



Designated Operational Entities
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Subject **Views on possible changes to the modalities and procedures for the clean development mechanism**

-Submission in response to the invitation by the CMP8

At its eighth session, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) invited Parties and admitted observer organizations to submit to the Secretariat, by 25 March 2013, their views on possible changes to the modalities and procedures for the clean development mechanism for consideration by the Subsidiary Body for Implementation at its thirty-eighth session.

The D.I.A. strongly supports the continued efforts of the international community to improve the effectiveness of its flexible mechanisms, here in this context especially of the CDM.

In our capacity as the voice of engaged Designated Operational Entities and Independent Entities we would like to direct attention to those issues which are of special relevance for our member organisations who can refer to more than a decade of direct involvement in the registration process of CDM activities. The following topics are considered to be of special interest for DOEs when discussing changes in the modalities and procedures of the CDM:

- Accreditation
- Significant Deficiencies
- Materiality
- Contractual Relationship
- Programme of Activities
- Appeals Process
- Direct Communication

Accreditation

The recent version of the modalities and procedures for the CDM provided an Accreditation Standard as Annex A of the Marrakech Accords text. While this Annex could be viewed as a starting point or framework for the accreditation of DOEs, it included aspects which were hardly implementable and create obstacles in practical application. Instead of keeping the Accreditation Standard within the highest hierarchical level, i.e. the modalities and procedures, D.I.A. recommends focussing at this level on setting principles for the accreditation such as consistency, impartiality, transparency, confidentiality and competence. The synthesis of such principles shall on the one hand ensure the quality and accessibility of validation and verification services and on the other hand create a level playing field for all DOEs.

The CDM Executive Board should then be required to maintain an accreditation system based on these principles and to make the most recent version of the accreditation standard and accreditation procedure available on its website. Furthermore it is advisable to ensure a regular periodic review of these two documents (e.g. every two years).

Paragraph 4 (b) of the modalities and procedures requests promoting the accreditation of entities from developing countries. From our point of view any review of the regional and subregional distribution of DOEs should take into account the fact that numerous DOEs operate on a global scale and employ many staff in local offices in developing countries. The benefits of a global exchange of experiences are undervalued when promoting accreditation of entities in developing countries in a biased manner. Business reality has demonstrated that the regional distribution is a result of market aspects and not of regulations. D.I.A. members have central offices in annex-I and non-annex-I countries and have never perceived the need for special market protection. Regulatory supervision should not be used to distort what is a global market open to local, regional and international players.

DIA believes that there should be full alignment of the accreditation processes of CDM and JI into a single accreditation. This would deliver a potential for reducing transaction costs. As this would require a mandate for both the CDM Executive Board and the JI Supervisory Board to initiate any such development, we believe the SBI review of the modalities and procedures is an opportunity to promote this.

Significant Deficiencies

Closely related to the issues around accreditation and the actual role of DOEs, we believe it is essential to re-consider the objectives and principles of paragraphs 22 and 24 of the CDM M&P dealing with the issue of significant deficiencies in validation, verification and certification reports and the implicit liability for resulting excess issuance of CERs. D.I.A. supports the suggestions made by the CDM Executive Board that the SBI should elaborate a different set of key principles to recommend to the CMP¹. We consider it essential for the success of the CDM that the principles to be applied in the context of significant deficiencies and excess issuance provide a level playing field for all DOEs and deliver access to DOE services at reasonable costs.

D.I.A. believes it is important that environmental integrity is maintained and supports the principle of rectifying excess issuance. However the impacts on the viability of the DOE model and on the CDM market as a whole would be severe, if the entire responsibility for excess issued credits is placed upon the DOEs. The fact that the CDM EB and CMP have not been able to agree procedures for the implementation of paragraphs 22 and 24 illustrates the point that these requirements are not workable and need to be revised. The members of D.I.A. fully recognise their responsibility and duty to ensure the highest quality in the work they deliver, however attributing liability for excess issuance to DOEs would result in an unacceptable exposure to unquantifiable and therefore unlimited financial risks. Any necessity to manage such risks (e.g. by insurance products) would unavoidably lead to severe negative impacts on the whole CDM, such as increased transaction costs and an amplified imbalance in the regional distribution of CDM activities.

