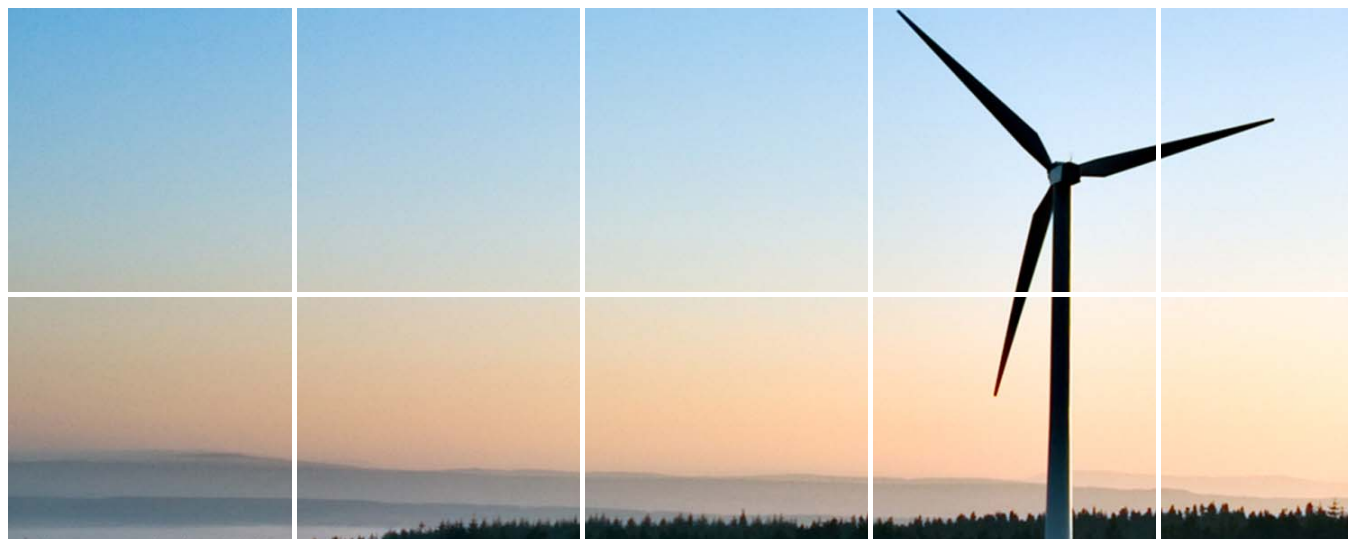




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Briefing paper “Governance of the Clean Development Mechanism (CDM)”

Authors: Jackie Nyaoro and Bipasha Chatterjee, AEA Technology

Study on the Integrity of the Clean Development Mechanism



Briefing paper “Governance of the CDM”

ED56638

Issue Number 1

December 2011

Ref: CLIMA.B.3/ETU/2010/0020r

Table of Contents

1	Abbreviations	4
2	Summary	6
3	Introduction	7
	3.1 What is governance?	7
	3.2 CDM governance	7
4	CDM governance: merits and limitations.....	10
	4.1 Limitations with regard to decision making at the EB level	11
	4.2 Limitations with regard to DOEs	18
	4.3 Limitations with regard to decision making – DNAs	20
5	Brief status of the current reforms and proposed reforms to address CDM governance	23
	5.1 Short-term reforms (before 2012)	23
	5.2 Longer term reforms (post 2012)	25
6	Conclusion.....	29
7	References.....	30

1 Abbreviations

AP	Accreditation Panel
AWG-KP	Ad-Hoc working group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP). -
CCBS	Climate, Community and Biodiversity Standards
CDM	Clean Development Mechanism
CER	Certified emissions reduction
CMP	Meeting of the Parties to the Kyoto Protocol
COP	Conference of the Parties
DNA	Designated National Authorities
DOE	Designated Operational Entities
EB	Executive Board
EIA	Environmental impacts assessment
EU ETS	European Union Emission Trading System
GHG	Greenhouse gas
IETA	International Emissions Trading Association
IGES	Institute for Global Environmental Strategies
LoA	Letter of approval
NGO	Non-governmental organisation
PDD	Project design document
PoAs	Programme of Activities
PP	Project participants
RfR	Request for review
RIT	Registration and Issuance Team
SBSTA	Subsidiary Body for Scientific and Technological Advice
UNFCCC	United Nations Framework Convention on Climate Change
VVM	Validation and Verification

Manual

2 Summary

The Clean Development Mechanism (CDM) is one of the flexible mechanisms defined in the Kyoto Protocol. It is supervised by the CDM Executive Board (EB) and is guided by the Conference of the Parties (COP) of the United Nations Framework Convention on Climate Change (UNFCCC). The COP serves as the meeting of the Parties to the Kyoto Protocol (CMP). The EB is the main regulatory body of the CDM and translates the decisions of the CMP to the project level. The EB is assisted in this task by the Designated Operational Entities (DOEs), Designated National Authorities (DNAs), the UNFCCC Secretariat and various expert panels.

This paper reviews experience with the CDM governance process and assesses its merits and shortcomings. The paper builds on a variety of information sources¹, chief among these a series of expert literature (Figueres, C. and Streck, C., 2009; Streck and Jolene, L., 2008; Fuhr, H. and Lederer, M., 2009; Newell, P., 2009; International Emissions Trading Association (IETA), 2010; Schröder, M., 2010; Institute for Global Environmental Strategies (IGES), 2010) and relevant ‘position papers’ from stakeholders and parties to the Kyoto Protocol. Further information and input has also been gained from targeted interviews with experts in academia, non-governmental organisations (NGOs), market participants, the CDM EB and one DOE².

Our research has highlighted weaknesses in CDM governance regarding process, participation and accountability. Whilst there has been significant progress in recent years, further improved governance is important for both, increasing the Mechanism’s integrity and lowering transaction costs. Literature suggests a number of different reforms, which the EC might wish to consider further. These include:

- Improved efficiency through implementing the concepts of Materiality and Level of Assurance into all relevant CDM processes. This would ensure work is prioritised based on risk and impact and processes are streamlined through more-effective quality controls. It could furthermore help to reduce delays in the CDM management system and those at project level;
- Enhanced stakeholder participation in decision-making processes including right to appeal procedures. Many stakeholders, in particular on the national and local level, do not participate in decision-making even over projects that directly affect their livelihoods. These concerns could be better managed if stakeholder participation were enhanced at the validation stage and supported with ex-post monitoring of sustainability issues at the verification stages;
- Simplification of tools and standardisation of baseline setting could enhance the environmental integrity of the Mechanism and help eliminate inefficiencies in the process.

While it is suggested that the CDM integrity could be enhanced through reforms in governance, such reforms should avoid introducing unnecessary layers of bureaucracy that could threaten the primary goal of incentivising countries to achieve cost effective emissions reduction. Wherever possible, simplification and standardisation of the rules and procedures should be encouraged, while ensuring the environmental soundness of the methodologies.

The briefing paper is organised in the following structure.

Section 1 provides an introduction to the concept of governance, including an explanation on CDM institutions and the project cycle to help understand the regulatory framework governing the CDM.

Section 2 provides a literature review of the limitations of the CDM relating to its governance.

Section 3 summarises proposed reform options and discusses whether they have the potential to address existing shortcomings of the CDM governance.

Section 4 presents conclusions as well as suggesting further research needs.

¹ Discussion topic papers, academic studies and including stakeholders and parties to the Kyoto Protocol ‘position papers’; CDM-related decisions by the CMP up to COP 16 (COP/MOP 6) in Cancun, 2012; resolutions of the CDM Executive Board (EB) up to its 60th meeting in March 2012.

² See references for a list of those interviewed

3 Introduction

3.1 What is governance?

To enable and facilitate the discussion in this paper, the term of governance in the context of the Clean Development Mechanism needs to be defined. Conceptually, governance (as opposed to “good” governance) can be defined as “the process – by which authority is conferred on rulers, by which they make the rules, and by which those rules are enforced and modified”³.

Within this concept of governance, the obvious second question is: What is good governance, i.e. how can we assess governance along a set of policy criteria? Typically, it is defined in terms of the *mechanisms* thought to be needed to promote it⁴.

The World Bank uses the following working definition(s) for their governance related programmes in developing countries “Good governance is epitomized by predictable, open and enlightened policy-making, a bureaucracy imbued with a professional ethos acting in furtherance of the public good, the rule of law, transparent processes, and a strong civil society participating in public affairs.

Poor governance (on the other hand) is characterized by arbitrary policy making, unaccountable bureaucracies, unenforced or unjust legal systems, the abuse of executive power, a civil society unengaged in public life, and widespread corruption.”⁵

In 2000 the European Community defined good governance as follows:

*“In the context of a political and institutional environment that upholds human rights, democratic principles and the rule of law, good governance is the transparent and accountable management of human, natural, economic and financial resources for the purposes of equitable and sustainable development. It entails clear decision-making procedures at the level of public authorities, transparent and accountable institutions, the primacy of law in the management and distribution of resources and capacity building for elaborating and implementing measures aiming in particular at preventing and combating corruption.”*⁶

This paper follows the above definitions of good governance adapting them to the particular institutions and processes established by the Clean Development Mechanism to test how far they follow principles of democratic decision making, transparency, accountability, efficiency and environmental integrity.

3.2 CDM governance

The CDM is a governed mechanism that embraces a wide range of stakeholders. It transcends levels of national and areas of governmental decision making. This briefing paper focuses on the CDM's regulatory framework, which comprises its institutional roles and functions (Figure 1) and the project cycle process, i.e. its procedures and methodologies as laid down in the Marrakech accords (Figure 2).

