Subject: IETA response to call for input from EB56 regarding the "Draft standard on the use of the concept of materiality and level of assurance in the 'Clean Development Mechanism'"

15 October 2010
UNFCCC Secretariat
Martin-Luther-King-Strasse 8
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Germany

Dear Mr. Mahlung,

I am writing to you on behalf of the International Emissions Trading Association (IETA) in response to the call for input on the "Draft standard on the use of the concept of materiality and level of assurance in the 'Clean Development Mechanism,'" released as Annex 2 to the annotated agenda for EB 56.

The following comments attempt to address the specific issues put forward in the call for input.

(a) Threshold of the application of materiality;

(1) IETA encourages efforts to harmonize the divergent materiality thresholds that would apply within the two flexible mechanisms of the Kyoto Protocol (CDM and JI) and the EU Emissions Trading Scheme. The draft standard under consideration by the CDM-EB indicates 0.5 % for large-scale projects of more than 500 kt emission reduction per year, 2 % for activities with less emission reductions and 5 % for small scale activities. This summer the JI Supervisory Board released guidance on materiality requiring thresholds of 5 % for projects with emission reductions of less than 100 kt and 2 % for all other activities. Recently the EU-ETS applied materiality thresholds of 5 % for verification at installations with annual emissions smaller than 500 kt, and 2 % for installations with annual emissions greater than 500 kt. We believe a single, agreed-upon set of thresholds for materiality will best serve all involved. However, we do not consider this divergence an issue that justifies further delay of this development.

(b) Scope of the application of materiality;

(1) **IETA recommends that materiality apply to project parameters that have a quantifiable impact.** In a validation assessment, for instance, the sensitivity analysis need not include all measurable parameters, but it must include those that could have a material impact. In a verification assessment, for instance, materiality should be applicable to any parameter or combination of parameters relevant to the calculation of Emission Reductions. Further, materiality should be applied by the Registration and Issuance Team (RIT) and EB when evaluating the need (or not) to call a project for a review.

(2) **IETA suggests that the scope of application of the concept of level of assurance should not be limited to assessments of emission reduction claims**. To that end, we believe paragraph 6 should be rewritten to conclude: "... It defines the degree to which the DOE is confident in the

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validation or verification conclusion that projects comply with the requirements of the CDM without material errors, omissions or misstatements."

As an example, additionality is a concept that cannot be fully proven for any CDM project, because the existence of the project precludes the business as usual scenario from taking place; reality and its counterfactual cannot be compared *ex post*. A reasonable level of assurance is therefore sufficient to validate a given project's emission reductions as additional. Compare that to the output of a project that generates electricity, which can be directly measured with high accuracy. In this case, it is appropriate to demand a high level of assurance to verify project output.

(3) **IETA suggests that the revised standard clarify the relationship between accuracy and conservativeness as it pertains to materiality and level of assurance.** We believe that paragraph 6 should be followed by a new paragraph: "Accuracy refers to the degree of exactness with which an information or the value of a parameter can be determined. Different levels of accuracy have different implications on costs and practicability to prove a case; conservativeness is a means to cope with insufficient accuracy. If for any reason, accuracy is not possible to the required level of detail, or the cost of achieving a high level of accuracy is burdensome, then conservativeness shall be applied in the assumptions to make up for the gap."

As an example, to prove biomass surplus in a region, one cannot accurately account for every discrete instance of demand and every single offer. Conservative assumptions are therefore required -- to overstate the demand and understate the offer. Together with the conservative requirement to have 25% more offer than demand, the overall use of conservativeness to ensure biomass surplus availability appropriately accommodates the lack of available accuracy.

IETA further suggests that paragraph 9 should be rewritten to conclude: the risk "... shall be mitigated by the project proponents improving data accuracy when means are available, and taking a conservative approach when sufficient accuracy is not available or would incur burdensome costs. The DOE shall use its expert judgment to assess whether the approach taken by the project proponents to apply the requirement is accurate or sufficiently conservative when the required accuracy is unavailable. The DOE shall request a clarification from the Board in case of doubt."

