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To info@unfccc.int
From Gareth.Phillips@pd-forum.net
Date 22 September 2011
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Subject **Letter relating to the annotated agenda of the 63rd meeting
of the CDM Executive Board / Annexes 12 and 16**

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Mr. Martin Hession,
Honorable Members of the CDM Executive Board,

The Project Developer Forum (PD Forum) notes the publication of the last remaining annexes to the annotated agenda for EB63. Due to the late publication, we are unable to submit comments within the allotted time scale however, we believe the last two documents are also important and we would like to make the following comments:

Annex 12: Draft Procedure for submission and consideration of standardized baselines

In general we consider this procedure to be a good proposal however we would like to note several points:

Scope of the procedure: This procedure only covers standardized baselines which are applied to existing methodologies. Given that the most exciting aspect of the concept of standardized baselines is to ability to propose new ways of establishing a baseline and new ways of quantifying emission reductions and removals, we would urge the Board to also consider better and faster procedures for new types of standardized baseline methodologies.

Paragraph 8 refers to an assessment report prepared by a DOE. We would request the Board to publish guidelines for the preparation of the assessment report highlighting the quality criteria for the data, as soon as possible to facilitate progress. We also note that the issue of paying the DOE may be problematical for some DNAs and we would urge the Board to consider alternative ways of funding these activities, for example, a loan repaid from resulting CERs.

Paragraph 11 indicates that the Secretariat will complete an initial assessment within 21 days. We observe that this is a relatively short space of time, helped by the fact that Meth Panel is not being involved.

Paragraph 12 provides DNA with 42 days in which to reply to an incomplete message. Whilst it is in everyone's interest to progress the development of these methodologies, we see no reason why DNAs should be so pressured to provide a response. Where DNAs have to engage with external parties and fulfil bureaucratic requirements, 42 days may be insufficient time to gather the necessary information, have it reviewed by a DOE and then approved for submission. We would suggest that either there is no specific time limit at this stage or alternatively, DNAs should be provided with a means to request an extension should circumstances warrant more time to address the issue.

Paragraph 14 indicates that the submitted documentation will be made publicly available, but it gives no

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indication as to how comments by stakeholders can be submitted and how they are to be taken into account. This is an important element, especially given the fact that the Meth Panel are not being consulted on the new methodology.

Paragraph 20 once again provides DNAs with 28 days to reply. We are concerned that this may be too short a time and could result in the rejection of otherwise good proposals. We suggest that there is a longer time limit or no specific time limit set on this stage.

Paragraph 21: We are pleased to note the specific inclusion of direct communication. The PD Forum has long argued that direct communication may resolve many of the challenges and mis-understandings associated with new methodologies and indeed, requests for registration and issuance. Many of our members have had the opportunity to discuss proposed new methodology technical issues with the secretariat and they found the exchange very useful. We hope that the formalizing of this feature will prove a positive experience for the Secretariat and that the Board will encourage them to extend this practice.

Annex 16: Information note on approach for and addressing significant deficiencies in past validation, verification or certification reports.

PD-Forum members attended the three day integrated workshop in strength and we are pleased to note that the draft procedure discussed there has not been presented but rather scaled back to an information note.

The PD Forum understands and accepts the desire to have a mechanism in place to correct errors in the number of offsets issued thereby protecting the environmental integrity of the mechanism. However, we also believe that it is not possible to “make the system whole” and replace every CER that has been issued incorrectly with a corresponding emission reduction. Therefore we urge the EB to take a pragmatic approach to ensure that environmental integrity is not questioned and that the procedure adopted does not lead to disproportionate risks for DOEs and PPs that could have a severe impact on the functioning of the mechanism as a whole.

Our detailed comments are as follows:

Paragraph 8: We would urge the Board to clarify that the focus is firmly on significant deficiencies and not all deficiencies. This decision will set a crucial precedent that will enable the system function effectively by recognising that “making the system whole” is not an achievable goal. Furthermore, we would like to highlight that CDM methodologies and the verification process already includes significant conservative factors and, while it is impossible to accurately quantify the volume of emission reductions that have not been issued due to this, it is reasonable to assume that these may well exceed the value of any erroneously issued emission reductions¹.

Paragraph 9: We would strongly propose that significant deficiencies are restricted to gross negligence and fraud on behalf of the DOEs and/or PPs. Proving any other kind of failure beyond reasonable doubt will be too difficult.