A. CDM institutions

As shown in Figure 1, the CMP acts as the supreme body of the Kyoto Protocol with the EB being the main centralised regulatory body. The CMP decides on the broader policy framework and the strategic development of the CDM and it is the EB that translates these to the project level. When implementing the CMP's decisions, the EB engages in subsidiary law-making; both through direct rule-making and

³ World Bank definition of governance, see

<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/EXTMNAREGTOPGOVERNANCE/0,,contentMDK:20513159~pagePK:34004173~piPK:34003707~theSitePK:497024,00.html>

⁴ Ibid.

⁵ World Bank 1994: *Governance: The World Bank's Experience*.

⁶ European Council definition of good governance as of April 2011: [http://www.venice.coe.int/docs/2011/CDL-AD\(2011\)009-e.pdf](http://www.venice.coe.int/docs/2011/CDL-AD(2011)009-e.pdf)

by its decisions as an adjudicator (Streck, 2008). In essence the EB takes decisions on methodologies and projects, mandates reviews and is assisted in these tasks by its support structure: The DOEs that serve as the validators and verifiers of projects and emission reductions and the DNAs that exercise their support functions at a decentralised level. The credibility of the CDM governance therefore depends on the integrity and robustness of this regulatory framework and it is these dimensions that this paper reviews and assesses in the following sections.

Figure 1: Regulatory institutional structure

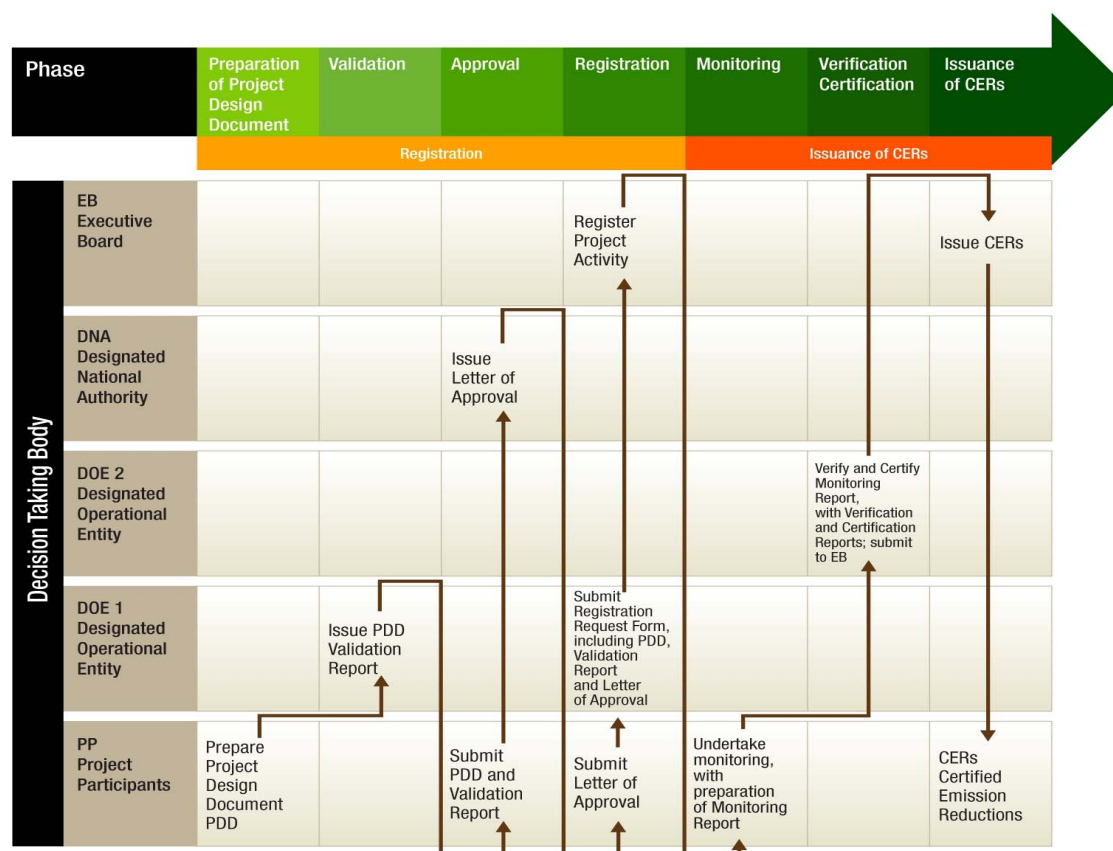


B. The CDM project cycle

Figure 2 below explains the project cycle. The basic operational principle of the CDM is the crediting of greenhouse gas (GHG) emissions reductions generated by project activities implemented in developing countries. The figure shows a step-by-step process from preparation of the project design document (PDD) to issuance of Certified Emissions Reduction credits (CERs) indicating the decision making bodies (as further elaborated in Table 1) at each stage. The validation of PDDs by DOEs is one of the most crucial steps in the governance of the CDM, hence the importance of clear validation standards, procedures and guidelines, and strict principles for the accreditation of DOEs. Other

phases from approval to issuance of CERs are also areas that are affected by the governance of the EB. We will focus on all aspects of the project cycle in the following sections.

Figure 2: CDM project cycle



Source: adopted from UNCTAD CDM guide document⁷

Table 1: CDM institutions decision making

Stage	Institution	Decision making	Comments
Preparation of PDD	Project Participants	None	
Validation	DOE 1	Project validation	No decisions beyond the individual project
Approval	DNAs	Approve CDM projects at national levels	
Registration	EB	Approval of projects registration and baseline and monitoring methodologies;	Supervise the CDM under the authority of CMP and interprets decisions of the CMP
Monitoring	Project Participants	None	
Verification and certification	DOE 2	Project verification and certification of emission reductions	No decisions beyond the individual project

⁷ http://www.unctad.org/en/docs/cdm2009_en.pdf (last accessed 6 May 2011)

Issuance of CERs	EB	Issuance of CERs	
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4 CDM governance: merits and limitations

When the CDM was established under Article 12 of the Kyoto Protocol in 1997, there wasn't any clarity on how the CDM market would evolve during the first commitment period of the Protocol. Now the picture is much clearer. In the 7 years since the registration of the first CDM project on 18 November 2004, 3,055 CDM projects have been registered, with expected annual average CER generation of more than 469 million⁸.

Some of the CDM's success stories are routed in its inclusive form of climate governance involving state and non-state actors. It has brought in new parties (e.g. the European Union Emission Trading System (EU ETS) participants, voluntary offset sellers and buyers) who manage low carbon finance flows from developed to developing countries. Originally initiated by country governments (i.e. parties to the Kyoto Protocol) private actors have become an inherent part of the CDM structures and processes, with governments holding the constitutive rule-making powers.

Merits of this inclusive form of governance identified by interviewed stakeholders include:

- Through the demand for CERs from the private actors e.g. EU ETS participants, the CDM market has developed into a massive success, much bigger than expected at the time it was conceived. EU-15 remains the chief source of demand with more than 70% of volume or about 350MtCO₂e (Kossov and Ambrosi, 2010);
- Through its transfer of funds for clean energy development projects, it allows developing countries to gain firsthand experience and to enhance their local population's capacity and their institutions (e.g. DNAs) for managing and controlling GHG mitigation.
- One of the major successes of the CDM is the confidence investors developed in the system due to a UN body issuing the credits centrally. The centralised system of issuing the credits helps to deal with counter party, currency and country risks. The way the credits get issued and distributed in the current system facilitates the financial structuring and security over investments in projects. Therefore, CERs can and are used as collateral to secure debt financing into projects, leveraging local private sector capital⁹.

Although it has had success, concerns about the CDM have been raised by CMP, market participants, observers and critics of the mechanism. Purdy (2009) noted that “governance first arose as an issue at the Montreal negotiations in 2005. Since then, aspects of the CDM's structural organisation and operational effectiveness have come under increasing scrutiny, with questions raised as to whether current regulatory structures are robust enough to meet the challenges of regulating a fast expanding international market mechanism.”

The below sections discuss the limitations and potential reforms of CDM governance as highlighted by position papers of the CMP pursuant to its Article 9 Review¹⁰, followed by those that have been at the centre of continuous debate amongst expert circles.¹¹ Our review highlights the fact that governance concerns and many proposed reforms are focused at the international level, i.e. the Executive Board and UN FCCC structures. Governance deficits on the national level have been neglected so far..

Our findings are classified into three dimensions:

- Limitations in the decision making/regulatory processes with particular focus on the EB;
- Limitations in decision making with particular focus on the DOEs;
- Limitations in decision making with particular focus on the DNA.

