

Submission

To: UNFCCC Secretariat
From: Global Public Policy Institute
Subject: Second Review of the Kyoto Protocol pursuant to its Article 9
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The third Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol (CMP3) in paragraph 6 (d) of the decision *Scope and content of the second review of the Kyoto Protocol pursuant to its Article 9* invited Parties and relevant organizations to submit their views on:

6 (c) - Privileges and immunities for individuals serving on constituted bodies established under the Kyoto Protocol; and

6 (d) - the scope, effectiveness and functioning of the flexibility mechanisms, including ways and means to enhance an equitable regional distribution of clean development mechanism projects¹

The Global Public Policy Institute welcomes this opportunity to exchange views and submits its views on the issues which need to be considered in order to further improve the governance structure of the Kyoto Protocol's Clean Development Mechanism (CDM).

1. Background

As the market created by the CDM develops and the number of projects grows it becomes evident that the CDM governance, as it currently stands, cannot fully and impartially meet the requirements of a well-functioning international regulatory system. Criticism from market participants over the CDM's institutional performance abound.

The main flaws which have been often pointed out in the current system can be summarized as follows:

- *Transparency* – problems relating to a lack of transparency regarding the activities performed by the CDM Executive Board (EB) and a deficiency of communication channels between the main CDM regulatory bodies and project participants. Although the CDM approval process provides for public participation at the project level, involving both local and international stakeholders, there is no direct communication between the EB or its panels and project participants. There is not even a guarantee that private entities will be informed about deliberations regarding their projects.
- *Predictability* – the decisions and interpretations of the EB are often hard to predict and many of its decisions have come as a surprise to project participants and technical project experts. The EB does not provide any rationale for its decisions and does not always follow its own precedents. There are a number of issues that increase the risk of

¹ *Review of the Kyoto Protocol pursuant to its Article 9*, para. 6 (c) and (d), FCCC/KP/CMP/2007/L.8 of 14/12/2007.

inconsistent decision-making practices by the EB, namely: (i) the lack of institutional memory and the rotation of EB members; (ii) insufficient technical expertise; and (iii) politically motivated conflict of interest issues among EB members.

- *Efficiency* – the complex and burdensome CDM project cycle has raised valid objections from many stakeholders. Whether it is the approval of new baseline and monitoring methodologies, which can take up to two years, differences in interpretations between the EB and its subordinated Methodologies Panel (as in the case of the decision on double-counting of biofuels²), or the insufficient and ineffective communication between project participants and CDM bodies, the CDM process remains full of pitfalls and stumbling blocks, rendering the approval of a CDM project a time consuming, cumbersome and risky business.
- *Review Process* – the EB’s decisions have direct effect on private entity rights. While the EB is effectively a regulatory agency whose decisions have significant legal and financial consequences for private sector participants in the CDM, the EB is not subject to the usual political and legal controls common to domestic regulatory agencies. There is no independent review procedure within the CDM regulatory framework to which aggrieved entities may appeal for a review of an EB decision. This gives aggrieved entities, who may have suffered damage from EB decisions, no right of recourse and essentially little if any due process rights.

The above issues are inconsistent with commonly accepted principles of good governance and administrative procedure. These gaps in providing access to due process do not only put at risk the confidence of Parties and non-state actors in the Mechanism, they also create a risk for the Board itself and its members. The Kyoto Protocol does not extend immunities to the Executive Board or its members exposing the Board to the risk of being held accountable in domestic courts. Provided that an expert serving on a constituted body of the Kyoto Protocol was acting in the performance of his official capacity, the body will be liable for his acts. In the absence of a review mechanism and other basic procedural rights, however, claimants may seek compensation for damage suffered from actions of the body or its Members and national courts may decide to review these claims. This increases the risk that members of the Executive Board could be held personally liable for its activities on the Board.³ The CDM is unlikely to survive as a global mechanism if it is subject to litigation in various Parties and, consequently, differing judicial interpretations of the rights and obligations under the Kyoto Protocol.

In the sections that follow, we put forward proposals to address these problematic issues that impact negatively in the institutional framework of the Mechanism and curtail the evolution of the CDM as one of the cornerstones of the international emissions trading market.

² Meeting Report, EB 26, Annex 12.

³ From October 2006 to August 2007, twelve complaints were made by private legal entities, the majority of which against to the decisions taken by the EB. *Note by the Secretariat, FCCC/KP/CMP/2007/2 of 13/11/2007.*

2. Bringing Transparency to the CDM

The CDM needs to rely on transparent decision structures to enhance the acceptability of the Mechanism and the accountability of its institutions. In this respect, we propose establishing basic due process procedural rights to the parties involved, together with a proper set of compiled rules to assist in the reference and management of the several decisions that govern the CDM.

Procedural Rights

In order to bring transparency to the CDM, entities that are directly affected by the decisions of the EB should have the right to be heard before a final decision is taken. The tendency of the EB to deal with an increasing number of issues behind closed doors gives grounds for concern. The EB meetings should be embedded in an open, transparent process that gives stakeholders a right to engage in opened dialogue with decision-makers.

Other relevant procedural rights, such as the right to petition, or pronouncement, and unrestricted access to EB meetings should also be provided. These would ensure transparency and facilitate communication between interested parties and the EB.

In addition, the EB should state the reasons which have informed its decisions and establish clear timelines for official responses and action.

Creation of a Focal Point

Communication would be made more efficient and reliable with the establishment of a focal point within the UNFCCC secretariat to handle complaints from project participants and DOEs. Such a focal point would not have decision-making responsibilities, but serve an entirely administrative function of ensuring efficient and consistent interaction with the EB, its panels, and the review mechanism.

