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Subject **PD Forum response to the call for input on efficiency in the operation of the CDM and opportunities for improvement**

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Dear Mr. de Jonge,

The Project Developer Forum (PD Forum) warmly welcomes the opening of the above call for inputs by the Executive Board at its 46th meeting. The PD Forum also appreciates and welcomes the initiative shown by both the Executive Board and the Secretariat to examine areas such as transparency and access to decision of the Board, revised and enhanced procedures for CDM Programme of Activities, accreditation procedures and standards for DOEs and timelines for registration and issuance related processes. Incorporating changes in these areas would help further develop the strength and integrity of the overall system.

As a key representative of the project developer community the PD Forum is pleased to offer its perspective on areas where improvements could be instrumental in achieving greater efficiency within the CDM architecture:

- A. Enhancing the supervisory role of the CDM EB and streamlining the CDM bodies' decision-making processes
- B. Improving communication lines with stakeholders and stakeholders' participation
- C. Indexing and publishing of decisions, legal value of precedent decisions and right to a second hearing
- D. Ensuring decisions are not applied to projects on a retroactive basis
- E. Providing a clear rationale for decisions
- F. Helping decision makers appreciate the importance of decisions which can be effectively / efficiently applied on the ground
- G. Filling the critical gaps in the guidance:
 - i. Operationalising CDM Programme of Activities (PoAs)
 - ii. Incorporating the concept of materiality into CDM processes
 - iii. Defining an acceptable level of assurance
 - iv. Providing Methodology Tools
- H. Rationalising DOE penalties
- I. Continuously improving the UNFCCC CDM website

A. Enhancing the supervisory role of the CDM EB and streamlining the CDM bodies' decision-making processes

Delegating responsibility for technical aspects of administration (e.g. processing of requests for reviews, approving corrections etc.) has a significant potential to free up the EB's time so increased focus can be placed on strategic issues (e.g. improving efficiency). The need for this enhancement is evidenced by agenda items repeatedly being postponed from meeting to meeting.

The allocation of time during EB meetings between general issue/guidance and case-specific decision-making is currently unbalanced: the majority of EB meetings' time is spent reviewing projects on a case by case basis with the result that insufficient time is allocated for the EB to discuss and decide on general guidance and other non project-specific issues¹.

Moreover, the current decision-making process, particularly in regards to registrations and issuances, is onerous and inefficient. In order for a project to be registered or for credits to be issued, the current process of "audits" is:

- i. DOE audit (validation/verification);
- ii. Secretariat completeness check; and
- iii. Full document review during the 'requesting registration/issuance' period:
 - a. By Secretariat
 - b. By the RIT

The process should be streamlined to focus upon making the system more efficient and to avoid duplication, while still maintaining environmental integrity.

The need to streamline decision-making is also demonstrated through certain issues that have been pushed back and forth between the EB and Meth Panel. A prime example of this is biofuels methodologies. This issue has been discussed since the inception of the CDM, yet years later there still exists but one biofuels methodology (AM0047) which has very limited applicability². While various related issues and methodologies have been going back and forth between the Methodology Panel and the EB, it is unlikely that substantive progress will be made absent an EB commitment to further discuss these issues and make a progressive decision. In order to proceed, it is essential that the EB discusses the issues further and makes a progressive decision.

Suggested improvements include:

- Recommendations on review outcomes to be made by Secretariat and endorsed by sub-committee of EB members outside of scheduled EB meetings;
- Corrections to be signed off by Secretariat rather than having to be endorsed by the Chair of the EB;
- Some EB roles to be made full-time (e.g. Chair and Vice Chair). Whereas we understand that it is more convenient for the holders of this position to keep their other assignments, we are convinced that the CDM benefits greatly from a full-time Chair and Vice Chair. A possibility would be to extend the mandates for these two positions from one year to four years;
- Fixing the starting date of the crediting period (e.g. 6 month after start of the validation -or later if suggested within the PDD- or on the later of (i) commissioning or (ii) 8 weeks after

