



AUSTRALIA

Submission to the SBI | May 2013

Views on the Review of the Modalities and Procedures for the Clean Development Mechanism

I. Overview

This submission responds to the invitation in paragraph 10 of decision 5/CMP.8 *Guidance relating to the clean development mechanism* of the eighth Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP.8). It contains Australia's views on the review of the modalities and procedures of the clean development mechanism (CDM). In referring to the modalities and procedures of the CDM, Australia notes that they extend beyond decision 3/CMP.1 to include all CMP decisions relating to the modalities and procedures of the CDM.

Over the course of its ten years of operation, the CDM and its related institutions have developed a considerable body of expertise on the operation of an international carbon market mechanism through the more than 6600 projects registered to date, including more than 100 Programmes of Activities. The CDM has also enabled significant environmental and financial benefits such as delivering 110,000 megawatts of renewable energy capacity and spurring US\$215 billion of investment in developing countries by the end of 2012¹. It has also provided a stepping stone for government and the private sector, building their capacity to go beyond project-based emission reduction activities to market-based approaches with broader coverage. Australia acknowledges the development and improvement of CDM processes that have been implemented by the Parties, the CDM Executive Board (EB), the Panels and the Secretariat over these years and looks forward to contributing to further improvements.

In this submission Australia focuses on potential reforms to two areas which are essential for the continued operation and credibility of the CDM. These are environmental integrity and governance.

II. Environmental integrity

The ability of the CDM to defend its environmental integrity is essential if it is to continue its important role in the international carbon market. The core aspect of this is whether potential CDM project investors, CER purchasers and market observers have confidence that projects can be shown to meet the conditions established in Article 12 of the Kyoto Protocol, particularly paragraphs 5 (b) and (c) on delivering "real, measurable, and long term benefits related to the mitigation of climate change" and "reductions in emissions that are additional to any that would occur in the absence of the certified project activity".

¹ http://cdm.unfccc.int/press/releases/2012_26.pdf



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For this reason, the current review of the modalities and procedures should include revisions to the approaches to additionality and baselines to improve confidence in these fundamental environmental characteristics. Reforms should address the following issues:

Additionality test

Confidence in the additionality of each project is essential for the credibility of the mechanism. However, proving additionality can be complex and time consuming. These issues could be addressed by alternative approaches to additionality such as those listed below.

- Increased use of standardised approaches, such as performance benchmarks. Benchmarks should be set conservatively to increase the certainty of additionality across a population of similar projects and should account for technology and context-specific factors, moving away from more subjective financial additionality tests.
- Identification of positive lists (such as pre-approved technology types) to simplify additionality assessments for project types in contexts where there is a low risk of non-additionality.

Project baselines

Project baselines exist to enable calculation of the emission reductions caused by a CDM project below a business as usual (BAU) projection. BAU is not static over time due to technological development, improvements in industry standards (including roll out of CDM projects) and government policies. Project methodologies should allow for these changes while still providing adequate certainty to investors. Making these adjustments increases confidence that the mitigation delivered by the CDM is real. Approaches to this could include:

- Crediting periods that are shorter, or more flexible and related to the technologies involved, acknowledging that different project types will involve different rates of technological change. Shorter periods, specified in project methodologies, would enable review of baselines more frequently in order to provide more certainty that emissions reductions are real and additional. It would also enable simplification of the additionality test because the original test would not have to be shown to be valid for seven to ten years.
- Pre-established automatic baseline adjustments to allow for technological progress but without affecting investor certainty.
- Reappraisal of the E+/E- rule (on incorporating domestic mitigation policies into baseline calculations), by requiring that baselines and additionality assessments include all relevant domestic policies. This is necessary to avoid double counting and the crediting of BAU domestic action but should be carried out in a way that does not discourage the adoption of domestic mitigation policies.