When reconsidering the principles for dealing with significant deficiencies in validation, verification and certification reports and for dealing with excess issuance, D.I.A. recommends SBI to differentiate between:

1. Professional negligence on the part of the DOE (apart from possibly resulting excess issuance);
2. Fraud by an individual within the DOE, or by the DOE as an organisation (again apart from possibly resulting excess issuance); and

¹ Report EB-72, Annex 2

3. Excess issuance, by all possible causes (including professional negligence of fraud by DOE but also other causes).

Professional negligence is a clear accreditation issue where the CDM EB can already refer to measures like suspensions or withdrawals of accreditation, therefore we do not see the need for further procedures to be elaborated by SBI on this point. The CDM should continue to treat professional negligence by a DOE as severe misconduct under the accreditation rules. This removes the need for the CDM-EB to attempt to enforce legal claims, and yet still ensures equivalent penalties for all offending DOEs. A clear definition of professional negligence should be adopted.

Fraud should be addressed through the accreditation process, which is the most effective way to manage the performance of DOEs. SBI should consider provisions on how this could be implemented. In case of fraud there is no mandate by the EB to trigger any police investigation, a prerequisite for justifying any conviction. It needs to be further elaborated how DNAs could be involved in such a situation. D.I.A. supports measures which aim to penalise fraudulent or corrupt behaviour in case somebody is convicted of such misconduct.

Excess issuance might have various causes, however all situations should be dealt with by procedures that are as straightforward as possible. It is important to avoid lengthy ex-post investigations, and the system should rather focus on the practical measures that can ensure project participants behave properly and DOEs perform effectively in order to prevent any excess issuance from happening in the first place. In order to redress any excess issuance, various suggestions have been made already by a variety of stakeholders, including deducting from future issuances of the same project, replacement of CERs by the PPs, and the introduction of a reserve pool or extra share of proceeds. D.I.A. recommends keeping the modalities in this context simple and enforceable. If the concluded modalities result in lengthy investigations of individual cases, it may have negative impacts on the attractiveness of the CDM, and use up significant resources, putting a strain on the system as a whole.

Finally, the procedures for erroneous inclusion of CPAs should be part of the same process as for standard CDM projects. The current procedures for erroneous inclusion of CPAs act as a barrier to validation of CPA inclusions, act to increase the costs and time taken for this service, and require sometimes complex contractual arrangements between DOEs and PPs. D.I.A. demands that SBI includes this aspect when considering the significant deficiencies issue in order to create a holistic and consistent approach. The rules for excess issuance should be the same for PoAs (and their CPAs) as for regular CDM projects.

Materiality

Dec.9 / CMP7 mandated the introduction of a materiality standard in the CDM². It provided information on the initial coverage of the scope of materiality, with a limited application at the stage of verification by DOEs. In implementing this CMP decision, the CDM Executive Board introduced further limits, resulting in a procedure that is only relevant for verification of emissions reductions in standard CDM project activities. The D.I.A. proposes a wider applicability including verification activities in Programmes of Activities and also with respect to data verifications that need to be performed as part of a validation.

² Decision 9/CMP.7, Materiality standard under the clean development mechanism

Considering the fact that Dec.9 / CMP7 refers to “initial” coverage we would like to use the momentum of the review of the modalities and procedures to re-launch the discussion on next steps. We strongly support the need to develop a consistent approach that embraces all project and assessment activities, not just those performed by DOEs during validations and verifications but also those of other parties (e.g. within the RIT process). D.I.A. believes this issue should be included in the review of the modalities and procedures.