¹ For example, during EB 46, there was not sufficient time to review the following decisions (from the EB 46 meeting minutes):

- issue of permanence (para 17)
- draft guidance on the barrier "first-of-its-kind" (para 27)
- draft guidance on the application of common practice analysis (para 27)
- the input received as a response to the call for inputs on the proposal for the enhanced barrier test (para 28)
- an assessment of approved methodologies and registered project activities with a view to assessing the extent of project activity types covered by the applicability of the proposed guidance (para 28)
- draft guidance on an accurate plant load factor for wind power project activities applying ACM0002 taking into account the variability of the wind parameters and gaps of data (para 30)
- Code of conduct (para 96)
- privileges and immunities (para 97).

In addition, the long-awaited guidance on post-registration changes in the PDD is still not formally included on the EB agenda.

² Note there are no projects registered using AM0047 to date, despite the methodology being available since 16 February 2007.

submission for registration), irrespective of the time demand for the completeness check and any request for review. Such a step would ensure the proper realisation of an investment plan according to the original design as presented in a PDD;

- Hiring an independent consultant, with proven records of expertise in administrative process reviews, to analyse the current procedural arrangements, identify efficiencies and suggest areas for improvements;
- Working to reduce the number of projects requiring deviations and review, the number of methodologies requiring clarification and revision, and the number of monitoring plans requiring revision by implementing the proposals below, particularly concerning focus on significant issues and accuracy (see sections G.ii and G.iii below); and
- Establishing clear timelines for the process of approval of the new methodologies and of revisions to the existing methodologies, with a timeline for each proposed methodology or a revision being reported on the CDM website.

B. Improving communication lines with stakeholders and stakeholders' participation

Clear communication is crucial to ensuring that all stakeholders understand their respective roles and responsibilities, and that expectations are aligned. This would also improve efficiency via smoother validation and verification activities, and subsequently fewer requests for reviews and reviews.

Suggested improvements include:

- Quarterly interactive forums and/or webinars with representation from all relevant stakeholders (EB members, Secretariat, DOEs, DNAs and Project Developers) to review progress and discuss concerns;
- Quarterly technical training sessions, open to all stakeholders, but especially focused at DOEs, Project Developers and Secretariat staff, to work through 'good' and 'bad' examples of implementation of rules, reasons for requests for reviews etc, with a view of calibrating expectations and allowing all stakeholders to better understand how the EB interpret their own guidance. This could take the form of interactive workshops and/or webinars to encourage wide participation;
- Formal guidance to stakeholders on issues repeatedly flagged through requests for review (e.g. 10% benchmark issue for Chinese hydro-electric projects);
- In certain cases, project developers and DOEs have been required to nominate a contact person for the review process including for a conference call in case the EB wishes to address questions to him/her during the consideration of the review at its next meeting. However, this provision is rarely used by the UNFCCC. Greater use of this approach will improve communication and understanding which could avoid significant delays in the entire process;
- The Secretariat is encouraged to nominate internal focal point persons dealing with each specific project under consideration and to communicate their name to DOEs and project participants to streamline communications; and
- In connection with the above point, direct communications (e.g. though conference calls) should be enabled and encouraged between project participants/developers, DOEs and the Secretariat staff assigned to each specific project. This would greatly enhance the communication lines, considerably speeding up the process of clarifying any issue that may arise from the Secretariat's check of the project documentation. Transparency issues can be dealt with by issuing notes which can be made available to relevant entities.

C. Indexing and publishing of decisions, legal value of precedent decisions and right to a second hearing

Since its inception, the EB has issued a very significant volume of decisions and guidance. The lack of a rational categorisation and indexing system makes it very difficult for Project Developers to keep constantly up-to-date with the latest applicable version. In addition, despite the work initiated by the EB at its 45th meeting, there still remains considerable uncertainty over the nature and hierarchy of many of the documents adopted by the Board. Relevant guidance for project participants often remains scattered across different UNFCCC website locations, in form of EB meetings annexes, with no clear, content-based links between different documents.