Compilation of Rules

In addition to the adoption of procedural rules, we recommend making available the complete set of CDM rules in a comprehensive and easy accessible format. As it stands today, anyone who does not spend a significant amount of time trying to understand how the CDM functions (including many project participants) will inevitably be lost in the thicket of decisions and interpretations that govern today's CDM. To facilitate fair and transparent application of all CDM relevant rules, the UNFCCC secretariat should make available a compilation of all rules governing the CDM. The three sources of these rules are: (i) the Kyoto Protocol, (ii) CMP decisions, and (iii) EB decisions that are currently spread over a high number of documents and their annexes. The rules should be thematically organized, referenced, and indexed.

Such an official compilation of CDM rules should be maintained and updated by the UNFCCC secretariat. The EB should review the rules periodically and present the updated compilation annually to the CMP for endorsement. In the event that there is more than one version of a rule and a dispute arises, the latest effective version on file with the division should be deemed the authoritative or binding version.

The Catalogue of Decisions is a start in the right direction. However, the catalogue appears to be primarily a search function without any attempt at organizing or collating the plethora of information found in EB decisions.⁴

3. Enhancing Predictability and Efficiency

It is crucial that the various rules and decisions of the EB be applied in a consistent manner to ensure that DOEs and project participants are treated fairly. There are currently a number of issues that increase the risk of inconsistent decisions practice: (i) the lack of institutional memory and the rotation of the EB members; and (ii) insufficient technical expertise. In addition, political interests may play an additional role in influencing EB decisions.

The EB is confronted with an increasing number of technical issues which lie beyond the expertise of its members. The requirements of daily micro-management of project- and methodology- related issues lead to delays in the approval of projects and the review of methodologies, exacerbating to the overall inefficiency of the process.

The EB holds a position of a *de facto* market regulator. Therefore, in order to enhance predictability and efficiency of the governance structure of the CDM, the EB should rise to the occasion and fulfill its role as a credible and efficient market regulator. A first step in this direction is to professionalize the EB.

Professionalization of the EB

The professionalizing of the EB would require the recruitment of full-time salaried individuals whose collective experience spans the entire range of sectors (including project finance, law, business management, engineering and science) and is grounded in practical, project-level experience and knowledge of the CDM. Appointments should be able to be extended beyond an initial employment period to enable retention of institutional knowledge. Technical expertise should therefore be the governing criterion for the selection of EB members. The right of the various geographical constituencies to nominate EB members should not be affected, but nominations should be backed by the technical expertise and experience that the nominee can bring to the EB. EB members could be formally hired as employees of the UNFCCC reporting directly to the CMP in order to minimize the potential for political interference. Further, the creation of a direct reporting channel between the EB members and the CMP would help foster greater accountability.

Staffing the EB with professional staff would also help avoid conflict of interests since individuals are no longer made to serve several parallel agendas and interests. To avoid conflicting interests before and after the time an individual serves on the EB, eligibility to the EB should be limited to individuals who did not hold a position that involved political or legislative decision making on CDM-related matters for a defined period before serving on the Board and should be excluded from such offices for a time after they cease to be active EB members.

⁴ For example, a search for “additionality” yields a total of 327 results, with large numbers of results under each sub-category. This overload of insufficiently organized information is very difficult for the outsider to manage.

Funding and Supporting Staff

In addition, adequate staff should be made available to support the EB in its work. Given the high number of CERs that the EB is expected to issue in the coming years till 2012, the share of proceeds to cover administrative provides an adequate and predictable source of funding.

4. Establishing a Review Process

The CDM should be brought in line with due process requirements and procedural rules guiding administrative processes in the majority of national legal systems. In this regard, we propose the introduction of additional administrative processes and rules into CDM decision-making.

Review Process

The CMP should establish an independent review process which gives standing to entities that are granted rights and obligations under the CDM and guarantees a full review of EB decisions. The review body could consist of a small number of individuals nominated by the CMP competent to hear cases and pass judgment upon claims alleging the violation of procedural or substantial rules governing the CDM. The review body would adopt rules of procedure that would itemize the formal requirements of submissions and hearings as well as other matters regarding the functioning of the Mechanism. The decisions of the review process would have to be final. The review body would be supported in its activities by the UNFCCC secretariat. Its proceedings as well as the considerations for any judgment would be publicly available.

The CDM review mechanism's mandate or jurisdiction should be clearly defined in its constitutive document (preferably, and likely to be, a CMP decision). It is important that the terms of reference for the operation of the review mechanism be clearly set out in the constitutive document. The availability of an accessible and effective remedial mechanism should be made known to all entities which may be adversely affected by a decision of any of the constituted bodies under the Kyoto Protocol, but the scope of its operation should also be emphasized to prevent creating unrealistic expectations about what the review mechanism can achieve.

A potential CDM review mechanism should be empowered to issue binding decisions. Aggrieved parties want an efficient, impartial and effective settlement of disputes. The inability to render binding decisions will hamstring the review mechanism's ability to conclusively resolve disputes and make remedial orders. The CDM appeal mechanism must therefore be a satisfactory alternative to litigation in the national courts.

The review mechanism should be sufficiently funded to carry out its purposes. An inadequately funded office will lack true independence as it will not be able to perform its functions properly. The review mechanism should not be answerable to the EB for its budget, but to the CMP which is the quasi-legislative body which is also very unlikely to be the subject of complaints by project participants (who have very little, if any, direct contact with the CMP).