

VIEWS TO THE REVIEW OF THE MODALITIES AND PROCEDURES OF THE CLEAN DEVELOPMENT MECHANISM

25 March 2013

On behalf of the accredited organization German Forum Environment & Development, Carbon Market Watch, a project by Nature Code, welcomes the opportunity to provide its views on the review of the modalities and procedures (M&P) of the Clean Development Mechanism (CDM).

INTRODUCTION

The CDM is at a cross-road. In 2012, the market collapsed and prices, currently below one Euro, may not recover any time soon. At current price ranges, it is all but impossible to implement CDM projects that are truly additional. The reason for the price collapse is two-fold: first, low demand due to very weak emission reduction targets; and second, a significant over-supply of carbon credits due to lenient rules, in particular rules on additionality. Such lenient rules allow for business-as-usual projects to qualify for the CDM and hence have resulted in the issuance of millions of credits that do not represent any emission reductions. Both the lack of demand due to insufficient ambition and the over-supply have to be addressed urgently.

Despite the uncertain future of the CDM, we believe that it is important to address its flaws and improve its rules for the following reasons:

- 1) Its rules have served and will continue to serve as a blueprint for other carbon market mechanisms. Because the CDM is used as a reference by many other emerging schemes, it is vitally important that its rules are well - designed and have integrity.
- 2) Despite the imbalance between supply and demand, a significant number of credits are expected to be used by Parties that plan to join a second commitment period. If these credits come from projects with poor environmental integrity, the CDM will continue to undermine the already weak emissions reduction targets.

We urge Parties to strengthen the social and environmental integrity of the CDM and to address, as a matter of priority, the following issues:

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Fundamentally reform additionality requirements

The current rules for the demonstration of additionality, the proof that projects are only viable because they receive CDM support, have long been criticised as ineffective. A large number of current CDM projects are likely not additional – they would be implemented even without the incentives from the CDM. Carbon credits from such free-rider projects do not represent real emissions reductions and lead to an increase in global greenhouse gas emissions.

Research¹ recently released under the CDM Policy Dialogue confirms that large-scale power supply and methane projects are unlikely to be additional. If such projects remain eligible in the CDM, they could increase cumulative global GHG emissions by up to 3.6 Giga tonnes CO₂e through 2020. Non-additional credits also undermine the economic effectiveness of the CDM by artificially increasing the supply of credits that do not represent actual emission reductions. This is especially relevant, since the CDM is projected to be significantly oversupplied until 2020. Reducing the large number of non-additional projects therefore not only strengthens the CDM's environmental integrity, it is also a vital step in ensuring the continuation of the mechanism. A transition away from large-scale power supply CDM projects and other project types with low probability of additionality would address the over-supply CDM credits, enable projects that truly depend on the CDM, and improve the overall integrity and mitigation impact of the CDM.

RECOMMENDATIONS:

1. **Strengthen and elaborate on the criteria of assessment of additionality and require, inter alia, to consider the impact of CER revenues on the economic attractiveness of a proposed CDM project activity and to define appropriate thresholds that determine whether a project is deemed additional.**
2. **Limit CDM project types to the ones that have a high likelihood of being additional and exclude those project types with low likelihood of additionality (e.g. large greenfield infrastructure projects).**
3. **Exclude project types where baselines and additionality are intrinsically difficult to determine (e.g. because of signal-to noise ratio issues).**

Change E+/E- Rule

The CDM Executive Board has decided that new policies that promote emission reductions (so-called E- policies) need not be taken into account when setting baselines. Instead, baselines may be based on a hypothetical scenario without the policy. The rationale was to not create a perverse incentive for developing countries to not introduce climate-friendly policies in order not to damage their CDM potential. However, the cut-off date in the current rules is 11 November 2001, more than 11 years ago. Baselines of CDM projects are therefore becoming increasingly unrealistic.

In addition, the situation has changed since the adoption of the Bali Action Plan and the Cancún Agreements, where developing countries have pledged to reduce their emissions. Emission reductions might be counted twice in 2020 if no

¹ Assessing the Impact of the CDM. Report Commissioned By The High-Level Panel On The CDM Policy Dialogue. July 2012. http://www.cdmpolicydialogue.org/research/1030_impact.pdf

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adjustments are made. With the current rules, CDM projects assist developing countries in achieving their pledges and at the same time the CERs from these projects are used by Annex I countries for their Kyoto compliance.