Suggested improvements include:

- Advancing the work on the definition and classification of different document adopted by the EB;
- Clearly define a pyramidal hierarchy of documents to cope with eventual inconsistencies or conflicts;
- Setting up a functional indexing system for decisions, organising them on the basis of their content, which must include a clear system to identify the latest versions to ensure that all of the EB's proceedings are 'accessible, transparent and up-to-date for the appropriate users'³;
- Appropriate precedent setting should be indexed too. A request for deviation approved for a particular project should be accepted for other projects with similar scenarios without need for deviation approval by CDM EB. Issues accepted by CDM EB following request for review/review on a project should form precedent for other projects. Rejections should not form precedent so that there remains room for improvement to the CDM; and
- Finally, a process for project participants and DOEs to request the reconsideration of decisions of the EB (appeal process), in cases of project activities being refused registration or a requested quantity of CERs not being issued, with the aim of ensuring that due process has been followed, should be designed and implemented.

D. Ensuring decisions are not applied to projects on a retroactive basis

The 'non-retroactivity principle' is largely recognised as a general principle of law, instrumental to ensuring that a regulated community within an administrative system can rely on a minimum level of legal certainty. We understand that certain EB members are of the opinion that new issues identified during the RIT's/Secretariat's review constitute simply new ways of confirming already existing criteria and the PD Forum agrees, in part, with this interpretation. However, the waves of questions raised clearly evidence the learning curve of the assessors at the secretariat. For instance, currently, many hydro projects' coefficient of effective electricity supply is questioned. While this is certainly relevant to confirm the old criteria of additionality, a simple consultation with a technician expert in the industry would show the reasoning behind this industry-wide applied coefficient. If the EB later decides that more information on the calculation of this coefficient should be included in the validation report, then such guidance should be clearly issued, not via a request for review, and applied only to projects that have not yet started validation or, at least, not yet been submitted for registration.

Furthermore, in several cases there have been questions posed to project participants by the Secretariat through the DOEs of the validity of the project at verification and issuance stages, without justification and not based upon any CDM rule or specification of the relevant methodologies. Such late stage decision-making qualifies as retroactive review of an approved project and is contrary to establishing a predictable implementation framework for CDM projects.

When project participants have acted in good faith according to the rules in force before the adoption of the new decision by the EB, they should not be adversely affected by newly issued guidance. Legal certainty achieved through the application of the non-retroactivity principle is paramount to increase

³ A good example of indexing and classification of decisions can be found at: <http://www.cdmrulebook.org/>.

investor's confidence in the CDM architecture. This is also a clear wish by the CMP as expressed in its decision from last December in Poznan⁴.

Suggested improvements include:

- Appropriate 'grace periods' should be introduced and respected for *any* decision of the EB, and not only for methodologies and tools.

E. Providing a clear rationale for decisions

The decision-making process within CDM institutions is such that some decisions are made with a lack of justification. When an affected project participant asks about the reasons behind a particular decision, for example during consideration of a new methodology, rarely if ever is an explanation given via the Secretariat from the Methodology Panel. Instead, the Secretariat recommends making a formal request for clarification after the approval of the methodology that would only delay the process further. While the EB and Secretariat strive to make decisions with integrity, this seeming unwillingness to educate stakeholders can sometimes be misinterpreted (in the press, for instance) as evidence of 'back room dealings'.

Communicating the rationale for decisions on projects and increasing the breadth of project information currently available on the CDM website, in addition to responding to basic procedural rights principles, would enable stakeholders to learn more effectively from requests and decisions from the Board. This should avoid similar requests from the Secretariat/EB featuring in reviews discussions across several EB meetings.