⁸ UNFCCC, CDM Statistics, available on the Internet at < <https://cdm.unfccc.int/Statistics/index.html> > (last accessed on 6 May 2011)

⁹ Interview with Stephen Gray (CCC/CMIA), 22/0/2011

¹⁰ Submissions on this review were received from Argentina, Costa Rica, France on behalf of the European Community and its member States, Japan, New Zealand and South Africa, Australia, Switzerland, Colombia. Further details on Article is provided in Appendix 2

¹¹ IETA: State of the CDM 2008; State of the CDM 2009, State of the CDM 2010; and also borrows heavily from Streck 2008: Project Developer Forum response to the call for input on efficiency in the operation of the CDM and opportunities for improvement; and were reconfirmed by many of the stakeholders interviewed and the a webcast for the 59th meeting of the EB

4.1 Limitations with regard to decision making at the EB level

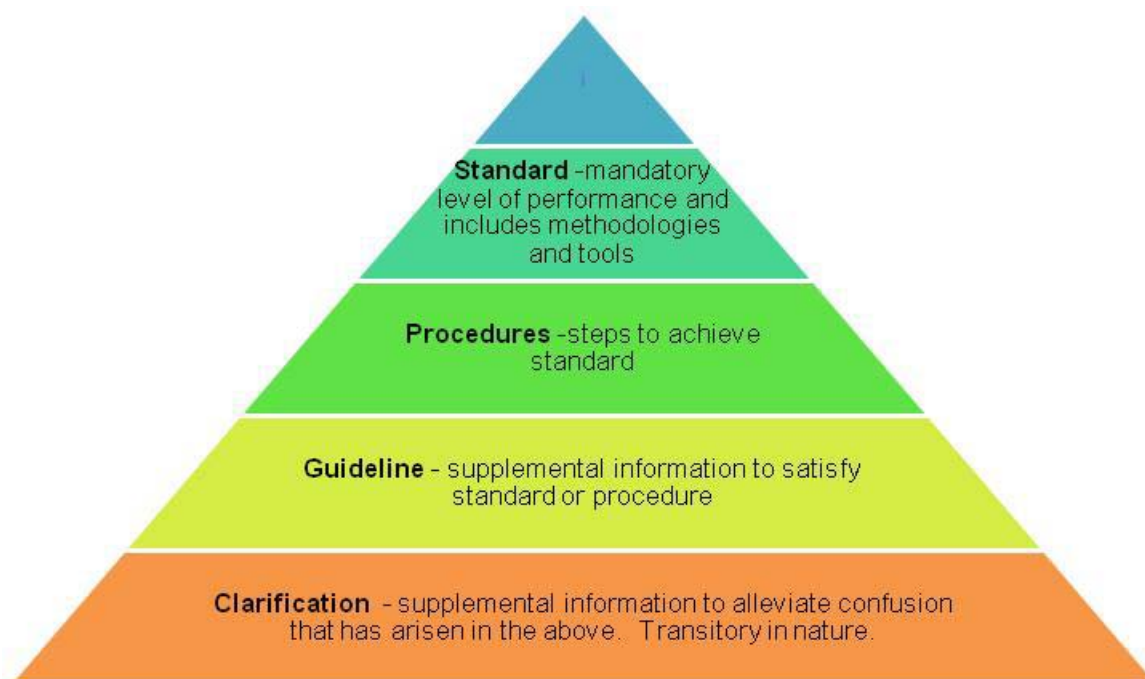
This section gives an overview of the current framework in the decision making of the EB before moving on to the current limitations.

According to the new CDM decision making framework¹², all decisions taken by the EB must be consistent with those of the CMP. Decisions taken by the EB are hierarchical in nature and are published in their meeting reports and the accompanying annexes, which together are an official record of the proceedings of any EB meeting.

The EB classifies its decisions into three categories: operational, regulatory and rulings.

- 1) Operational decisions are essentially administrative in nature.
- 2) Regulatory decisions relate to the establishment of standards, procedures, guidelines and clarifications (further elaborated in Figure 3).
- 3) Rulings relate to compliance with the modalities and procedures hence are project specific. Notably, 'rulings' apply to the accreditation of DOEs; approving methodologies; registering project activities; and issuing CERs.

Figure 3: Hierarchy of regulatory decisions



Source: adapted from the UNFCCC website

The above new decision making framework was adopted to tighten up definitions, remove unused document types and combine the decision making hierarchy and the different document types issued by the EB. However, there still remain frustrations on the decision making by the EB. Key concerns identified are highlighted in Box 2 below and discussed further in the sections that follow.

¹² Decision Hierarchy and Definitions (EB 53 Report, Annex 38) available here http://cdm.unfccc.int/EB/053/eb53_repan38.pdf (last accessed 6 May 2011)

Box 2: Concerns with the EB decision making process

Key concerns:

- **Efficiency:** slow and inadequate decision making procedures and doubling of efforts have continued to cause delays and inefficiencies in the CDM management system;
- **Environmental integrity:** the inadequate guidance on additionality and the setting of baselines has either contributed to high numbers of non-additional projects or projects that are additional but do not meet the criteria and are hence not registered (lost opportunities)
- **Transparency:** process openness, communication and accountability in decision making still fails to meet stakeholder’s expectations.
- **Participation:** the access to information, engagement in decision-making, and access to appeal procedure is considered as either limited or lacking by stakeholders.

A. Efficiency in decision making

Although considerable efforts have been made¹³ the stakeholders have expressed views that the efficiency of the EB’s decision making still falls short of the expectation of market participants. For example, it is claimed that when issues are discussed by the EB they are often left inadequately or partially resolved (IETA, 2010). Also, agenda items are sometimes repeatedly postponed from meeting to meeting¹⁴. A good example of this is the delay in the issuance of revised standards and procedures relating to the Programme of Activities (PoAs)¹⁵. Although the PoA approach was established in 2007 the EB has only in the last year adopted standards relating to additionality, eligibility and application of multiple methodologies, which it now plans to consolidate.

Other delays have included the establishment of direct communication between the EB and PP in relation to individual projects. A request to enable such communication was made at the CMP’s fifth session (CMP5)¹⁶ and further reiterated at their sixth session (CMP 6).¹⁷ The EB has since acted on the issue and produced a direct communication procedure.

Other causes of previous delay include a lack of clear guidance on the use of ‘first-of-its-kind’ and ‘common practice analysis’ in the barrier analysis test and the ensuing case on the treatment of national emissions reducing policies (E+, E-)¹⁸. In many areas again, progress has been made with the adoption of procedures.

The development of new modalities and procedures to address the lack of clear guidance will be considered welcome. The concerns of stakeholders also, however, point to the slow pace of change in the development and adoption of new guidance.

¹³ The streamlining of procedures carried out in response to a request from the Parties to the Kyoto Protocol at their fifth session (CMP5). The new procedures lay the foundation for improving the efficiency and transparency of the operations of the CDM.

¹⁴ For example, during EB 58, there was not sufficient time to review the following decisions (from the EB 58 meeting report)

- consolidated methodology ACM0012 - paragraph 17 – still outstanding
- methodology AM0024 - paragraph 29 – still outstanding
- tool to assess the validity of the original/current baseline and to update the baseline at the renewal of a crediting period - paragraph 30 – still outstanding
- Terms of reference (ToR) for a Registration and Issuance Team (RIT) - paragraph 73 – since completed at the 59th meeting
- guidelines for requesting a review and making decisions and objections regarding review assessments”, and agreed to consider these at a future meeting - paragraph 74 - since completed at the 59th meeting

¹⁵ The concept of a Programme of Activities (PoA) (often called Programmatic CDM) is described in EB 47, Annex 29, paragraph 3 as:

A programme of activities (PoA) is a voluntary coordinated action by a private or public entity which coordinates and implements any policy/measure or stated goal (i.e. incentive schemes and voluntary programmes), which leads to anthropogenic GHG emission reductions or net anthropogenic greenhouse gas removals by sinks that are additional to any that would occur in the absence of the PoA, via an unlimited number of CDM programme activities (CPAs).

¹⁶ Decision 2/CMP.5, paragraph 8 available at <http://unfccc.int/resource/docs/2009/cmp5/eng/21a01.pdf#page=4> (last accessed 6 May 2011)

¹⁷ Decision 3/CMP.6, paragraph 21 available at <http://unfccc.int/resource/docs/2010/cmp6/eng/12a02.pdf#page=2> (last accessed 6 May 2011)

¹⁸ National and/or sectoral policies that give comparative advantages to more/less emission intensive technologies

The fact that all the above illustrations are usually discussed in closed sessions means that CDM stakeholders cannot determine what prevented the EB from taking action, or what dictated the pace of change. Observers have therefore attributed reasons for these delays to:

- The EB continuing to spend its time on detailed technical problems in projects, leading to neglect urgently needed policy and strategic decisions.¹⁹ An EB member interviewed²⁰ commented that this is no longer the case following the revision of registration and issuance procedures; however, some observers still feel it is a concern as most of the above issues remain outstanding²¹.
- The part time nature of the EB challenging the handling of increasingly complex and highly technical tasks²². Stakeholders are of the view that part time arrangements of the EB members limit the amount of time that they can spend in amending policy and making decisions. It is perceived that these arrangements lead to difficulties in finishing work and a poor focus on the tasks to be carried out by the EB.²³

Furthermore, the current decision-making process, particularly with regard to registrations and issuances of CERs, is still perceived to be onerous and inefficient.²⁴ It is recognised that there have been changes to registration, issuance and review procedures and a restructuring of the Secretariat to group staff in terms of logical functions. To contextualise the delay, in order for a project to be registered or for CERs to be issued, the current process of checks is:

- DOE audit (validation/verification);
- Document check by the Secretariat, where any submissions found to have errors are returned back to the queue for scheduling for completeness check; and
- Full document review during the requesting registration/issuance period:
 - Vetting by Registration and Issuance Team (RIT)
 - Vetting by EB
 - If a PP or three members of EB request review, project undergoes review, otherwise proceeds to registration.

The document review at multiple stages in the process could be streamlined. This would make the system more efficient and avoid duplication, whilst still maintaining environmental integrity.

B. Environmental integrity - additionality and baseline setting

The demonstration of additionality in emissions reductions is key to ensuring the environmental integrity of the CDM. If a project is not additional but nevertheless registered as a CDM project, the issuance of CERs results in an increase in global greenhouse gas (GHG) emissions. The additionality requirement and the setting of robust emissions baselines were introduced in the CDM to protect its environmental integrity.

