fairly by the CDM registration and issuance process. One concern about allowing project participants to have a right of appeal is that they will

simply appeal every project that is rejected, whatever the merits. While possible, this outcome is unlikely if previous appellate decisions serve as binding precedent for the registration and issuance processes. Under such a system, the costs of an appeal would be incurred only if particular factual or legal aspects of a project rendered it's case distinct from prior decisions or if an error had occurred in DOE, Secretariat, or possible CDM EB review of the project had occurred. More likely than not, project participants would be the most frequent users of an appeals process, no matter how broadly the CDM EB's interpretation of "stakeholders directly involved" because of their financial interest in a particular project as compared to others more generalized interest in the overall environmental integrity of the CDM as a whole. In any case, listed project participants should have standing to challenge registration and issuance decisions in the appellate procedure.

Stakeholders that submit public comments during validation of a project should also have the option of challenging registration decisions when they believe that the substance of their comments has not been addressed prior to final action by the CDM. Currently, public comments at the validation stage are supposed to be taken into account by the DOEs in their assessment and validation of PDDs. Despite the good intentions of many DOEs, it is far from clear to many who submit comments that this is in fact the case. There has arisen amongst the NGO community, a view that their views are not given due account in practice under the current system. This has led to a disengagement from the official CDM project approval process as well as to some skepticism as to the environmental quality of at least some projects that are entering the system. Providing access to the appeal procedure to parties that are interested enough to submit comments on a project would help to address this disengagement and skepticism by giving NGOs an opportunity to be heard by the CDM EB on project specific issues. It would likely lead to enhanced quality of comments and also to greater attention being paid to comments by DOEs and project developers lest they face an appeal later in the process.

Stakeholders that submit public comments during the validation stage of a project are "directly involved" in the development and approval of the project. These stakeholders, assuming that the DOE fulfills its obligation to take due account of all public comments, play an essential role in vetting projects, in increasing public confidence in the CDM by providing a source of public accountability, and in shaping the application of CDM guidance and methodologies to particular factual contexts. These stakeholders can play an important role in shaping DOE thinking on whether or not to validate a project by providing outside substantive expertise on technologies, sectors, or national settings. DOEs and even the Secretariat simply cannot be expected to have the breadth of expertise necessary to check all substantive aspects of project documents. Often, the DOE is left to take the word of the project developer, who is obviously an interested party, on hard to verify issues regarding the legal, economic, or policy context in which a project will operate. Without active public comment, important aspects of the setting necessary to assess additionality and/or calculate an emissions baseline may be missed. Thus, even

defined in a conservative manner, stakeholders that submit public comment are directly involved in the process of registering a CDM project.

It is worth emphasizing that providing a right of appeal to stakeholders that submit public comments would almost certainly not mean that all decisions to approve a project would be appealed. The reality is that NGOs face severe personnel and budget constraints that can and will continue to limit their ability to participate in the CDM generally and the appellate procedure in particular. NGOs would, because of these constraints, choose only to comment and then appeal decisions on projects that they believe present novel and/or especially important factual or legal issues or where they believe that egregious errors have occurred. Moreover, so long as appellate decisions create precedents that bind future registration and issuance decisions, almost all CDM decisions would not be worth appealing because the outcome would be predictable based on prior precedent. An NGO facing resource constraints would think long and hard prior to investing the time to review and comment on even a small set of PDDs, let alone appeal a final decision on them. Allowing these stakeholders into the appeal procedure will not create a flood of litigation.

Providing stakeholders that submit public comments on projects with this voice in the CDM system would both increase public confidence in the system. It would also create greater buy-in on the part of politically important constituencies. Many NGOs are concerned about environmental quality in the CDM but feel that they have no way to influence outcomes except by complaining to the media or by attempting to influence political decisions that drive CDM demand. Currently, NGOs are not really a part of the CDM EB process and have no rights except to comment to the DOEs and to ask questions of a general, non-project specific nature at the conclusion of EB meetings. This leads to unnecessary suspicion on the part of this critical stakeholder community while providing weaker than ideal incentives to both project developers and DOEs to maintain high standards of environmental integrity. Giving to stakeholders that take the time to submit a public comment a right of appeal would not overwhelm the appellate system – as discussed above, the project developer community is far more likely to do that – and would substantially increase ownership on the part of a critical constituency in the CDM. Thus, “stakeholders directly involved, conservatively defined” should include any individual or entity that submits a comment during the validation stage of a project.

Designated National Authorities of listed project participants must approve each project prior to submission of the PDD to validation. It might be the case that a DNA would desire to bring a grievance via an appeals procedure if it felt that a particular project had been rejected improperly. One can imagine that, for example, a DNA might wish to challenge a rejection where it felt that its E+ and E- policies had been misinterpreted or misunderstood during the project registration process. However, given that the project participants already have a right to bring an appeal against an improperly rejected project, it would seem that including DNAs

within the appeals process would create both redundancy and unneeded complication in the system.