Suggested improvements include:

- Publication on the CDM website of the rationale for the decisions to put projects under review and to reject them;
- Publication on the CDM website of the review clarifications and answers provided. The review scopes currently available on the CDM website are generic and do not facilitate a 'learning by doing' approach;
- Publication on the CDM website of the documents submitted by the project participants and the DOEs in response to the reviews, as is done for requests for review, unless the DOE requests otherwise for confidential documents;
- Standardisation of the wording for similar requests and decisions in order to avoid misunderstanding;
- Development of a dynamic compilation and/or of a database which would allow for analysis of the reasons behind requests for review, review clarification requests and rejections; and
- Webcast relevant sessions of EB meetings, where the rationale for decisions on project are discussed; and
- Organisation of webinars to discuss outcomes of EB meetings with DOEs and Project Participants.

Moreover, to promote investor confidence, any decision taken should be consistent with the body of decisions previously adopted on the same issue. In cases when inconsistencies or new interpretations of the rules occur, the EB should clearly justify the ruling and provide a clear rationale for the departure. As an example, some requests for reviews required the CDM revenue to be taken into account in the financial analysis although this is not a criteria/requirement.

⁴ The principle of non-retroactivity has been reiterated by CMP.4, in Decision -/CMP.4, which requests the EB to *adhere to the principle that any decision, guidance, tool and rule should not be applied retroactively*.

F. Helping decision makers appreciate the importance of decisions which can be effectively/efficiently applied on the ground

Project developers submit methodology change proposals and new methodologies (draft PDDs are required for new methodologies and revisions, but not for clarifications). However, the final decision on the methodology changes is made by the CDM EB with input from the Secretariat, Methodology Panel or Small Scale Working Group etc. It is too often true that the methodologies cannot be applied on the ground or with the corresponding PDD. While the environmental integrity of newly adopted methodologies or methodology revisions is paramount, the UNFCCC bodies should also focus upon establishing methodological solutions which are practical and feasible on the ground. Such a process begs cooperative consultation with project participants.

G. Filling the critical gaps in the guidance:

G.i. Operationalising CDM Programme of Activities (PoAs)

Nine PoAs have been submitted for registration since the PoA procedures were published in June 2007. Many more PoAs are in the pipeline, often in sectors with few projects feasible in traditional CDM but with high sustainable development benefits and located in countries with few traditional CDM projects (including LDCs). Unfortunately, the current risks and uncertainty of PoA development hampers their progress.

The work on revising the PoA procedures started by the Secretariat and the EB is likely to alleviate some obstacles to PoA development. However, it is paramount that the revised procedures address all the key issues linked to PoA implementation, including:

- Starting date of the CPAs, by allowing CPAs to start after the starting date of the PoA provided it can be clearly shown that the driving force behind their implementation is the PoA (including for example definition of clear criteria for inclusion of CPAs under the PoA, CDM consideration);
- Additionality demonstration, by clarifying the approach to take at the PoA and CPA levels;
- Debundling, by simplifying the procedure to follow for micro units;
- Methodologies, by enabling the use of several methodologies under a PoA;
- Inclusion of CPAs under a registered PoA and DOE liabilities, by defining a clear procedure for the review of a CPA identified as wrongfully included (including timeline, stage wise approach, opportunity for project participants and DoEs to provide inputs during the review process); and
- Simple procedures on how to deal with post-registration changes to the design, stating which changes are acceptable and which ones are not.

Furthermore, we propose that the EB promotes the establishment of a working group with the specific mandate of developing viable solutions to overcome the issues identified above, with representation from DOE, Secretariat, EB and Project Developers.