III. Governance

The modalities and procedures relating to governance of the CDM should consistently reflect the supervisory role of the EB. They should promote the EB's responsibility to implement a decision making process that is conducive to fairness and business confidence. This includes transparency, freedom from suggestion of conflict of interest, timeliness, accuracy and predictability. Governance reforms should contribute to the ability of members to fulfil their roles, encourage efficiency and empower the support structures to function fully within their designated parameters. Reforms should address the following issues:

Membership

Part C of the *Modalities and procedures for a clean development mechanism* (Annex to decision 3/CMP.1) sets out the role of the EB as the supervisor of the CDM. To carry out this role it is essential that the EB has a membership with a broad base of competencies. As a supervisory, rather than technical body, this should include people with competencies in the fields of regulation, law, finance and business. This is acknowledged in paragraph 5 of the *Terms of reference in relation to the membership of the Executive Board of the clean development mechanism* (decision 3/CMP.6, Annex I).

The current arrangements for EB appointment should do more to encourage candidate selection that results in an overall EB membership with the desired suite of competencies and experience. In addition, the current arrangements do not provide information to assure the public of the EB's broad competence and experience.

Australia would welcome discussion of possible solutions to help address these issues. On the matter of greater public transparency, the CVs of EB members and alternates currently available on the UNFCCC website could specifically indicate which of the desired competencies and experience a particular member/alternate will contribute. On the matter of securing a broader suite of EB competencies and experiences, nominating Parties or Groups should consider the blend of skills and expertise amongst ongoing members/alternates based on their published CVs, and select new nominees to complement the existing membership. Ideally, nomination letters would demonstrate how the candidates' expertise would complement and improve that of the existing EB by indicating in their nomination template which competencies and experience each candidate could contribute. CVs of nominees could also be made publicly available before an EB member/alternate is appointed to help identify any key gaps in a potential future EB's expertise.

Supervisory Role of the Executive Board

To further support the EB's supervisory function, technical processes such as project registration should be supervised by the EB but it should not have a role in the registration of individual projects. The current "request for review" process should be changed to delegate any necessary reviews at that stage to a panel of experts reporting to the EB with clearly defined review and appeal procedures. This would allow the EB to focus on its mandated supervisory role.

Term limits

Paragraph 8 (b) of the *Modalities and Procedures* (Annex to decision 3/CMP.1) relating to the term limits on membership of the EB is ambiguous and should be clarified to ensure that individuals cannot serve for more than two terms. Such limits are common in boards and serve to maintain equality among board members while ensuring that boards are continually replenished with new experience and do not develop dependence on particular individuals. Given the active role of alternate members, such limits should also be applied to alternate membership.

Transparency

Guidelines should be developed for circumstances where the EB could conduct closed sessions. These should be confined to circumstances such as the discussion of confidential commercial or personal information. Where closed sessions are held, reasons for non-disclosure should be clearly stated in the report of the meeting. This would promote transparency, an essential element in maintaining confidence in the CDM.

Predictability of case decision-making

Market development over time requires predictability in decision-making. Less predictability increases risks, and costs, for project proponents. Any increase in cost will have a disproportionate effect on project proposals that are more financially marginal, a category that has historically included projects from under-represented countries and projects with greater sustainable development co-benefits. The CDM decision-making process could help promote the market, and reduce costs, by making its registration and issuance case decisions more consistent over time; similar cases in one year should be decided in a similar way in the next year.

Conduct of EB Members and Alternates

To build public confidence in the EB, rules contained in the *Rules of Procedure* (decision 4/CMP.1, Annex I) on Conflict of Interest and Confidentiality (Rules 9-11) should be expanded to include the Code of Conduct adopted by the EB at its 47th meeting. Likewise the penalties and processes for breach of these rules should apply to breaches of the Code of Conduct.

The conflict of interest rules set out in Rule 10 should be extended, with mandatory disclosure requirements, including penalties and processes for non-disclosure. The rules should include all potential conflicts of interest and all cases where EB members have involvement in CDM projects, individually or as a member of a private or public organisation.

As they currently exist, the conflict of interest rules of the EB are not of a standard usually expected of a body of its status and responsibility. Conflict of interest judgments are left to the discretion of individual members, consequently exposing them to undue criticism. Paragraphs 4, 5 and 6 of Rule 4 of the *Rules and Procedures of the Compliance Committee of the Kyoto Protocol* (Annex to decision 4/CMP.2) could be adapted to the EB to address this situation.

Treatment of significant deficiencies in validation, verification and certification reports

Concerns by Designated Operational Entities and project developers about their risk exposure to over-issuance are genuine and can be a major barrier to investment in CDM projects. Related rules should be clarified, in a manner that reflects the interests of all stakeholders.