RECOMMENDATIONS:

Reform the E+ /E- rules to ensure environmental integrity and prevent double counting.

Shorten length of crediting periods

The current crediting periods (10 years or three times 7 years) are in many cases not appropriate because:

- Lifetimes of many technologies are shorter than these crediting periods
- In many cases the CDM only advances an investment which would be carried out at a later stage anyhow. Such CDM projects should only receive credits for the number of years the projects implementation has been advanced.

RECOMMENDATIONS:

The length of the crediting period should be set in a conservative way as to avoid issuance of credits from projects that can no longer be considered additional. Therefore, the length of the crediting period should be defined individually per project type in the respective methodology and take into account, inter alia, the rate of innovation and change in the relevant sectors as well as relevant market and socio-economic developments.

Ensure that all CDM Projects uphold human rights

In 2011, the CDM Executive Board registered two projects despite evidence of human rights abuses in both cases. The CDM Executive Board argued that it has no mandate to address the issue of human rights and that the responsibility for ensuring sustainable development lies with the host country.

However, numerous international human rights instruments are relevant to the CDM Executive Board. For example, the United Nations Charter, which is applicable to all UN bodies, imposes rights obligations on the CDM Executive Board (for example, Articles 1(3) and 55(c) call for international cooperation on economic and social issues and respect for human rights). More specifically, with respect to climate change, the UNFCCC Conference of the Parties decided that *“Parties should in all climate change related actions fully respect human rights”* (Decision 1/CP.16 paragraph 8).

RECOMMENDATIONS:

The CDM M&P should clarify that international law, including the UN Charter, fundamentally requires the CDM Executive Board to set up and impose relevant human rights standards to ensure that CDM projects uphold human rights. Such clarification should ensure that, inter alia:

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- All project activities registered, or seeking registration, under the CDM must be undertaken in a manner that respect human rights;
- Project activities are suspended if they are found not to meet human rights obligations and standards until the relevant concerns have been fully addressed;

The CDM M&P should establish a communications channel for case specific matters and a grievance mechanism to consider and address concerns about human rights impacts of a CDM project raised by or on behalf of individuals or communities (see points 7 and 8 for further information).

Improve the CDM's contribution to sustainable development

The CDM has two main objectives – achieving cost-effective emission reductions and achieving sustainable development in the host countries. Carbon Market Watch and other NGOs have highlighted the need for monitoring, reporting, and verification of compliance with CDM rules and procedures, in particular, as they relate to the contribution of CDM projects to sustainable development. Experience has shown that the lack of monitoring, reporting, and verification of claimed sustainability benefits has led to the registration of CDM projects that have no contribution to sustainable development and sometimes even negative impacts. Monitoring, reporting, and verification of the environmental, social, and economic impacts of CDM activities at the international level is essential to protect the rights and interests of project-affected peoples and communities, as well as to uphold the CDM's stated purpose of achieving sustainable development.

Moreover, certain project types in the CDM, such as coal power plants, do not support the goal of the CDM of contributing to sustainable development because they inflict a heavy toxic burden on local populations and ecosystems.

RECOMMENDATIONS:

To improve the CDM's contribution to sustainable development the revised CDM M&P should:

- Define minimum global standards on sustainability and “no harm” requirements that each CDM project has to meet;
- Require that Designated National Authorities make their sustainable development benefit indicators publicly available;
- Include mandatory requirements for monitoring, reporting, and verification of sustainability benefits during the entire project cycle;
- Exclude project types that support technologies or practices with high GHG emissions and that are associated with other high environmental and social costs (e.g. projects that support the extraction and use of coal)

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- Give authority to Designated National Authorities to withdraw letters of approval in the event that CDM projects do not meet sustainable development indicators at any stage during the project cycle, or violate applicable environmental, health, labor and human rights standards, laws and policies;
- Establish a communications channel for case specific matters and a grievance mechanism to consider and address social and environmental concerns raised by or on behalf of individuals or communities (see points 7 and 8 for further information).

Strengthened Civil Society Participation in the CDM process

Although stakeholder consultation is a key requirement in the CDM registration process, project developers and Designated Operational Entities (DOEs) lack clear criteria or guidance on how to conduct and validate stakeholder consultations. In many cases, peoples and communities that are directly affected by CDM are not adequately informed about CDM projects and their potential on-the-ground impacts. Current CDM stakeholder consultation requirements are insufficient as they are poorly defined, regulated and documented. There are dozens of instances where projects were registered despite insufficient stakeholder participation, strong local opposition and clear evidence that the projects cause harm to the local populations and/or ecosystem.