Further we propose that a time limit is set on how far back a review can look, recognising the ‘learning by doing’ nature of the CDM. We suggest that the introduction of the VVM marks a ‘line in the sand’ and suggest that the approach adopted does not consider requests for registration and issuance that precede the introduction of this document

¹ PD Forum would highlight, for example, the application of the default emission factor in the flaring tool which deliberately under-estimates methane destruction efficiency in enclosed flares; conservative grid emission factors; and deliberately conservative assumptions in AM0034 which discount CERs by as much as 25%.

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Section V: Paragraph 11: It is important that any review is considered against the prevailing rules and requirements of the CDM at the time of the original validation or verification. Interpretations (written or otherwise) of the rules as well as guidance (written or otherwise) have dramatically changed over the years.

PD Forum proposes that the EB limit its imposition of liability to DOEs on the basis that it has a contract with DOEs and it has a very high chance of successfully recovering damages. The EB does not have a strong legal basis from which to challenge PPs and if they did, there may be difficulties in enforcing a ruling. However, PPs do have a relationship with host and non-host DNAs who can raise a range of sanctions including objecting to a request for issuance, withdrawing the letter approving the participation of the PP and ultimately, in some DNAs, criminal liability for fraudulent statements. PD Forum suggests that the EB engage further with DNAs to strengthen their ability to control fraudulent behaviour amongst PPs.

Section VI: PD Forum considers that only the entities directly involved in a project should be able to initiate a review, specifically, DOEs, Parties and the EB. Other stakeholders who wish to raise an issue should do so through the host or non-host DNAs or by writing to the Board in the usual manner. We support a screening of proposed reviews before they are sent to the Board.

Section VII: The PD Forum suggests that a new Panel is formed to consider review cases including staff and experts from the Secretariat, the EB, DOEs, PPs and independent experts. In addition, a clear appeals process must be established to allow DOEs/PPs to make representations if significant deficiencies are established and a penalty applied.

Section VIII: PD Forum believes that the concept of surrendering emission reductions to “make the system whole” is not viable. This concept was proposed in the Marrakech Accords but after 10 years of learning by doing, it is clear that it cannot be applied:

- Such liabilities would force DOEs out of the market, reducing capacity and the geographic distribution of resources;
- Remaining DOEs would likely increase their costs for performing validations and verifications significantly, as they would need to purchase insurance to protect against possible future reviews.
- Surrendering CERs will not make the system whole because it is impossible to address all such deficiencies, and as we have highlighted above, there are already considerable forces at work which act to push the system in the other direction²;

We urge the Board to recognise also the potentially disproportionate impact that this could have on small scale projects in under-developed regions and particularly LDCs. With some DOEs leaving the market and those remaining charging higher fees, transaction costs for developing CDM projects will increase significantly. This will have a disproportionate impact on small and microscale projects thereby negating all the other work the EB has done in recent months to promote CDM in under-developed regions.

For these reasons, we strongly encourage the Board to consider a financial penalty, capped at, for example USD 1.0 million, scaled against a range of factors including, but not limited to:

- The magnitude of the over-issuance
- The extent of the deficiency, for example, an individual acting alone, opportunistically or systematically, or a systematic failure throughout the organisation’s controls
- The means by which the deficiency has been discovered and defended
- The costs associated with the review
- Historical performance with respect to significant deficiencies.

² It would be interesting to conduct a short study to quantify the impacts of some of the known conservative factors embedded in tools and methodologies.

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Section IX

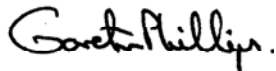
PD forum would like to highlight that the scope of the procedures for addressing significant deficiencies must stop short of de-registering a project. There are continued discussions on-going within the Parties over the appeals process and how to reverse a positive or negative decision by the EB. This procedure should not be presented as a means to usurp those efforts. There are already adequate procedures in place to ensure that no further issuance takes place for projects which are considered to have been registered by means of gross negligence or fraud, namely:

- The procedures for changes in PDDs following registration (where the Board can rule that no further CERs shall be issued);
- The raising of objections to issuance by host or non-host DNAs
- Risk assessment procedures within DOEs which may highlight unacceptable risks associated with the acceptance of a verification contract for a given project.

Importantly if new procedures allowed for the registration of projects to be reversed it would have a significant impact on how CDM projects get financed. Needless to say registration is an important milestone in the CDM project at which investors are willing to commit resources. However, if the registration of projects could be reversed it introduces further risks that investors will not be prepared to take, they will opt to pay on delivery of CERs leaving a financing gap in the CDM project cycle.

Finally, we encourage the Board to address this topic swiftly and unambiguously or request further guidance from the CMP. As long as the topic of significant deficiencies remains unresolved and on the agenda, it will continue to be a source of uncertainty for the entire CDM community, damaging confidence in the market and the system's credibility.

Kind regards,



Gareth Phillips
Chair, Project Developer Forum