Contractual Relationship

Paragraph 60 of the recent modalities and procedures and its strict implementation within the project cycle procedure require a direct contractual relationship between a project participant and a DOE. Experience has shown that this requirement sometimes creates unnecessary difficulties and longwinded searches for alternatives when it comes to real application. Without any loss in integrity or responsibility, it would offer benefits if the contractual relationship could also be with either a legal entity of any involved project participant or another company which has been empowered by the project participants to contract the DOE. It is D.I.A.’s view that this requirement should be reconsidered and would provide greater flexibility if introduced.

Several stakeholders have expressed the view that service contracts for DOEs should be made exclusively between the UNFCCC secretariat and individual DOEs following a selection process by the Secretariat which does not involve the project participants. D.I.A. opposes such an approach, which we believe is likely to increase transaction costs without having any impact on the integrity of the CDM. The independence of DOEs and the avoidance of any conflict of interest are firmly established principles in the accreditation process. It is the market mechanism that guarantees that service costs are driven by demand and supply and ensures the best value to project participants. Further, allocation of projects on a “cab-rank” basis by the Secretariat would undermine resource planning within the DOEs and may lead to reductions in overall capacity, again placing upwards pressure on costs. Finally, a complex legal situation is created if the same body is both the customer and the accrediting body: not only would this have an entirely negative impact on the independence of DOEs, it is anticipated that market participants would have little confidence in such an arrangement.

Programme of Activities

Recognising that the original modalities and procedures did not address Programmes of Activities (which have been developed at a later stage), it is important now that their inclusion is done in such a way as to promote consistency with the CDM.

In particular and with relevance for the DOEs, D.I.A. believes these aspects need to be addressed:

- the application of the concept of materiality to PoA;
- clarity with respect to erroneous inclusions of CPAs, recognising that recent proposals have created unacceptable risks for DOEs seeking to work in this field.

Appeals Process

The D.I.A. believes that DOEs should be granted equivalent rights to appeal against decisions of the CDM Executive Board decisions as those currently being considered for other participants. In the context of accreditation, it is a matter of fairness and transparency that any decision can be subject to robust appeal procedures.



Direct Communication

It has been established that the Chair of the DOE/AIE Forum provides a presentation at the beginning of EB meetings on issues with relevance for the DOE’s operations. This interaction is perceived as extremely valuable for all sides. Hence, D.I.A. requests to formalise this within the modalities and procedures. We also recommend extending these rights of interaction to other stakeholder groups, a process which is already realised in JI. Direct feedback by stakeholders on draft decisions at the earliest stage possible will lead to more efficient decision-making.

Apart from the views on various issues which we present in the upper text sections, we would also like to emphasize that CDM has already created a mature framework and infrastructure over more than a decade of learning and adjusting. When considering other recent discussions on new market based mechanisms, the framework of various approaches etc., it should be viewed as a matter of course to utilize the existing system or parts of it, if appropriate, and to take into account the lessons learned whenever a new set-up is required. Consequently, a discussion on changes to the modalities and procedures for the CDM should also lead to revisions that foster the applicability of the system by other mechanisms. We expect this to be within the objectives of the SBI review of the Marrakech Accords.

We trust that our views expressed will help to continue and further expand CDM as a credible and effective market based instrument. We are looking forward to contributing further on this matter.

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The Designated Operational Entities and Independent Entities Association (D.I.A.) is registered as an association in Geneva, Switzerland, creating a collective voice to represent the interests of companies auditing greenhouse gas (GHG) emission reduction projects in international carbon markets. The purpose of D.I.A. is to be an independent, not-for-profit organization dedicated to the development and establishment of effective processes and criteria for, and related to, the determination, validation and verification of emission reduction and sequestration projects and to represent the members at relevant bodies that administer the various GHG programmes that accept UNFCCC accredited bodies to carry out determination and validation or verification services.

Please note that opinions, ideas and recommendations contained within this document are the views of D.I.A., and do not necessarily represent those of its individual member organisations.