In practice, additionality is demonstrated through application of the “tool for demonstration and assessment of additionality” or the “combined tool to identify the baseline scenario and demonstrate additionality”. While these tools have contributed to an effective implementation of the CDM, they have equally raised concerns on the mechanism’s environmental integrity due to a lack of robustness in their application to project activities. The lack of robustness in using these tools is partly considered to be due to the EB’s failure to provide clarity and guidance, as well as the subjective use of the tools by DOEs at the validation stage of a project.

The issues of additionality and baseline setting are examined at length in an accompanying briefing paper as part of this project. Therefore we do not discuss them in detail here. Overall though, as demonstrated in the baseline and additionality briefing paper, there are serious concerns over the way

¹⁹ For example in Schröder, M; CDM reform – essential and possible; November 2010, KfW Carbon Fund; Carbon Markets Investors Association: EB46 Call for Input on ‘Efficiency in the Operation of the CDM and Opportunities for Improvement etc

²⁰ Martin Hession interview with AEA March 2011

²¹ Kim Carnahan interview with AEA March 2011

²² The EB is currently a part-time independent supervisory body consisting of 10 members and 10 alternate members. Members are nominated by the relevant geographical constituencies (according to decision 4/CMP.1) and elected by the CMP and may serve for a maximum term of two years

²³ Schröder, M; CDM reform – essential and possible; November 2010, KfW Carbon Fund.

²⁴ Project Developer Forum response to the call for input on efficiency in the operation of the CDM and opportunities for improvement; IETA: The State of CDM 2010

in which additionality and baseline tools are being applied, interpreted and assessed. This in turn leads to a reduction in the CDM's overall environmental integrity. The challenge for the EB is to find transparent and objective criteria that avoid a high number of non-additional projects being approved, and do not result in a high number of 'lost opportunities' (projects that are additional but do not meet the criteria).

C. Transparency, communication and consistency

Transparency and communication

Transparency as used for this paper implies openness, communication and accountability of processes and decision making. The need for transparency and involvement of stakeholders²⁵ are recognised to some extent in the EB's decision making principles, for example:

- organisation of attendance of meetings with accredited observers;
- publication of decision making documents and forms;
- publication of reasons for the rejection of submissions at completeness check stage;
- allowing PP to be more directly involved in clarifying concepts behind proposal under the revised procedures for approval of methodologies;
- allowing operational entities to appeal negative conclusions of the Accreditation Panel (AP) under revised procedures for accreditation.

Stakeholders are of the view that there are still issues insufficiently addressed. These include the following:

- 1) EB's continued decisions on registration and issuance in closed sessions.²⁶ According to Decision 3/CMP.1, paragraph 16, meetings of the Board *"shall be open to attendance (...) by all Parties and by all UNFCCC accredited observers and stakeholders, except where otherwise decided by the Executive Board."* However, due to a rising number of discussions on individual cases, large parts of EB meetings still take place behind closed doors. Although decisions are often published on the CDM website, these are not always clearly substantiated. This adds difficulty in the interpretation of EB decisions. It has been proposed by some stakeholders²⁷ that a standard practice be set where at least two observer members are allowed to participate in the decision-making sessions to enhance the transparency of the process. In the last year the EB has acted to improve transparency through the adoption of guidelines on reviews (initiated by EB members) of requests for registration and issuance.
- 2) Inadequate communication with stakeholders.²⁸ The requirements for consultation with stakeholders is currently limited to two main areas²⁹:
 - a. consultations with stakeholders where new rules and regulations are being prepared or existing rules and regulations are being revised that have an important impact on the stakeholders;
 - b. consultation with stakeholders regarding case submissions (requests for registration, issuance, deviations, revision of monitoring plans, new methodologies proposals, revision of an approved methodology, and clarification on an approved methodology or an approved tool).

The Secretariat initiates these consultations. There are limited opportunities for affected parties to communicate their concerns on issues not covered under these consultations but by unsolicited letters. In the Cancun decisions, the secretariat reserved itself the right to address project developers directly with any questions they have on project proposals, as formalised within the modalities and procedures for direct communication with stakeholders adopted at the 62nd EB meeting.. However, one of the experts we interviewed for this study emphasised that this has proven to be a one way channel that does not meet with the spirit intended for communication between EB and project

²⁵ According to the CDM rules

²⁶ Eva Flizmoser CDM Watch interview with AEA in March 2011

²⁷ E.g. Kim Carnahan, IETA interview with AEA March 2011

²⁸ IETA: State of the CDM 2010

²⁹ Perceived here as the act of conveying meaningful information

developers.³⁰ Improvements in direct communication could help to avoid delays from minor immaterial issues such as those shown in Table 2 for which projects are returned during the completeness check.

Table 2: Incomplete request for registration (results of completeness checks 24/10/2010 – 31/01/2011)³¹

Incompleteness message	Issue
Inconsistency: The Annex-I entity mentioned in the LoA issued by the UK DNA (i.e. Green Gas Management Services) is not consistent with the Annex-I entity mentioned in the project's view page, validation report, MoC and PDD (i.e. Green Gas International B.V.) Please clarify.	Minor issue. Secretariat could have requested the information via email or phone call instead of sending the PDD to back of queue for rescheduling.
Incomplete information: The Annex 1 of the MoC is missing. Inconsistency: Inconsistency in reported project participant. The Registration Form reports only one PP while the PDD, VR and project view page report two PP.	Minor issue. Secretariat could have requested the information via email or phone call instead of sending the PDD to back of queue for rescheduling.
Incomplete information: The unprotected IRR spreadsheet was not submitted.	As above.
Incomplete information: The DOE is requested to include the name of the entity in section 2 p. 1(focal point) of the MoC.	As above.

Source: UNFCCC CDM website³²

For such immaterial reasons the CMP5 and CMP6³³ concluded that the EB should enhance its communications with project participants and stakeholders by establishing procedures for direct communication between the EB and PP in relation to individual projects. The EB has since adopted modalities and procedures for direct communication with stakeholders, taking account of responses to its call for public inputs on the subject³⁴. The procedure prescribes general principles for communication with the EB on case-specific issues including that editorial issues shall not lead to the rejection of submissions and sets out provisions for direct communication between the secretariat (on behalf of the EB) and project participants/DOEs regarding submissions, prior to any decision on those submissions. This procedure should improve the resolution of incompleteness concerns with registration submissions.

The EB has also recognised the need to enhance its communication at a higher level. For example, in 2010 it organised CDM roundtables and created a new Stakeholder Development Unit. Roundtable events were held directly between the EB and project developers without going through the DOEs in June and October 2010 and most recently in August 2011 where project standards, project cycle procedures, the VVS and other important draft guidance and procedures were discussed openly. Stakeholders broke out in small groups to discuss the wording of documents and the Secretariat took notes of suggestions. This was well received by participants even though stakeholders were not given sufficient time to prepare a reaction to the documents³⁵.

³⁰ Interview with Stephen Gray (CCC/CMIA); CDM Watch letter to secretariat in June 2010 available here http://www.cdm-watch.org/wordpress/wp-content/uploads/2010/06/EB54-16_CDM-Watch_Transparency-about-unsolicited-letters-and-LoAs_response.pdf (last accessed 6 May 2011)

³¹ Assumption is that all the incomplete messages were sent to the back of the queue

³² Available at http://cdm.unfccc.int/Reference/Notes/reg_note13.pdf (last accessed 6 May 2011)

³³ CMP decision 3/CMP.6, paragraph 59, requested the EB to ensure that editorial errors which will not affect the assessment of compliance with verification and validation requirements do not lead to a determination that the request for registration or issuance is incomplete.

³⁴ The draft procedure was produced as annex to EB62 and was then adopted as per annex 15 to the meeting report http://cdm.unfccc.int/filestorage/K/C/A/KCA6Z0IBDRWJ7EHP4SOFQXM5NGTL2U/eb62_repor.pdf?t=MWx8bHN5NnFxfDBi-IgClvNtW0m3VU8D4cAp

³⁵ Interview with Stephen Gray (CCC/CMIA);

Consistency

The concerns over consistency in decisions mainly relate to:

- Lack of a systematic indexing of EB rulings that provide precedents for subsequent decisions;
- Lack of consistency and clarity in the methodology, guidance and procedures documents;
- Lack of clear timelines on implementation of new rules.

These shortcomings were recognised by the CMP in its Decision 3/CMP 6 when it recognised the publication of rulings by EB for registration and issuance but further requested that the EB:

- Ensure rulings contain explanations of and rationale for the decisions taken, and include sources of information used;
- Continue to improve transparency and consistency by revising their official documentation to comply with hierarchy of decisions adopted and detailed in Figure 3;
- Provide clarity regarding the timing and implications of introduction of new rules and decisions.

The current approach for the publication of EB decisions on project cases does not show whether new decisions overrule former decisions. Also, EB decisions to continuously reject cases do not provide full explanation as to why additional documentation provided by the PP and DOE fail to meet EB standards (KfW, 2010). Note in this respect the procedure for communication with stakeholders allows projects participants the opportunity to communicate with the secretariat regarding the reasons for rejection. In practice it is hard to show inconsistencies in decision-making. The current way of operating on a case-by-case basis can create the impression that decisions are not following a clear rule book. Therefore, the requests of the parties for the EB to cite past precedent and to give reasons why they made particular decisions are important to improve perception on transparency and consistency.

D. Stakeholder participation

The existing CDM stakeholder participation rights were established as part of the 'Marrakech Accords'.³⁶ Under these rules its institutions (in particular PP, DOEs, the EB and Secretariat) are obligated to grant and encourage stakeholder participation. "Stakeholders" in these rules is defined as "individuals, groups or communities affected, or likely to be affected, by the proposed Clean Development Mechanism project activity." This definition of stakeholders is considered by some experts as narrow and does not cover a wide range of individuals affected by the rulings (Eddy and Wiser, n.d.)³⁷. They suggest instead that stakeholder participation in the CDM should follow the principles laid out in the Aarhus Convention, i.e. access to information, engagement in decision making and access to appeal procedure³⁸.