G.ii. Incorporating the concept of materiality into CDM processes

Resources and efforts of DOEs, Secretariat and the EB should focus on significant issues⁵. The recognition of the concept of materiality, which is well established and applied throughout financial and installation-based GHG accounting, would greatly improve the efficiency of CDM operations by allowing DOEs to focus – during validations and verifications – on identifying issues that are of material significance. Similarly, establishing levels of materiality will help to reduce the number of requests for review at validation/verification, clarifications, deviations and revisions of methodologies

⁵ *Significant issues* should be considered as those which are not minor issues. A *minor issue* can then be defined as any issue that does not affect the environmental integrity and/or additionality of a project in a decisive way, and that will affect CER volume by less than 4%.

and monitoring plans. Again, this will free up secretariat and EB to focus on the more executive, vs. operational issues.

Materiality, with reference to the CDM, can be considered in two forms, quantitative and qualitative. Quantitative materiality relates to establishing a materiality threshold for the emission reduction calculations themselves. This concept of materiality is well understood and applied in practice in financial accounting as well as emissions accounting (eg the EUETS⁶). We propose that, as with financial auditing, the determination of materiality would be a matter of professional judgment of the DOE following appropriate guidance from the EB.

A concept of qualitative materiality also needs to be established when referring to the more descriptive elements of a PDD or monitoring plan. We propose that the EB could initially adopt a bottom-up approach for re-occurring issues which establish a materiality threshold for such issues. As an example, the EB could clarify that a monitoring plan revision is not necessary in the case of (i) change of emission factor calculation from ex-post to ex-ante, (ii) meter location, (iii) meter calibration, (iv) and meter accuracy change, as long as the new circumstances are still in line with relevant national regulations and the CDM methodology.

A bottom-up approach should also be applied to design changes after a project's registration. Such changes are often outside the control of project participants, and are not foreseen or foreseeable at the time of developing the project or the submission for registration. A PDD is written during the design and feasibility stages and registration will normally occur before commissioning. Changes to meters, equipment, etc. sometimes occur as part of the construction and commissioning process and this should be recognised within the mechanisms set in place by the EB. Although design changes are an inevitable part of project development, environmental integrity can still be safeguarded while adopting a more business-friendly approach, for example by means of a bottom-up positive list of design changes that can be scrutinized and "acknowledged" by the verifying DOE.

G.iii. Defining an acceptable level of accuracy

Throughout the VVM, there is mention of the word "accurate" (e.g. para 30, 64); para 196 also states "The accuracy of equipment used for monitoring is in accordance with the relevant guidance provided by the CDM Executive Board ". However, at no point in time has the Executive Board ever provided such guidance. Defining this level of accuracy (providing, for instance, permissible levels of uncertainty for the parameters monitored) will further improve the efficiency of validations and verifications by providing the DOE with a level of accuracy to which they can refer, particularly in regards to checking the calibrations and maintenance of equipment (see also point (h) in this regard).

Paragraph 109 (b) of EB 26 authorizes DOEs to make most conservative assumptions if activity levels or non-activity parameters have not been monitored in line with registered monitoring plan. However, it has been seen that CDM EB has not accepted such assumptions by DOEs during verification and has indeed discouraged DOEs in this regard by 'requesting reviews' of such cases.

In addition, methodologies are often not useable because of the present exaggerated request for accuracy. AM0042 for example, could greatly support sustainable development in some of the poorest countries. However, the requirement to measure the methane content in the flue gas stack by a competent agency and with regularly calibrated meters renders most planned projects impractical because – quite simply – the implementing organization does not have the expertise and organizational body to support such an elaborated monitoring management. Another example is the newly approved methodology AMS-III.Z. on brick production: benchmarks and conservative default values could be included as an alternative for those project developers that do not have the capacity to get the required level of assurance/accuracy.

G.iv. Providing Methodology Tools

One method to increase efficiency in the CDM process while at the same time enhance overall accuracy would be to make available methodology related calculation spreadsheet tools.

⁶ It is worth noting here that the EU EUTS applies a materiality threshold of 5%.