In addition to shortcomings in the notice and comment processes, there is no means for civil society to raise concerns once a project is registered even if adverse impacts occur during project implementation. As more than 5.000 CDM projects are currently registered and will be operational for many years to come, the current procedure of stakeholder involvement in the CDM needs to be reassessed and improved.

RECOMMENDATIONS:

To strengthen civil society participation in the CDM process the revised CDM M&P should:

- Strengthen and clarify the requirements for stakeholder involvement.
- Establish a communication channel for case specific matters and a grievance mechanism to address the social and environmental impacts of specific CDM projects (see points 7 and 8 for further information).

The operationalization of the revised CDM M&P on stakeholder participation should include the following:

Local Stakeholder participation:

- *Provide guidance on how local stakeholders are to be informed regarding the stakeholder consultation, including a requirement that invitation letters be sent at least to local people impacted by the project or their official representatives, local policy makers and representatives of local authorities, an official representative of the DNA of the host country of the project and local NGOs working on topics relevant to the project.*

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- *Require that prior to the consultation a non-technical summary of the project activity be published in the local language(s) as well as a non-technical description of the project's EIA analysis including the project's projected scope, lifetime, adverse impacts and management plans, along with all other relevant information about the project;*
- *Require several rounds of local stakeholder consultation to ensure consultation early in the process and that comments provided were received and how they were taken into account;*
- *Establish clear guidelines for DOEs on how to validate local stakeholder consultations, including who the stakeholders are, how stakeholders need to be contacted and involved, what information needs to be provided, how feedback is to be documented and analysed.*

Global Stakeholder participation:

- *Set up email notification systems for registration, issuance and methodology processes as well as for all public participation procedures that are time sensitive;*
- *Improve the user-friendliness of the UNFCCC CDM website including the translation into all official UN working languages;*
- *Clearly communicate the end date and time of the commenting period and ensure that all supporting documents are uploaded prior to the start of the public commenting period;*
- *Allow submissions of comments through locally feasible means and in the language(s) of the host country.*
- *Increase the duration of the public commenting period on new projects to at least 60 days for all projects.*
- *Increase the duration of the public commenting period on new methodologies*
- *Establish automated system for uploading comments in real time to the UNFCCC website*
- *Develop guidelines that specify how DOEs must respond to stakeholder concerns*
- *Establish automated notification system about the status of a project's validation to stakeholders who have submitted comments*

Address conflict of interest of DOEs

Designated Operational Entities (DOEs) are currently chosen and paid by a project's developer. This can put pressure on auditors to approve projects and work quickly in order to preserve their business relationships with the developers. This compromises the auditors' independence and neutrality. According to Decision 3/CMP.1 (Marrakech Accords – Modalities and Procedures for a CDM) a DOE shall acquire and transfer CERs for cancellation if a review reveals that "significant"

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deficiencies in validation, verification and certification reports issue by that DOE resulted in excess CERs, thus endangering the integrity of the CDM. Although a draft procedure (annex 28 to report EB-69) was submitted for adoption at CMP8, CMP8 deferred the issue to be dealt with as part of the CDM M&P review.

RECOMMENDATIONS:

To avoid conflicts of interest of auditors and project developers and to preserve the integrity of the CDM by ensuring that excess CERs due to deficiencies are compensated, the revised CDM M&P should:

- **Require rules and procedures under which DOEs are assigned and paid by a UNFCCC body and where CDM project developers pay validation and verification fees to that body; Establish rules for dealing with significant deficiencies in validation, verification and certification reports.**
- **Establish a grievance mechanism for cases when there is probable cause that a Designated Operational Entity (DOE) may not have performed its duties in accordance with the rules or requirements of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol and/or the Executive Board.**

Establish a communications channel for case specific matters

The current procedure for direct communication with stakeholders allows for comments about policy matters but does not allow for comments related to case specific matters. It is therefore currently impossible to submit concerns about a specific project, e.g. if comments submitted during the local or global stakeholder consultation process have not been validated adequately or if concerns related to the additionality of a project appear after the global stakeholder consultation. This is not only relevant for projects during the validation stage but also for projects during their implementation. Such a communications channel is needed in addition to a grievance mechanism as outlined below. Such a communications channel would allow reviewing and addressing concerns efficiently and by doing so avoiding escalation of issues. E.g. allowing comments at an early stage in the process, when they can still be taken into account for decisions related to registration or issuance of credits could help avoid potential future appeals. Such a communications channel for project specific comments should be modeled after the already successfully implemented communications channel for policy matters.