The below sections provide an overview of the current stakeholder participation in the CDM and examine the concerns as highlighted by the stakeholders with particular focus on the three Aarhus principles of participation.

Limitation on access to information and engagement

The CDM rules establish two mandatory opportunities for stakeholders to comment on projects. The first mandatory participation occurs with the preparation of the PDD. PPs must invite local stakeholders to provide comments on the proposed project activity. In this case the local stakeholders are actively approached to provide their inputs. The CDM rules do not specify how PPs should extend this invitation for participation but state the PDD should have a brief summary of how the comments

³⁶ FCCC/CP/2001/13/Add.2 (2001), Decision 17/CP.7 further detailed in the modalities and procedures for a clean development mechanism, as defined in Article 12 of the Kyoto Protocol

³⁷ According to Nathalie Eddy and Glenn Wiser - Nathalie Eddy is a Climate Campaigner with Greenpeace, and Glenn Wiser is a Staff Attorney with the Center for International Environmental Law (CIEL)

³⁸ Where according to Article 2, Paragraph 5 of the Aarhus Convention: "The public concerned" means the public affected or likely to be affected by, or having an interest in, the environmental decision-making Where the "public" here refers to a broad group of stakeholders, including individuals and families living near the project, indigenous groups, religious groups, public sector officials, private sector companies, civil societies and NGOs at the local, national, and international level. Whereas the "participation" used in decision making of stakeholder groups refers to access to information, engagement in decision-making, and access to judicial redress.

were solicited. The second opportunity is at the validation stage where international stakeholders and UNFCCC accredited NGOs are permitted to submit comments on the validation requirements. These stakeholders have 30 days to provide their comments. Other than the PDDs, there is no access to other information such as environmental impacts assessments (EIA), financial analyses or confidential documents (CDM Watch, 2010). In contrast to local stakeholders who are actively invited to provide comments, international stakeholders are only notified of project activities via publishing of new CDM projects on the CDM website. Work is underway to review the adequacy of the stakeholder consultation process at the validation stage and the EB plans to consider options for improving the process.

Although great efforts have been made many experts and market participants feel that stakeholder participation still falls significantly short of expectations: There are opportunities for public participation throughout the CDM validation process; however, there are no further opportunities once the validation report is submitted to the UNFCCC. If a DOE decides to validate a project activity despite serious concerns by civil society, there are no official ways for critics to challenge this decision (CDM Watch 2011b). The only possible route to raise criticism is through unsolicited letters. In the recent procedure for direct communication with stakeholders there remains no scope for stakeholders not directly involved in the project (i.e. other than project participants and DOEs) to initiate communications with the secretariat or EB on case-specific issues. It does, however, allow for the secretariat to initiate communication (with whom the procedure is not specific) if it considers that this would resolve concerns related to the compliance of the case.

The above findings highlight that significant gaps remain in stakeholder participation at key stages in the project development and registration processes. The lack of any opportunities for stakeholders to initiate complaints about a project (beyond any existing procedures under the national law of the host country and post validation) render the CDM out of step with the principles of the Aarhus Convention and with established practices of international financial institutions, such as the World Bank Group (Purdy 2009).

Limitation on appeals procedure

A common criticism with stakeholder participation is not allowing aggrieved parties to appeal a decision made by the EB (Figueres and Streck 2008 cited in Purdy 2009). Participants in the CDM who have been adversely affected by EB decisions continue to have no right of appeal. While the EB is effectively a regulatory agency it is not subject to the usual political and legal controls to which a domestic regulatory body would be subject (Streck, 2008). It has been reported that the EB allegedly received twelve threats for legal proceedings from project developers in 2007³⁹. This prompted calls for incorporating an appeal mechanism which would improve transparency and accountability in the CDM decision making process. A key reform proposal at the Conference of the Parties in Poznan in 2008 under the Article 9 review was therefore the introduction of an appeal mechanism against decisions of the EB. Though there has been ongoing work on this, no independent tribunal to which aggrieved parties may appeal for review of EB decision has yet been established. However, changes are visible in the EB's latest annual report (for the period 17 October 2009 to 14 October 2010): A recommendation has been issued for the CMP on the establishment of an appeals procedure⁴⁰ against rulings requesting registration or issuance. Since these recommendation were issued, invited Parties, intergovernmental organisations and admitted observer organisations have also submitted their views to the Secretariat on procedures, mechanisms and institutional arrangements of the recommended appeals procedure. The secretariat received eight such submissions⁴¹ (see Appendix 3 for a summary of the details).

Stakeholders recognise that the recommendations on the procedures for appeals provides a good basis for the design of a CDM appeals procedure, subject to some changes as summarised in Appendix 3.

The adoption of the appeal procedure will not only strengthen the mechanism in the eyes of all stakeholders, it will increase support for the CDM both politically and in the form of investment in CDM projects and to enhance accountability and public trust in the mechanism.

³⁹ Charlotte Streck and Jolene Lin, "Making Markets Work: A Review of CDM Performance and the Need for Reform", 19(2) The European Journal of International Law (2008), pp. 409 et seq, p.410.

⁴⁰ See Annual Report of the Executive Board to the Clean Development Mechanism, 2010, Recommendation on the procedure for appeals against rulings by the Executive Board of the clean development mechanism regarding requests for registration or issuance, Annex II.

⁴¹ Four submissions from Parties and one from a United Nations organization and three from non-governmental organizations

4.2 Limitations with regard to DOEs

This section first provides an overview of the DOEs role in the CDM project cycle before moving to current concerns on their work as validators and verifiers of the CDM projects as identified in the expert literature.

As explained in Figure 1, the DOE's role is to validate project(s) by evaluating the PDD against the CDM's modalities and procedures. This also includes the verification of project activity to confirm that it has indeed resulted in a reduction or removal of GHG emissions that are additional to any that would have occurred in the absence of the proposed project. Their role also includes undertaking voluntary pre-assessment of new baseline and monitoring methodologies⁴² and identifying and submitting requests for deviation prior to submitting request for issuance.⁴³

In carrying out their work, DOEs follow the CDM Validation and Verification Manual (VVM) ensuring each project activity meets all applicable CDM requirements.

There have been a number of criticisms on the quality of DOE submissions at validation and verification stages. At one point the increasing number of projects rejected by the EB led to the questioning of the quality and functioning of the validation process that evolved through a 'learning by doing' approach where rules and procedures have evolved in a piecemeal way⁴⁴. Until the VVM was approved in late 2008 and the Accreditation Standard was adopted in 2009, the DOE's relied on rules spread across in meeting reports. This not only led to inefficiencies in their validation and verification work but also to misunderstandings between the EB and DOEs regarding the application and interpretation of CDM standards, guidelines and procedures.

Current concerns on DOEs are highlighted in Box 3 and further elaborated in the sections that follow.

Box 3: Concerns on DOE governance

Key concerns:

- **Poor quality project documentation:** PDDs submitted to the EB and Secretariat are often of poor quality leading to increased work load on the side of the Secretariat and delays in the projects' timelines.
- **Lack of independence:** lack of independence from project developers in the CDM validation process

A. Poor quality of project documentation

The qualities of PDDs submitted to the Secretariat are said to be often poor leading to continued delays and uncertainties in the registration and issuance process (CMIA, 2009). As an example, Figure 4 below shows that direct registrations of CDM projects by the EB dropped from 90% in 2005 to 50% in 2008. The concern on quality led to excessive checks by the EB and the Secretariat, resulting in long delays for project registration. While there has been an improvement⁴⁵ since 2010, shown by an increase in automatic registration, the quality of project submissions is still not considered adequate.⁴⁶

⁴² In accordance with EB 21 report paragraph 14, available at <http://cdm.unfccc.int/EB/021/eb21rep.pdf> (last accessed 6 May 2011)

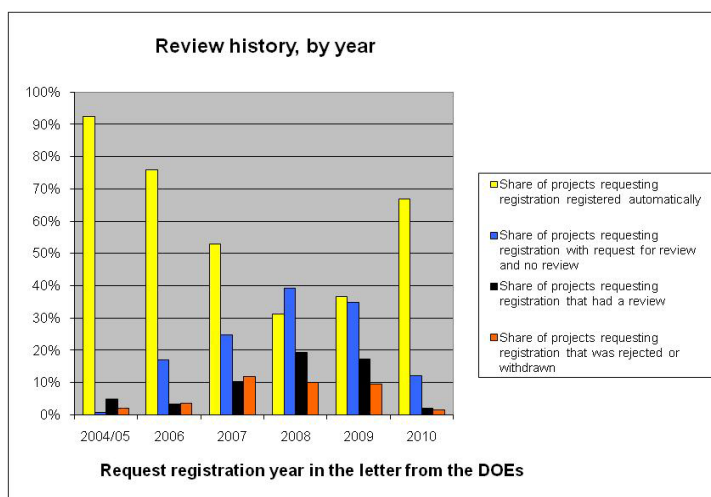
⁴³ In accordance with EB report 49, annex 26 and 27, available at http://cdm.unfccc.int/EB/archives/meetings_09.html#049 last (accessed 6 May 2011)

⁴⁴ By DOE interviewed (who requested to be anonymous)

⁴⁵ With the EB adopting a new accreditation standard, monitoring DOE's performance, training those who assess DOEs and harmonising interpretation of requirements

