

Response to SBI 40 Call for input on "Possible changes to the modalities and procedures for the clean development mechanism"

The Project Developer Forum (PD Forum) and Climate Markets and Investment Association (CMIA) welcome the opportunity to comment once again on the topic of the reform of the CDM Modalities and Procedures (CDM M&P). This is a topic which we believe is of great significance to the future of the CDM. The CDM has suffered greatly from criticism from a variety of sources over recent years and yet has in many ways proven to be a great success. The total value of declared investments in CDM projects which prepared PDDs, engaged a DOE and posted a PDD for international stakeholder consultation exceeds USD500 bn¹. Few would dispute that the CDM has delivered benefits which extend well beyond reducing GHG emissions. The international project development community, host countries, technology developers and many others have learnt a tremendous amount about undertaking projects and programmes to reduce emissions, and we believe that all of the participants in the CDM now have a greater understanding of the role of the CDM in the national and international low carbon policy environment.

It is the PD Forum and CMIA's contention that only a small number of changes, some fundamental, some relatively minor, are required to adjust the nature of the CDM such that it can play a very important role in the future. We see the effort of reforming the CDM M&P as a stepping stone towards anchoring the CDM deeply in the 2015 agreement and giving it back the relevance it deserves. Through the reform process we envisage the CDM to become an even more effective and credible tool, embraced by all Parties, that is fit for a range of purposes, including, but not limited to, its original role of generating offsets for Annex-I countries. Beyond that, the CDM could become an important instrument for supplying domestic offsets, for example in the emission trading schemes of developing countries, contribute to NAMAs or play a role in result-based payments and the disbursement of funds of multilateral climate facilities such as the Green Climate Fund. We commend the CDM EB for creating the opportunity for voluntary cancellation of CERs, which we see at the heart of such extended uses of the CDM. Both host countries and buying countries can use the tool for achieving net mitigation through CDM projects, The exact nature of burden sharing between countries should however not form part of the negotiations of the CDM M&P. These should be carried out in negotiations streams under the ADP where they belong in order not to hold up the reform process of the CDM as a tool. In this vein, the concept of net mitigation, which we generally support, should not become a mandatory component of the CDM M&P given that it critically touches upon burden sharing aspects better dealt with outside the instrument itself. We believe, however, that the M&P should be reformed in such a way that it facilitates fair burden sharing at different paces for different countries.

We call upon the Parties to recognize this opportunity and act now to make the changes necessary to enable the CDM to contribute real benefit to Host Parties and the fight against climate change.

A. Composition of the Executive Board

The PD Forum and CMIA considers that the impact of changing the numbers of members of the Executive Board (EB), quorum rules etc. to be too great and therefore we do not propose to change the number of voting members at this time. That said, we support the inclusion of two observers each from Civil Society and Business and Industry NGOs (broadly representing the Private Sector). This is the model adopted by the Green Climate Fund. In due course it may be appropriate to consider allowing these observers to vote.

We support the reallocation of one existing Non-Annex 1 seat to an LDC on the basis that Least Developed Countries have a very significant role in the CDM going forward.

We would welcome greater gender balance on the EB and call upon Parties to simply nominate more female members rather than create procedures which require them to nominate more female members.

We support the proposal to limit the duration of engagement with the EB by removing the rule that "terms as alternate members do not count".

¹ UNEP Risoe CDM Pipeline <http://cdmpipeline.org/> ; only 68% of listed projects declared the investment level

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We suggest that now is not the time to create professional positions for key members of the EB however, if and when market conditions improve and the volume of work increases, then this point may be revisited.

We believe that the existing conflict of interest procedures are proportionate to the risks created for EB members who are serving members of DNAs, project developers, investors etc however, we believe that a major conflict of interest exists where EB members also serve as negotiators for Parties at the CMP. The EB reports to the CMP and CMP directs the EB and as such, members of the EB should not be in a position where they report to themselves and give themselves direction. Such a relationship is not tenable or appropriate in a well-governed organisation. For this reason we propose that EB members shall not be members of Delegations to the CMP during their appointment to the EB.