The draft text itself demonstrates the importance of distinguishing accuracy, conservativeness and materiality. IETA suggests that Note 2 to paragraph 9 be improved to prevent confusion; the lack of a prescriptive requirement does not necessarily imply the level of increased risk for inaccurate measurement of emission reductions that would trigger the need to adopt a conservative approach. We recommend Note 2 be rewritten to conclude: "... if a methodology requires the calibration of measurement equipment at appropriate frequencies with regard to their specific conditions for use, the project proponents shall prioritize accuracy when determining the appropriate frequency of calibration. If the PDD states monthly calibration whereas the observed frequency is quarterly – yet this practice is still in line with the methodology and relevant national/sectoral requirements for accuracy – the DOE can approve such a change and simply address it transparently in the verification report."

(c) How to implement in practice the concept in CDM.

(1) **IETA believes that the draft standard creates an ambiguous and potentially unfair burden for DOEs to provide objective evidence for all prescriptive CDM requirements.** It is inappropriate to ask the DOE to provide "objective evidence" for such findings because in many cases, evidence simply does not exist. Such a requirement would add a new and significant barrier

to expanding the CDM in developing countries, particularly those in sub-saharan Africa. We thus suggest that paragraph 11 be revised to conclude: "... It is the responsibility of the DOE to confirm, based on its local and sectoral expertise, that the aggregated impact of the ignored information, taken as a whole for a CDM project, is not material."

(2) **IETA recommends the EB work toward a bottom-up approach for implementing materiality.** In principle materiality is already applied in many cases. What really needs to be introduced is the common understanding of the when the concept of materiality is applied and how it is applied by the DOEs and the acceptance of the CDM-EB for the application to be transparently presented. This should be jointly developed and presented by the Secretariat and the DOEs to the Board, if necessary over time, and incorporated through consecutive revisions of the Validation & Verification Manual. This process should begin immediately through a focused workshop between the DOEs and Secretariat— possibly with the EB Chair and Vice-Chair and Chairs of the relevant panels and working groups. It does not need to include the entire Executive Board, as it is a technical issue and should be addressed by technical experts.

(3) **IETA recommends the development of a simple, direct communication channel into the secretariat to resolve quickly minor (non-material) errors and omissions (per the recommendation of CMP 5)**. At present, such issues are delaying good projects for months. As an example of the outcome this improvement could prevent, a review of verification is currently in process for a project which is now stalled because the DOE did not request a design change to account for the fact that the stator diameter of the installed generator is 5 cm shorter than foreseen in the PDD (ref. 2612, not our project). Though this particular issue is minor, the consequence is not: The DOE is now afraid of taking any type of judgment on its own. Further, the EB54 meeting report, paragraph 69 requested the secretariat to prepare draft revisions to the guidelines to incorporate the examples of minor changes that could be dealt in the verification report, for its consideration at a future meeting. IETA encourages the EB and the secretariat to also indicate that deviations from the PDD regarding the following items will no longer require a request for monitoring plan revision:

- Calibration frequency
- Lack of backup meter
- Numbers of meters and meter accuracy
- Meter location
- Shared main meter
- Diesel generator for hydros
- Model/parameters change of equipment (minor changes)

Additional input:

Many methodologies apply non-linear equations in which the effect of each parameter is specific to the relevant project data. It is impossible to understand from the plain formulas which impact a single parameter will have on the total emission reductions of a project. However, understanding the impact of a single parameter on the total emissions is important in the assessment of a project. Analysis of non-linear equations is not simple and has to be case specific.

It is however possible to use mathematical tools to perform a project case specific sensitivity analysis on individual parameters of a methodology with regards to their influence on a project's emission reduction. IETA would be happy to provide further information to illustrate how such analysis might be carried out.

In closing, IETA thanks you for your attention to our input to this very important issue, and we remain available for further discussion or clarification at your convenience.

Sincerely,

Henry Derwent
President and CEO, IETA