⁴⁶ Issue discussed at the EB 59th meeting elaborated further in the meeting report paragraph 76 available here <http://cdm.unfccc.int/UserManagement/FileStorage/GAYSZRFOITL9BU4XDN0C1VJW2H5M8P> (last accessed 6 May 2011)

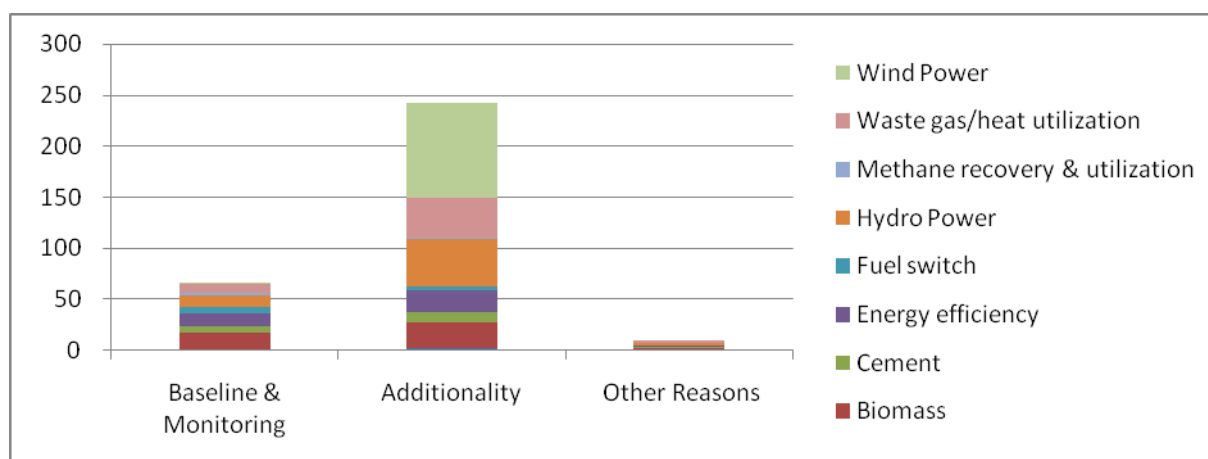
Figure 4: History of projects requesting for registration



Source: UNEP Risø Centre CDM pipeline (April 2011)

The cause of poor quality submissions has been attributed to the subjective nature of the baseline and monitoring methodologies and the additionality tool. The VVM requires DOEs to cross-check technical data at validation and verification. According to CMIA the ambiguities in standards make the DOEs increasingly act as if they have no mandate or authority to exercise judgments (CMIA 2009). Further to this, one of our interviewees highlighted “an unhelpful dynamic has evolved over the years between the EB and the DOEs: Roughly two years ago there was a complete loss of confidence in the DOEs’ ability to assess project additionality which lead to an extremely strict and conservative implementation of the guidelines and rules by the EB. This conservative approach is hindering the development of new and innovative approaches for data generation and baseline discovery⁴⁷. . To illustrate this, in 2009 more than 50% of the projects applying for registration received a request for review before registration (see Figure 4 above). The reasons for reviewing projects varied according to project type; however, of the total number of reviews conducted, additionality was the major factor (see Figure 5). This is particularly true for wind and hydro power projects (IGES, 2010).

Figure 5: the reasons for review of project application by the EB



Source: IGES 2010 Project Type-Reason analysis database

The myriad of judgements that have to be made by DOEs, secretariat and the EB is worsened by the lack of a harmonised materiality concept included in the VVM. As an example IETA (2011) notes that it is impossible to conduct a reasonable verification without the concept of materiality and the acceptance of a reasonable level of assurance. In reality a DOE cannot check every data element and so must make a professional judgement about where to place the emphasis in its assessment. The concept of materiality is already being used by DOEs to a certain extent. The problem lies with the fact

⁴⁷ Interview with Stephen Gray (CCC/CMIA)

that the concept of materiality being used by them and by the Secretariat is not harmonised. Having clear materiality guidelines for DOE analysis and Secretariat reviews will lead to more consistent audit results across DOEs and less discrepancies between the findings of the DOEs and the Secretariat. It would also give DOEs greater confidence in interpreting existing standards and procedures.

The improvement of standards, procedures, guidelines and tools to enhance objectivity and environmental integrity in the assessment of project applications is critical with the view to improving the efficiency of the mechanism, regulatory processes and the DOE's quality of work.

B. Independence

Impartiality, independence and safeguarding against conflicts of interest are principles for validation and verification work of the DOEs.⁴⁸ Under the current CDM rules, project developers choose a DOE and directly pay this DOE for the validation and verification services. This ensures competition among DOEs and, as a consequence, low prices for validation and verification services (Schneider 2007). On the other hand, the high competition among DOEs and the close commercial relationship between PPs and the DOEs has led to a situation where DOEs that raise fewer questions may be preferred by PPs (Schneider 2007). This could lead to DOEs being under considerable pressure to validate projects positively. As such it has been argued that DOEs cannot be relied upon to be objective auditors (Hern and Schneider 2008). Stakeholders have called for the rules to be changed so that project developers are not responsible for the hiring of the validators. This conflict of interest would be mitigated if the UNFCCC hired validators directly and assigned them randomly to projects, as suggested by International Rivers (2008).⁴⁹

4.3 Limitations with regard to decision making – DNAs

This section evaluates the CDM governance at the national level. It first provides an overview of the DNA role in the CDM before discussing the governance shortcomings as identified by experts (highlighted in Box 4) in the sections that follow.

DNA is the body assigned by a country's government to authorise and approve participation in CDM projects. The main role of the DNA is to assess potential CDM projects to determine whether they will assist the host country in achieving its sustainable development goals and to provide a letter of approval (LoA) to project participants. The LoA must confirm that the project activity contributes to sustainable development in the country. If however the project owner wishes to add an Annex I project participant to the project (e.g. buyers of the CERs), those entities have to present evidence of authorisation and approval from their Annex I country government. These letters are then submitted to EB to support the registration of the project.

As mentioned above reform of CDM governance on the UN/EB level will not be sufficient to re-install confidence with all stakeholders. As one of the few authors, Peter Newell⁵⁰ has done research into governance processes on the DNA/national level. . As currently not much further evidence on this subject exists, concerns highlighted in Box 4 and further discussed below draw heavily on Newell's work.⁵¹

⁴⁸ According to the CDM Validation Verification Manual version 01.2

⁴⁹ See study by International Rivers, Lori Pottinger (2008) "Bad Deal for the Planet: Why Carbon Offsets Aren't Working...And How to Create a Fair Global Climate Accord," Dams, Rivers and People Report 2008, International Rivers, Berkeley, CA. available at http://www.internationalrivers.org/files/DRP2English2008-521_0.pdf (last accessed 6 May 2011)

⁵⁰ Peter Newell is Professor of Development Studies at the University of East Anglia and currently holds an Economic and Social Research Council (ESRC) Climate Change Leadership Fellowship to work on the Governance of Clean Development.

⁵¹ Newell, P., (2009); Varieties of CDM Governance: Some Reflections; The Journal of Environmental Development; December Vol 18 No.4; (395-424).

Box 4: Concerns on governance processes at the DNA level

Key concerns

- **Divergence in governing rules of the CDM at the national level** e.g. the sustainability development criteria as assessed by DNAs.
- **Political autonomy:** Non-Annex I countries are unevenly placed with regard to their ability to set terms for investors and to exercise their political autonomy.
- **Capacity:** limited capacity to receive and process requests and to meet the demands of the CDM EB in ensuring projects are conducted in a satisfactory way and are aligned with national priorities.

A. Divergence in governing rules of the CDM at the national levels

According to the CDM rules, the country where a project is implemented, the 'host country', has the right to determine which project proposals fall within their national sustainable development priorities, and reject those that do not meet this criteria. Whether a CDM project assists in achieving sustainable development is assessed by the DNA. In most cases the project documentation is assessed against a set of pre-defined criteria, encompassing environmental, social and economic aspects of sustainability (Kolshus, Vevatne et al 2001 / Najam, Rahman et al 2003). However, when it comes to the concrete assessment of sustainability impacts of CDM projects there is no single authoritative approach or methodology available.

Many countries have established and published criteria to assess this. Some host countries have very ambitious criteria. According to Newell (2009b) Brazil provides an example of a national government spelling out clear criteria aimed at guaranteeing environmental integrity of projects, whereas other countries have adopted a more laissez-faire approach. According to Newell Brazil uses five key sustainable development criteria⁵² to evaluate all projects. By contrast, China has not published criteria for assessing the sustainable development benefits of CDM projects. The assumption is that a project will have a positive impact if it is implemented in three Chinese priority areas⁵³ identified as national priorities, and will by definition contribute to sustainable development. In India, Schneider (2007) notes that while there are sustainable development criteria, projects do not need to comply with all of them, but only need to meet one criteria. The above examples show that sustainable development criteria are not clearly defined by all DNAs. As the assessment of sustainable development through the CDM is discussed elsewhere (please see Briefing Paper on Sustainable Development through the CDM published as part of this study) this paper will primarily focus on the governance aspects involved in the assessment of DNAs.