B. DOE Liability

The PD Forum and CMIA believes that this is a critical issue and that the proposal to simply delete the requirement in the existing Modalities and Procedures would do a great dis-service to the CDM. The CDM is the only baseline and credit mechanism which can deliver true environmental integrity and addressing this issue will remove one of the final barriers to this goal. In doing so, the CDM sets itself significantly above all voluntary and national schemes and can ensure that it becomes a mature mechanism which is fair not only to today's participants but to future generations who will be forced to deal with the problems we create if we do not ensure environmental integrity.

It is also vital however that this issue is resolved once and for all and in a way that does not place undue burden on and uncertainty for DOEs. Given current market conditions, many DOEs are questioning the value of CDM accreditation. The CDM community has already lost two key DOEs and if we lose many more, there will be no infrastructure or institutional memory to perform the key roles which have been assigned to them. Uncertainty over liability costs, alongside the costs of accreditation, is a major factor in the decision of DOEs to leave the market.

The technical paper explains that there are two issues: environmental integrity and DOE performance.

The PD Forum and CMIA's proposal addresses both issues. The proposal includes 4 elements:

- 1) We propose that projects pay an Environmental Integrity fee of [2]% of CERs at issuance. These CERs are held in an insurance account and are called upon and cancelled at times when errors have been detected. This account is managed to meet the demand, increasing or decreasing the fees as required. However, this account is NOT allowed to sell any emission reductions into the market as this is a form of competition with the remaining CERs which PPs receive and, at times of surplus, could result in depressed prices, exacerbating the impact of the fee.
- 2) The strict liability for DOEs is altered to fraud and professional negligence and at times when such actions are proven, DOEs will be fined up to [10] times the financial value of the contract[s] under which the work was performed. This gives DOEs a clear level of indemnity which they can manage by ensuring that they do not act fraudulently or with gross negligence and through insurance. Fines from DOE's can be contributed to the adaptation fund.
- 3) The duration of the liability shall last for the longer of [7] years or until the end of the current crediting period of the project.
- 4) DOEs shall not inflate their costs for the provision of validation and verification services to cover the costs of insurance premiums.

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C. PoA

We support the proposal to elaborate a separate section containing the modalities and procedures for PoAs

D. Duration of the Crediting Period

PD Forum and CMIA believe that a review of the duration of the crediting period is long overdue. Since embarking on the CDM we have come to understand several key factors:

- The risks and barriers to investment are not the same in all Non-Annex 1 countries and as a result, a "one-size-fits-all" approach simply encourages investors to find the most profitable investment situations. This has resulted in the un-even distribution of CDM activities which is currently observed today;
- Some technologies need support for a relatively short period of time, being further supported by underlying cash flows, whilst others have no other source of income and require financial support until such time as the host country regulates to require certain levels of performance;
- Many CDM projects overlap with low carbon policies to a greater or lesser extent and as more and more countries undertake their own mitigation activities, export of emission reductions from some kinds of projects becomes increasingly incongruous, for example where a host country economy subsidises a renewable energy project with a feed in tariff yet 100% of resulting CERs are transferred out of the country; and
- When investing at expected returns above 10%, it is difficult to justify that revenues after 15 years or more have any bearing on the investment decision. Such prolonged crediting periods will continue to award CERs to projects long after the original investment terms have been fulfilled and as such constitute free rent.

Varying the duration of the crediting period offers a very flexible way of addressing these issues and the PD Forum and CMIA propose that this could be done by giving the Host Country DNAs the responsibility of defining the crediting period for different types of projects in different geographic locations whilst following guidelines from the Executive Board. Such guidelines could, for example, stipulate that advanced developing countries may allow a maximum crediting period of [7] years whilst LDCs may apply up to [21] years, with other countries selecting and justifying their choice between these two numbers. Pure abatement technologies can continue until such time as the host country's low carbon policies and measures regulate differently. At the end of the crediting period, assuming the project activity continues, the project starts to contribute to host country mitigation.