RECOMMENDATIONS:

To improve social and environmental integrity of CDM project activities, the revised CDM M&P should:

- **Establish a communications channel for case specific matters, both before and after the registration of CDM project activities;**

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Set-up a Grievance Mechanism

There is currently no means for civil society to raise concerns once a project is registered. As more than 6.000 CDM projects are currently registered and will be operational for many years it is necessary to establish a grievance mechanism that ensures that adverse impacts that occur during project implementation are addressed.

Under SBI parties have been considering an appeals procedure for decisions of the CDM Executive Board since its 34th session. The inclusion of an appeals procedure in the CDM project approval process presents a crucial opportunity for the Executive Board (EB) to secure human rights and to promote enhanced accountability, legitimacy and public trust in and acceptance of the CDM as a valid tool for reaching its goals under the Kyoto Protocol – namely, mitigating global climate change while promoting sustainable development. The adoption of a robust appeals procedure in the CDM is a critical opportunity to improve the good governance of the CDM. Indeed, the appeals procedure must serve the interests of project developers as well as those of affected stakeholders, so as not to prioritize corporate profit over the public interest and address the wider impacts that flawed CDM projects have on global climate change and sustainable development.

Furthermore, whereas the appeals procedure, as proposed, would address procedural and substantive concerns, it is essential that this process be complemented by a grievance mechanism to address the social and environmental impacts of CDM projects to ensure access to justice for all and to build the public's confidence in the integrity of CDM project activities. The CDM has an interest in addressing community-based grievances before disputes escalate or create conflict between stakeholders and project participants.

RECOMMENDATIONS:

To improve social and environmental integrity of CDM project activities, the revised CDM M&P should:

- Ensure that the appeals procedure is swiftly implemented and provides for broad legal standing;
- Establish a complementary grievance mechanism to address the social and environmental impacts of CDM projects during implementation of CDM project activity, e.g. when sustainable development co-benefit criteria are not realised as described in the PDD and to consider and address concerns about human rights impacts of a CDM project raised by or on behalf of individuals or communities.

Improve the constitution and conduct of the CDM Executive Board and supporting bodies

In 2012, the CDM Policy Dialogue identified the following issues pertaining to the CDM Executive Board:

- failure to implement criteria (other than maintaining regional balance) for the nomination of members;
- lack of transparent processes by which members are nominated by their regional groupings; and
- absence of an explicit code of conduct that does not rely on each individual member to determine what should be reported and whether he or she is in a position of conflict of interest.

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The CDM Policy Dialogue Panel further identified the following problems with the internal governance of the UNFCCC Secretariat:

- fundamental tension between its responsibility to provide services to the CDM Executive Board and its status as an independent structure with its own accountability systems;
- lack of a strict separation of its functions between supporting the setting of standards and supporting the assessment of projects; and
- absence of a formal CDM-specific code of conduct for staff members working on CDM matters.

Carbon Market Watch emphasizes the importance of professional, transparent, accountable and independent governance for the CDM. The composition of the Board directly impacts how CDM rules are developed and implemented. Decisions in the past indicate that the two primary goals of the CDM (real, additional and verifiable emission reductions and sustainability benefits) are not always sufficiently considered. This can undermine the success of the CDM.

RECOMMENDATIONS:

To improve the constitution and conduct of the CDM Executive Board the revised CDM M&P should:

- **Require that the CDM Executive Board implement robust codes of conduct for all members of the CDM governance structure, including the CDM Executive Board, working groups or teams assisting the Board, and members of the UNFCCC Secretariat. These codes of conduct must include means for objectively assessing and addressing conflicts of interest.**
- **Prohibit nominations from representatives with vested interest in the CDM in order to prevent potential conflicts of interests. CDM Executive Board members should not be allowed to work for a Designated National Authority (DNA), a Designated Operational Entity (DOE) or for a public or private institution that develops CDM projects or purchases or trades CERs.**
- **Ensure that quota rules on composition of the Board are established that ensure that members from environmental and academic organisations are represented.**
- **Apply the term limits cumulative for serving both as member and as alternate member, so that board members are limited to serve a maximum of two terms of two or three years each.**

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