Another example of divergence of rule application on the national level has been the application of the EU ETS Linking Directive, Article 11b⁵⁴. Civil society organisations such as International Rivers had raised serious concerns with how the World Commission on Dams (WCD) guidance was being implemented with varying degrees of rigor. The inconsistencies in the application of this provision raised doubts over whether the Linking Directive was really addressing the environmental and social integrity of hydro CERs used for compliance within the EU ETS. These doubts led the European Commission to attempt harmonizing Member States' procedures and criteria for approving credits under Article 11b(6). The resulting new approach uses a Compliance Report template that sets out the criteria that Member States should apply to ensure compliance with Article 11b (6). It cannot be said for certain that the simplified harmonised approach has eliminated the concerns entirely, since the harmonised approach is voluntary. Also some of the experts interviewed were of the opinion that the requirements of the directive should be adopted for all sizes of hydro projects as standardisation is of key importance for the longer term success of the CDM.⁵⁵

⁵² (1) Income distribution, (2) local environmental sustainability, (3) development of work conditions and net employment generation, (4) capacity building and technological development, and (5) regional integration and interaction with other sectors

⁵³ (1) tap the large business opportunities of greenhouse gas emission reductions establishing China as one of the leading CDM markets in the world, and (2) align the CDM with its own priorities, namely the improvement of energy efficiency (3) improvement of its energy infrastructure in remote areas (Newell, 2009).

⁵⁴ The European Union Linking Directive, Article 11b, 6 states: "In the case of hydro-electric power production project activities with a generating capacity exceeding 20MW, Member States shall, when approving such project activities, ensure that relevant international criteria and guidelines, including those contained in the World Commission on Dams year 2000 Final Report, will be respected during the development of such project activities."

⁵⁵ Eva Filzmoser interview with AEA march 2011

B. Political autonomy

Another problem is the tendency of competition among non Annex I countries to attract investments resulting in the setting of low sustainability standards in some cases. This is a problem known as 'race to the bottom' (Sutter, 2003). According to Newell (2009) "some states have more power to attract investors on their terms than others." This degree of autonomy is mainly seen in the countries that currently have the largest market share in registered CDM projects (i.e. China, India and Brazil). Newell finds that where China is able to attract foreign investments on its own terms, the Chinese government is in a position to impose strict rules on limiting foreign ownership (until 2009 a 51% Chinese ownership rule was imposed). This is not clearly the case with African countries; a continent that hosts just 2.6% of registered CDM projects⁵⁶. Authority is seen as decisive in the resolution of any tradeoffs such as in small-scale as opposed to large-scale projects that can earn lots of CERs but perhaps deliver fewer benefits to host countries.

The authors see that standardisation of CDM rules and procedures can be key in helping to address the issue of authority as it would not only eliminate the 'race to the bottom', but also create competition amongst projects (large-scale vs small-scale) and amongst countries.

C. Capacity

The lack of capacity within the CDM EB at the international level is in many ways mirrored by a lack of capacity at the national level among DNAs. The capacity and rigour in evaluation affects the processing period of a project by DNAs and the time spans vary considerably as a consequence. The evaluation takes four to six months in Brazil, one month in China and only one week in India (Friberg, 2008 cited in Newell 2009). Whilst the Brazilian government has been accused of adopting an excessively rigorous approach, it is perceived by experts as being thorough but fair in handling CDM applications. In contrast 50% of projects rejected at registration originate from India raising the questions over quality of applications.

The CMP and EB will need to promote the strengthening of DNAs' capacity and skills to improve their capabilities to perform sustainability assessments and equally limit the delays realised at the validation stage.

⁵⁶ According to the UNEP Risoe CDM pipeline [last accessed on the 03/05/2011]

5 Brief status of the current reforms and proposed reforms to address CDM governance

There are a number of reforms discussed on the UN level and in expert circles to address the shortcomings in the CDM governance, as summarised in this briefing paper. These reforms are further analysed in the following sections. We have distinguished between short and longer term reforms as there are still a lot of uncertainties with the future of the CDM post 2012 which need to be resolved by the Parties to the UN FCCC before longer term solutions for the CDM can be considered.

5.1 Short-term reforms (before 2012)

A. Introducing concepts of materiality and level of assurance into all relevant CDM processes

Introduction of the concept of materiality⁵⁷ and level of assurance into all relevant CDM processes is seen as an important step to not only improve the concerns on operational processes but also towards improvement in the EB's decision-making (IGES, 2010). In more detail, introducing concepts of materiality and level of assurance into all relevant CDM processes will ensure matching of effort to effect - where work is prioritised based on risk and impact and streamline processes through more-effective quality control⁵⁸.

Currently there is a draft materiality standard that CMP's 6th session (CMP6) requested the Subsidiary Body for Scientific and Technological Advice (SBSTA) to consider with a view to recommending a draft decision on the matter for adoption at CMP's 7th session (CMP7) in Durban. A review of the submissions⁵⁹ following an SBSTA invitation shows a strong support of the materiality concept by government parties, intergovernmental organisations and admitted observer organisations. Key messages from these submissions include:

- The concept of materiality is key in all relevant CDM processes (i.e. utilised not only by DOEs but also by the CDM Secretariat and EB during the review process). The current draft standard on materiality suggests that the concept will only be used by DOEs. This is seen in the submissions as insufficient to help in improving efficiency in the CDM system.
- That materiality will bring an invaluable benefit by reducing the current extend of project reviews and delays that come with them. For example if an issue arises during an audit, auditors will be able to explain the issue, confirm that it has no material impact (using the guidelines on materiality provided by the EB), and request registration or issuance without needing to request approval of a deviation from the monitoring plan.
- The CMP and EB should aim to harmonise the materiality approach taken under the CDM with existing approaches in the carbon markets as much as possible.

The scope for application of the standard is assessed by stakeholders as follows:

- It should apply to the level of detail in the PDDs, validation and verification by DOEs but also in the review process and decisions by the Secretariat, the RIT and the EB.
 - Materiality in relation to the review process will require that the EB, Secretariat and RIT consider the thresholds when deciding whether or not to send back a project document at completeness check or to trigger reviews of projects.
 - Materiality in relation to decisions by the EB requires that the EB considers the thresholds applied by a DOE when deciding on registration and issuance.

⁵⁷ The proposed CDM draft standard on Materiality adopts the International Accounting Standards Board (IASB) definition: "An information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

⁵⁸ Interview with DNV, Kim Carnahan, CDM reform – essential AND possible November 2010, KfW Carbon Fund

⁵⁹ In response to the invitation (FCCC/CMP/2010/L.8, paragraph 30 and 31) to Parties, intergovernmental organizations and admitted observer organizations to submit to the secretariat, by 28 March 2011 - summary of these submissions is attached in Appendix 4

Following these arguments, materiality, though a concept, could certainly enhance the efficiency required in the CDM system.

B. Enhanced transparency and communication with stakeholders

Transparency of information and appropriate and continual involvement of stakeholders are key features of 'good governance'. As seen in section 2 a number of the procedures adopted by the EB in the past year have sought to enhance and improve the transparency of the CDM process and broaden the involvement of stakeholders. However, to continue enhancing stakeholder support and participation the following reform options are brought forward by experts:

The direct communication procedure adopted by the Secretariat needs immediate and full implementation by the EB. This will facilitate better communication and a more efficient and an open process in the CDM registration and issuance project cycle. Enquiries should be answered within a specified time period. Two-way direct communications should be enabled and encouraged between PP, DOEs and the Secretariat staff assigned to each specific project (Project Developer Forum 2009 / Stephen Gray 2011). This would considerably speed up the process of clarifying any issue that may arise from the Secretariat's check of the project documentation; more so at the completeness check stage. The use of previous precedents in decisions would help to ensure consistency in decision making by the EB. For example, issues accepted by the EB following request for review (RfR) or review on a project should form precedent for other projects. As recommended by the CMP6, paragraph 12, the EB should ensure that rulings include clear explanations and a rationale for the decision taken. This should also include the sources of information used. The use of precedent does not imply that the EB would be tied to past decisions for all future ones; they can deviate, but would have to do so as part of a process that clearly justifies why such a deviation has been necessary and clearly outlines how this has affected the context that future decisions will be made in (Streak 2008)

C. Enhance stakeholders' participation

Public participation in the CDM's decision making is currently limited. According to Eddy, n.d the lack of any opportunities for stakeholders to initiate complaints about a project (beyond the validation stage) makes the CDM fall behind principles of international law as outlined in the Aarhus Convention (). Newell (2011) suggests for the EB and CMP to introduce further mechanisms to address these gaps, e.g. specific guidance on an ex-post validation comment period and public consultation for comments before a LoA is issued by the DNA (open at least a month before the LoA is issued). The introduction of ex-post monitoring of sustainability claims during the verification stage, already included in voluntary offsetting schemes such as Plan Vivo and Climate, Community and Biodiversity Standards (CCBS), is also recommended⁶⁰. The experience gained in these schemes could be used to develop further proposals for enhanced stakeholder participation.

The review in this paper also highlighted that current stakeholder participation is limited to a small number of stakeholders. Participation of diverse stakeholders in the CDM project cycle is an important element in maintaining transparency in decision making. The CMP should consider adopting a broader term of stakeholders such as that of the Aarhus Convention to realise the full potential of stakeholder participation and to further increase stakeholder's perception in the integrity of its governance.

5.2 Longer term reforms (post 2012)

A. Professionalization of the institutions

The professionalization of the EB and its institutions would require the recruitment of full-time staff with well grounded experience in all sectors and expertise on the project level (Streck, 2008). According to Purdy (2009) "[in] the Article 9 review in Poznan, Kyoto parties considered replacing a part-time EB with a full-time EB. The European Union proposed that the Chair and the Vice-Chair of the EB might be full-time, but this was rejected by Kyoto parties."

However there is strong evidence in favour of making EB members full-time, particularly if it could speed up decision-making. A consequence of this would be that EB members would have to be paid full-time. Moving to full-time EB members could start from just having the Chair and Vice-Chair on a permanent basis with greater delegation of the decision-making to the Secretariat.