Alternatively, the duration of the crediting could be specified in methodologies according to country groupings or in standardized baselines and additionality tests.

E. Additionality

The PD Forum and CMIA do not think that the additionality test and criteria should be debated at the level of the CMP but rather that they should be set and managed by the EB. We note that Additionality and the duration of the crediting period are linked because for many technologies, CDM support accelerates the implementation or penetration of technologies which are additional at the time of the decision to invest but do not remain additional beyond the end of a crediting period. This indirectly creates a limit to the period of time for which a given technology could be considered to be additional and form the basis of a new registered project activity. Hence limiting the duration of the crediting period for such technologies addresses many of the failures of the additionality test reported to date.

We strongly endorse the progress on standardized approaches as these reduce risks, transaction costs and barriers to CDM related investment and if these concepts were systematically combined with limited duration of crediting periods as described above, we believe that many of the problems with the credibility of the CDM would very substantially addressed.

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F. Enhanced role for DNAs

The PD Forum and CMIA support calls for formalized definition and standardisation of roles and responsibilities of DNAs, including but not limited to, elaborating transparent procedures for the issuance, suspension and potentially ultimate withdrawal of Letters of Approval. Many host countries, donors and multi-lateral development banks have invested significant resources in DNA capacity. Looking to the future, we see a major role for DNA-type institutional infrastructure and would point to the roles of competent authorities in the early years of the EU ETS as the potential future of DNA resources. We also note that the Green Climate Fund calls for a National Authority, the potential need for some kind of coordinating entity for NAMAs etc., and we urge Host Parties to seek to unify these departments under one body to make best use of the support and capacity building resources which may be made available.

G. Simplification of the project cycle

The PD Forum and CMIA support measures to simplify the project cycle and reduce transaction costs. We support the extension of positive lists for additional technologies, enhanced scope for micro scale projects and greater use of standardized approaches. We support the proposal to assess micro scale activities at the level of installed equipment rather than the cumulative level, on the basis that the current rules create real barriers to the roll-out of desirable technologies and encourage economically inefficient and perverse behaviour. This is particularly relevant for micro-scale PoAs where the small-scale thresholds should be dropped in favour of no artificial boundaries for micro-scale CPAs. We note the value that validation provides to the investment cycle, with a positive validation opinion often triggering binding investment decisions. Therefore steps to allow validation at the first verification should allow flexibility over the validation stage. We also request that the project cycle procedures are modified to accept a draft monitoring plan at validation and a final monitoring plan to be validated during the first verification, as this allows the PPs time to elaborate an accurate monitoring plan after the equipment has been installed rather than before.

H. Additional points for consideration:

The PD Forum and CMIA propose that **the limitations on certain categories of projects** be extended to include coal-fired technologies unless coupled with carbon capture and sequestration. We believe that technologies which lock in the use of the most carbon intensive technology without abatement in the form of capture and sequestration have no place in the Clean Development Mechanism.

We propose that **a time line for the second review** of the M&P is set to be initiated at CoP 24 in 2018 with a view to completion at CoP 26 in 2020.

Conclusion

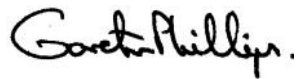
The PD Forum and CMIA strongly believe that if the Parties were to make these changes to the CDM, CERs could once again assume an important role in the international fight against climate change. CERs with these kinds of quality criteria could stand "shoulder to shoulder" with allowances from the finest Emission Trading Scheme. They would be significantly fewer in number but of such quality that importing Parties would not feel the need to apply qualitative restrictions. Quantitative restrictions on their use would continue to apply in order to respect the concept of supplementarity, but the tables would be even if host countries are similarly cancelling a proportion of CERs such as the generation of CERs is supplemental to domestic action.

The CDM brings unparalleled levels of transparency and rigour to the investment of funds in low carbon technologies and has demonstrated that it is feasible to transfer material quantities of investment into new technologies in developing markets, bringing sustainable development and helping host countries to leap-frog old technologies and avoid the lock-in of carbon intensive energy systems.

There remains much to do but at the same time, there is much to build on.

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Kind regards,



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