Designated Operational Entities are important stakeholders in the CDM process. Their purpose is to insure that PDDs and Requests for Issuance (RFIs) of CERs comply with all applicable CDM guidelines and methodologies. However, it's not clear why a DOE should have standing to bring an appeal or would ever want to do so. Presumably, a DOEs views are made manifest in its review of a project's PDDs and RFIs. Given that a project proponent needs to receive DOE approval prior to submitting these documents to the CDM EB for final approval, there would seem to be no need to grant DOEs access to the appellate procedure even given their essential role in the successful operation of the CDM.

Local Stakeholders are given a voice in the project development process via the Environmental Impact Assessment (EIA) that must be completed prior to submitting a project for validation and whose content must be summarized in the PDD. Typically, such EIAs are designed to comply with host country legal regimes regarding projects that may have a significant impact on the environment. As such, their content and form should and generally is governed by local laws and regulations. Thus local stakeholders, although their input is required under the CDM, provide that input through a legal process that is not a part of the CDM. For this reason, local stakeholder appeals of an EIA are more appropriately the concern of the host-country government than of an international body such as the CDM EB. Thus, local stakeholders should not have a right of appeal before the CDM EB, unless of course they choose to submit public comments to the DOE during the public comment period of validation, which would render them a stakeholder submitting public comment, and hence directly involved in the project.

III. STAKEHOLDERS DIRECTLY INVOLVED SHOULD ONLY BE PERMITTED A RIGHT OF APPEAL FOR ISSUES THAT HAVE PREVIOUSLY BEEN RAISED BY THEM OR ANOTHER PARTY IN THE REGISTRATION AND ISSUANCE PROCESS

All stakeholders should have as their objective that situations requiring an appeal occur as infrequently as possible. The best means of insuring that use of the appellate procedure is infrequent is to require that all views are presented to decisionmakers as early on in the process as is possible. In order to create incentives for parties to state their views in a clear fashion as early as possible, and to provide the opportunity for project proponents to modify or correct perceived deficiencies prior to registration, right of appeal should be limited to those issues raised earlier in the process by the appellant.

This would limit appeals for those parties with standing to four situations. For a project developer, if their project is reviewed prior to its being rejected, they might appeal in two contexts: (1) based upon arguments that they raised at the review stage and (2) in response to arguments made by a public stakeholder comment that were the ultimate cause for a rejection of a project or that are the

basis for an appeal by another stakeholder. For a stakeholder who submits public comment to the DOE during validation, right of appeal should likewise be limited to two contexts: (1) those issues raised in the public comment and not addressed adequately, in the opinion of the stakeholder, by either the DOE or the CDM EB during the registration process and (2) those issues raised in the public comment, that were addressed by the DOE or the CDM EB but which are now the basis of an appeal by a project participant.

By limiting the scope of appeals in this way, all parties will have a fair opportunity both to voice their concerns with a project and to alter a PDD if for some reason it includes unintended errors. At the same time, there will be a strong incentive to make opinions known to DOEs and the Secretariat in a timely and efficient manner so as to minimize the need for appeals. If however, there is a genuine disagreement between stakeholders and the regulator as to the eligibility of a project, then appeal would still be possible.

IV. DECISIONS MADE BY THE APPELLATE BODY SHOULD CONSTITUTE BINDING PRECEDENT FOR FUTURE CDM REGISTRATION AND ISSUANCE DECISIONS

An appellate procedure for the CDM registration and issuance process will reduce the level of risk and delay that currently exists for project development only if it helps to create clear standards that bind future decision makers. If it is simply an additional level at which to argue either for or against registration of a project, it might actually increase uncertainty and would certainly increase delays in resolving individual cases within the CDM administrative process. The CDM does not need more process for either project participants or for other stakeholders directly involved unless it creates a more efficient system, at least in the long-run and for most projects. An appellate procedure that creates a body of well argued and buttressed decisions regarding the application of CDM modalities and procedures to specific sectoral and national settings could make significant strides towards creating greater regulatory certainty for project proponents. A body of precedent, once created, would provide much greater predictability than does the current, case-by-case analysis that occurs within the registration and issuance process. Of course, for precedent to guide future decision making, appellate decisions would have to be explained and justified in sufficient detail so as to provide a clear roadmap to both project developers and to other interested stakeholders on critical issues. Even so, there would likely be ongoing appeals as new factual settings arose, or as circumstances within a particular sector or host-country evolved. Over time however, as the body of decisions increased, some intuition as to how past precedent might be applied to these new settings would almost certainly also develop, thus further reducing regulatory risks for project participants.

V. CONCLUSIONS

Design of an appellate procedure for the CDM holds both great opportunities and great risks for the future of the international offsets market. A well-designed

system will create greater real and perceived environmental integrity for the CDM. It will also, in the long run, reduce regulatory uncertainty for investors in emission reduction projects and increase perceptions of fairness by investors. At the same time, an underinclusive and ineffective appeals procedure will further reduce demand for post-2012 CERs and limit the possibility for incorporation of potential buyers into the CDM system because it will undermine confidence. I encourage the CDM EB in its consideration of an appeals process to include both project participants and stakeholders that submit public comments to bring appeals but conservative in terms of the issues that may be appealed. In addition, creation of a body of well argued precedent that governs administrative decision making in the registration and issuance process will go far to improve perceptions of fairness and dues process within the CDM. This is essential if further private sector investment in the system is to occur.