⁶⁰ Peter Newell interview with AEA on March 2011

Another key area is the increase in capacity of the EB support structures. According to the World Bank (2010), considering the significant growth in the number of projects submitted, the capacity of the Secretariat needs to be increased to ensure that they can adequately process the projects within the timelines specified for different stages of the project cycle.

Kyoto parties in negotiations have focused their attention to the upgrading and resourcing of the current institutional structure. For example, the focus for reform at Poznan was clearly on ensuring effective use current support structure including the Secretariat.⁶¹ Purdy (2009) compared the budgets and staffing levels of three major regulatory bodies in the UK (the Financial Services Authority, Ofgem and Ofcom) demonstrating that these bodies are significantly better staffed and financially resourced than the Secretariat under the CDM process. Purdy further analyses the budget and profit declared in EB annual reports and concludes that profits currently going into a trust fund should from now on be used to maintain and improve levels of services in the regulatory system, to remunerate staff and to increase staff numbers.

B. Simplification and standardisation of tools

While the EB has taken several measures to improve the DOE accreditation process and their performance to deliver good quality PDDs, it is clear that the remaining issue is the passing of judgments based on subjective interpretation of the data available. Therefore, the ideas of simplification of tools, the introduction of concepts of materiality and level of assurance into all relevant CDM processes and the standardisation of baselines are seen as important steps to improve operational process and the EB's decision making. IGES (2010) suggests that "removing the leeway in passing judgments is key and can be achieved by introducing a more objective approach, one based on clear eligibility criteria and quantitative parameters".

The review and analysis in this briefing paper highlights that CDM processes and procedures need simplification and standardisation. There is a general view among stakeholders that only simplified rules based on unambiguous and clearly verifiable criteria will allow an increase in the number of expected project registrations and smooth and reliable CERs issuance processes up to 2012 and beyond. KfW (2009) states that "simplification will be crucial to reinforce the reputation of the CDM, to re-establish and increase trust in the mechanism, and to maintain the CDM as a key reference for effective project based mitigation in the context of future international agreements." However, simplification should not undermine environmental integrity. According to the Designated Operational Entities and Independent Entities Association (D.I.A.) (2011) "the concept of conservativeness plays a major role in CDM in order to safeguard environmental integrity. It is noted that in general understanding this concept and the concept of materiality are quite frequently mixed. Thus, any guidance on materiality should also reflect the differences between the two concepts and should provide unambiguous cut-off points in assessment either set by the one or the other concept or by both."

Simplifications need to be introduced in the assessment and testing of additionality of emission reductions. As illustrated by the Institute for Global Environmental Strategies (IGES), doubts over additionality are held responsible for 67% of all reviews conducted at request for registration in projects. Within that category results from investment analysis are the EB's focus of attention (IGES 2010). Hence simplification and standardisation of rules and tools and the introduction of user-friendly guidelines will limit varied interpretations and judging while still providing a high level of environmental integrity.

C. Implementation of standardised baselines

One reform proposal that has been discussed in the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP) is the development and introduction of standardised baselines⁶² for the determination of additionality of CDM projects (IETA 2009b). The

⁶¹ Decision -/CMP.4, supra, note 6, para. 5(b)

⁶² CMP6 definition: baseline established for a Party or a group of Parties to facilitate the calculation of emission reduction and removals and/or the determination of additionality for clean development mechanism project activities, while providing assistance for assuring environmental integrity.

reform is seen as vital in enhancing limitations discussed in efficiency in decision making and processes, environmental integrity and also regional distribution of the CDM (not a focus on this briefing paper).

Experts hope that standardised baselines will help to:

- Improve efficiency by reducing transaction costs, complexity and uncertainty for project participants;
- Enhance transparency and objectivity;
- Facilitate access to the CDM;
- Contribute to the streamlining of CDM procedures;
- Promote the scaling-up of mitigation actions while ensuring environmental integrity.

CMP5 requested SBSTA to recommend modalities and procedures for the development of standardised baselines under the CDM that are broadly applicable, provide a high level of environmental integrity and that take into account specific national circumstances. After two calls for submissions, a technical paper that took into account all submissions was prepared for CMP6.

The CMP6 has since decided on the implementation of standardised baselines under the CDM, through decision 3/CMP6. The decision is that the CMP, PPs, as well as international industry organisations or admitted observer organisations may submit proposals for standardised baselines through the host country's DNA (a bottom up approach). The decision also allows the EB to develop standardised baselines in consultation with relevant DNAs, prioritising methodologies that are applicable to underrepresented regions and project activity types (a top down approach).

The technical paper on standardised baselines prepared for SBSTA34 (FCCC/ TP/2010/4), highlighted that standardisation can be achieved through different tools and options such as:

- emissions intensity benchmarks and standards;
- default values that can also include conservative estimates of the emission reductions per unit for a given project (e.g. a solar lamp or a compact fluorescent lamp);
- positive lists, which are lists of project types that are considered automatically additional under certain conditions (e.g. location, technology or size); and
- standardised barrier tests where projects could be considered additional if the technology has not reached a certain market penetration in a particular country or region.

The above approaches are already part of some of the approved baseline and monitoring methodologies. The most prominent example is the emission factor for electricity systems, determined through the tool to calculate the emission factor for an electricity system. Once applied, a single default value for the emissions intensity of the electricity system can be used by all projects displacing grid electricity⁶³.

According to the CMP management plan there is work ongoing on the top-down development of standards and standardised baselines that are particularly applicable in geographical regions and sub-regions which are underrepresented in the CDM, as well as covering new project types. Whereas this is good progress, the EB would have to consider some of the perceived shortcomings⁶⁴ of implementing standardised baselines.

First, in determining project types and establishing 'positive lists' the issue of centrality of power (political difficulty of agreeing positive lists) as already seen amongst DNAs will need to be addressed and well managed. According to IETA (2009b) CMP had previously attempted to establish positive lists with little success. The advantage is now that the CDM is mature and the EB can use its experience to promote certain sectors and projects which had difficulties in the past. According to the technical paper FCCC/ TP/2010/4 the EB has subsequently decided to prioritise the following sectors: energy for households; transport; energy efficiency in construction; and agriculture.

Second, the standardisation of baselines is perceived by some stakeholders as having the potential to weaken the environmental effectiveness of the CDM by either over-crediting or under crediting⁶⁵.

⁶³ http://cdm.unfccc.int/filestorage/B/0/K/B0KRVLYO5MQPFJ2TE71S69H4IDZAN3/eb60_propan03.pdf?t=Qk58bHN0MGxtfDB91ZCZntmpqIXQ00q6ez-l

⁶⁴ This list is heavily pulled from IETA 2009: Explaining Standardized Baselines Under the CDM

⁶⁵ As recorded in the submissions on Standardized baselines under the clean development mechanism by two non-governmental organizations (Carbon Markets and Investors Association [CMIA] and Climate Action Network International [CAN]) and Parties to the Kyoto (Australia, Argentina, Belgium and European Commission (EU) on behalf of EU and its member

IETA (2009b) highlights that “there would still be some non-additional projects registered and receive more credits than deserved. However this will be balanced out by the corresponding amount of under crediting via ineligibility of some truly additional projects. “The principle of conservativeness when applied to standardised baselines will ensure additionality and appropriate crediting on aggregate”.

states, Switzerland and Japan), available here <http://unfccc.int/resource/docs/2010/sbsta/eng/misc13.pdf> [last accessed 04/05/2010]

6 Conclusion

Research for this briefing paper has highlighted weaknesses in CDM governance regarding process, participation and accountability. Whilst there has been significant progress in recent years, further improved governance is important for both, increasing the Mechanism's integrity and lowering transaction costs. Literature suggests a number of different reforms, which the EC might wish to consider further. These include:

- Improved efficiency through implementing the concepts of Materiality and Level of Assurance into all relevant CDM processes. This would ensure work is prioritised based on risk and impact and processes are streamlined through more-effective quality controls. It could furthermore help to reduce delays in the CDM management system and those at project level;
- Enhanced stakeholder participation in decision-making processes including right to appeal procedures. Many stakeholders, in particular on the national and local level, do not participate in decision-making even over projects that directly affect their livelihoods. These concerns could be better managed if stakeholder participation were enhanced at the validation stage and supported with ex-post monitoring of sustainability issues at the verification stages;
- Simplification of tools and standardisation of baseline setting could enhance the environmental integrity of the Mechanism and help eliminate inefficiencies in the process.

While it is suggested that the CDM integrity could be enhanced through reforms in governance, such reforms should avoid introducing unnecessary layers of bureaucracy that could threaten the primary goal of incentivising countries to achieve cost effective emissions reduction. Wherever possible, simplification and standardisation of the rules and procedures should be encouraged, while ensuring the environmental soundness of the methodologies.

The main research gap identified is governance processes at the national level. Most governance concerns and reforms discussed are focusing on the UN level. This will certainly not be enough to warrant the confidence required in the Mechanism. As such any reform considerations should also be extended to focus on the national DNA.

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Stakeholders interviewed:

1. University of East Anglia: Professor Peter Newell: Professor of Development Studies at the University of East Anglia and Leadership Fellowship to work on the Governance of Clean Development
2. DNV: Michael Lehmann and Trine Kopperud
3. CDM Watch: Eva Filzmoser
4. IETA: Kim Carnahan, International Director, International Emission Trading Association
5. EB: Martin Hession, Chairman the UNFCCC Executive Board
6. CCC/CMIA: Steven Gray, Stephen Gray, Vice President Carbon Finance at Climate Change Capital and chair of the CMIA working group on financial mechanisms and international architecture;

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