Currently PPs develop Excel (or other) spreadsheets based on the methodology and version being applied in the PDD. The development of the spreadsheet is time intensive and subject to many misinterpretations and formulation errors. The completed spreadsheet is then scrutinized during both validation and verification activities undergoing a cell-by-cell check to ensure the calculations have been properly developed/applied and the results are accurate. This audit process is also a very time intensive process for the DOEs and it must be recompleted with every change to the PDD and supporting spreadsheet. Once the DOE confirms the spreadsheet, this supporting document is again reviewed as it is submitted to the completeness check and further review by the RIT.

If approved spreadsheets applicable to each methodology and version were checked once, approved, security protected, and made available for optional use by the DOEs and PPs, the need to reinvent spreadsheets that must be confirmed via time intensive auditing could be averted.

H. Rationalising DOE penalties

The success of the CDM largely depends on the technical expertise, credibility and reliability of the accredited Designated Operational Entities (DOE) and the results of their work. According to the CDM governance structure the DOEs are acting as a technical expert and on behalf of UN institutions, in particular the CDM EB.

It is the DOE's role to validate the compliance of a potential CDM activity with the applicable rules (i.e. CDM eligibility and methodology applicability) before registration and verify the compliance with such rules after the registration in order to determine the level of emission reductions achieved by the activity.

In order to achieve and maintain system credibility and reliability and to enforce DOE compliance, a sanctioning catalogue should be introduced taking into account (i) the general objective of the CDM, i.e. to ensure that all emission reductions certified are real, measurable and meet the CDM requirements, and (ii) the general principle of proportionality of actions aimed at enforcing compliance. The catalogue of measures should contain the following sanctions, which could be also used in combination depending on a case-by-case analysis of the breach:

- i. Formal warning (for minor insufficiencies),
- ii. Proportional monetary fines,
- iii. Temporary suspension of the accreditation for specific scopes only,
- iv. Withdrawal of the accreditation.

With regard to the points (iii) and (iv) above, DOEs should still be allowed to continue processing existing projects, and not be allowed to start validation/verification services for new projects.

The use of such measures must take into consideration the level of non-compliance exercised by the DOEs. Thus a warning should be sufficient where it achieves compliance and the irregularity is minor in nature. The most severe sanction, i.e. withdrawal of the accreditation, should be applied if the DOE *intentionally or wilfully* infringed the applicable rules (e.g. knowingly using false information as a basis for the assessment of a project).

It is worthwhile to note that monetary fines should not be used to compensate the party (the investor or other entity engaged in the CDM project) contracting the DOE as this can be dealt with on the basis of the private contractual relationship between the DOE and such party in the current system and thus the monetary fining shall have the one objective of achieving compliance.

I. Continuously improving the UNFCCC CDM website

Over the past months, a number of key improvements have been introduced to the UNFCCC CDM website. It is important however, that the improvement process continues to be advanced, as the CDM website constitutes a key tool in the Project Developers' daily activities.

In addition to the improvements listed above (see section 'Providing the rationale for decisions'), suggested improvements include:

- Making available the report from the Accreditation Panel (AP) meetings as soon as possible after each meeting on the AP section of the website;
- Introducing a tracking system for requests for issuances, alike to the one recently introduced for requests for registration;
- Introducing a tracking system for requests for revision of monitoring plans, requests for deviation and the renewing of crediting periods;
- Adding a search function for methodologies related search, similar to the one for project related search. There could be two drop-down menus: one with the list of methodologies and the other one with the version of the methodology, with the option to select "all" for the versions. This would help searching among all the clarification, deviation and revision requests, which is currently cumbersome;
- Enabling the search for all request for reviews and responses for particular methodologies. When and if review communications become transparent, then to be able to search for these too. At the moment the user has to go to each and every EB meeting summary and then search under the individual project name; and
- Developing and making available on the website databases for reference values used in project activities (by compiling e.g. Grid factors per country/region, IRR benchmarks per sector/country etc.). This would greatly facilitate crosschecking of values for Project Developers and DOEs alike.

Yours Truly,



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Chair of the PD Forum