



## Annex 19

### CONCEPT NOTE: DRAFT RECOMMENDATIONS IN RELATION TO DRAFT PROCEDURE FOR ADDRESSING SIGNIFICANT DEFICIENCIES IN PAST VALIDATION, VERIFICATION AND CERTIFICATION REPORTS

(Version 01.0)

#### I. Background

1. In accordance with a request from the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) at its seventh session, the Executive Board of the clean development mechanism (CDM) (hereinafter referred to as the Board) and the secretariat have been investigating the impacts of, and consulting with designated operational entities (DOEs) on, the draft “Procedure for addressing significant deficiencies in past validation, verification and certification reports” (draft Procedure) which was considered by the Board at its sixty-fifth meeting.<sup>1</sup>

2. The final result of the Board and secretariat’s investigation and consultation will be a report to the CMP on the findings of its investigation, together with a revised draft Procedure for adoption by the CMP at its eighth session. Based on the results of the investigation and consultations to date, the following options are presented for the Board’s consideration with a view to revising the draft Procedure in accordance with some or all of the options.

#### II. Options

##### A. Possible amendments to draft Procedure

3. **Limiting liability under the draft Procedure:** under this option the liability attributed to the DOE under the draft Procedure could be limited in a manner which aims to allow DOEs to appropriately manage risk while continuing to incentivize DOEs to perform to an acceptable level:

- (a) To a pre-determined amount. There are a number of options for how that amount might be determined, including:
  - (i) Proportionate to the amount of fees generated by a DOE, such as the number of certified emission reductions (CERs) which are equivalent to a percentage of total fees generated by a DOE in the previous year; and
  - (ii) A fixed amount applicable to DOEs irrespective of fees generated but scaled in proportion to the size of the excess issuance, such as a total cap of 500,000 CERs per project activity or programme of activities (PoA). If the excess issuance were less than 500,000, the DOE would be liable to replace the CERs up to the actual number of excess issued CERs. A different cap could be included for large-scale and small-scale projects. This could work in a manner which is more akin to a penalty regime in which maximum penalties are determined by the regulator based on what the regulator considers has an appropriate deterrent value;

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<sup>1</sup> Annex 15 to the annotated agenda of the sixty-fifth meeting of the Board.



- (iii) An amount equivalent to a project activity or PoA's annual issuance; and/or
  - (b) To a pre-determined point in the past (in addition to the existing time boundary of 28 November 2008, i.e. the date on which the validation and verification manual (VVM) came into effect). A maximum of five years may be considered an acceptable "liability tail" period for insurance and record-keeping purposes. This limitation would need to be implemented on a rolling basis and a decision would need to be made as to the start date of the limitation period, for example by deciding that a review shall be commenced only if the relevant validation, verification or certification report was submitted on a date that is not more than five years from the "review commencement date".
4. **An appeals process** or stage within the draft Procedure so that a DOE or its representative (e.g. insurer) can challenge a decision of the Board imposing liability under the Procedure. In the absence of a separate appeals body established by the CMP that would cover significant deficiencies, this might help improve the "insurability" of the Liability Risk. Processes such as those in the Accreditation Procedure could be considered.
5. **Defining terms or concepts.** DOEs have requested further clarity with regard to:
- (a) The definition of "significant deficiencies". DOEs raised some concern about the definition in the draft Procedure because they felt that it was broader than the original mandate under the CDM modalities and procedures;
  - (b) The standard of care that applies to DOEs under the draft Procedure;
  - (c) Situations that might constitute professional negligence under the draft Procedure.

### B. Possible complimentary measure

6. **Ensuring environmental integrity.** A complementary approach to ensuring environmental integrity when significant deficiencies and excess issuance occur could include establishing a pool or reserve of CERs with the following purpose/functionality:
- (a) Funded from various sources and actors within the CDM, including bringing the fund up to an appropriate level by requiring a contribution of a share of each CER at every issuance. The DOEs proposed that the secretariat could adjust the percentage share once the fund reached the required balance;
  - (b) "Kick-start" the fund by injecting funds from fees collected from project participants at registration and issuance;
  - (c) DOEs would have the ability to buy CERs from the fund if it were found that an over-issuance was caused by the DOE's professional negligence or fraud.
7. There are implications for project participants, the Board and potentially the market with respect to the establishment of such a fund. Many of these implications were explored in a submission in the 2010 call for inputs on an earlier version of the draft Procedure – see [http://cdm.unfccc.int/public\\_inputs/index.html](http://cdm.unfccc.int/public_inputs/index.html).

### III. Expectation of the Board

8. The Board, at its sixty-eighth meeting, may wish to request the secretariat to:



- (a) Amend the draft Procedure in accordance with some or all of the options set out in section II. above for consideration by the Board at its sixty-ninth meeting whether to recommend the draft procedure for adoption by the CMP at its eight session;
- (b) Launch a public call for inputs on the development of a pool or reserve of CERs which could complement the draft Procedure by providing a mechanism:
  - (i) To meet the compensation gap, if any, between the compensation (i.e. CERs to be cancelled) that a DOE is liable for under the draft Procedure for its professional negligence or fraud resulting in a significant deficiency, and the actual number of excess issued CERs;
  - (ii) Whereby any significant deficiency not occurring as a result of a DOE's professional negligence or fraud could be compensated through the cancellation of the relevant number of CERs from the pool or reserve.

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**History of the document**

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