

Agenda item 4.2

Paragraph 19 of the annotated agenda, Annex 10

Procedure for addressing significant deficiencies in past validation, verification or certification reports

CDM EB 64

Bonn, Germany, 24–26 October, 2011



Background: Marrakech Accords

CMP 1

22. Registered project activities shall not be affected by the suspension or withdrawal of designation of a designated operational entity unless significant deficiencies are identified in the relevant validation, verification or certification report for which the entity was responsible. In this case, the Executive Board shall decide whether a different designated operational entity shall be appointed to review, and where appropriate correct, such deficiencies. If such a review reveals that excess CERs were issued, the designated operational entity whose accreditation has been withdrawn or suspended shall acquire and transfer, within 30 days of the end of review, an amount of reduced tonnes of carbon dioxide equivalent equal to the excess CERs issued, as determined by the Executive Board, to a cancellation account maintained in the CDM registry by the Executive Board.

23. Any suspension or withdrawal of a designated operational entity that adversely affects registered project activities shall be recommended by the Executive Board only after the affected project participants have had the possibility of a hearing.

24. Any costs relating to the review referred to in paragraph 22 above shall be borne by the designated operational entity whose designation has been withdrawn or suspended.



CMP 6

25. “*Requests* the Executive Board to adopt, taking into consideration the views of stakeholders, and subsequently apply a procedure to address significant deficiencies in validation or verification reports;

26. *Decides* that in developing such a procedure the Executive Board may review and amend the provisions contained in paragraphs 22–24 of the annex to decision 3/CMP.1 regarding:

- (a) The suspension of designated operational entities prior to the application of such a procedure;
- (b) The appointment of a second designated operational entity to conduct the review or correct the deficiency;
- (c) The 30-day time limit for the cancellation of units;
- (d) The liability of designated operational entities;”



Background: Mandate (2)

EB 63

- The Board considered information note and provided guidance on the direction to be taken in each area of the procedure.
- The Board requested the secretariat to:
 - a) Prepare a draft procedure based on the Board's guidance;
 - b) Draft a recommendation for CMP 7 to amend relevant paragraphs of CDM Modalities and Procedures (annex to decision 3/CMP.1).



Document structure

I. Definitions

II. Principles of liability

III. Initial review

- A. Identification of potential significant deficiencies
- B. Preliminary investigation and recommendation on review
 - 1. Preliminary investigation
 - 2. No action required cases
 - 3. DOE admission cases
 - 4. Review required cases

IV. Review of potential significant deficiencies

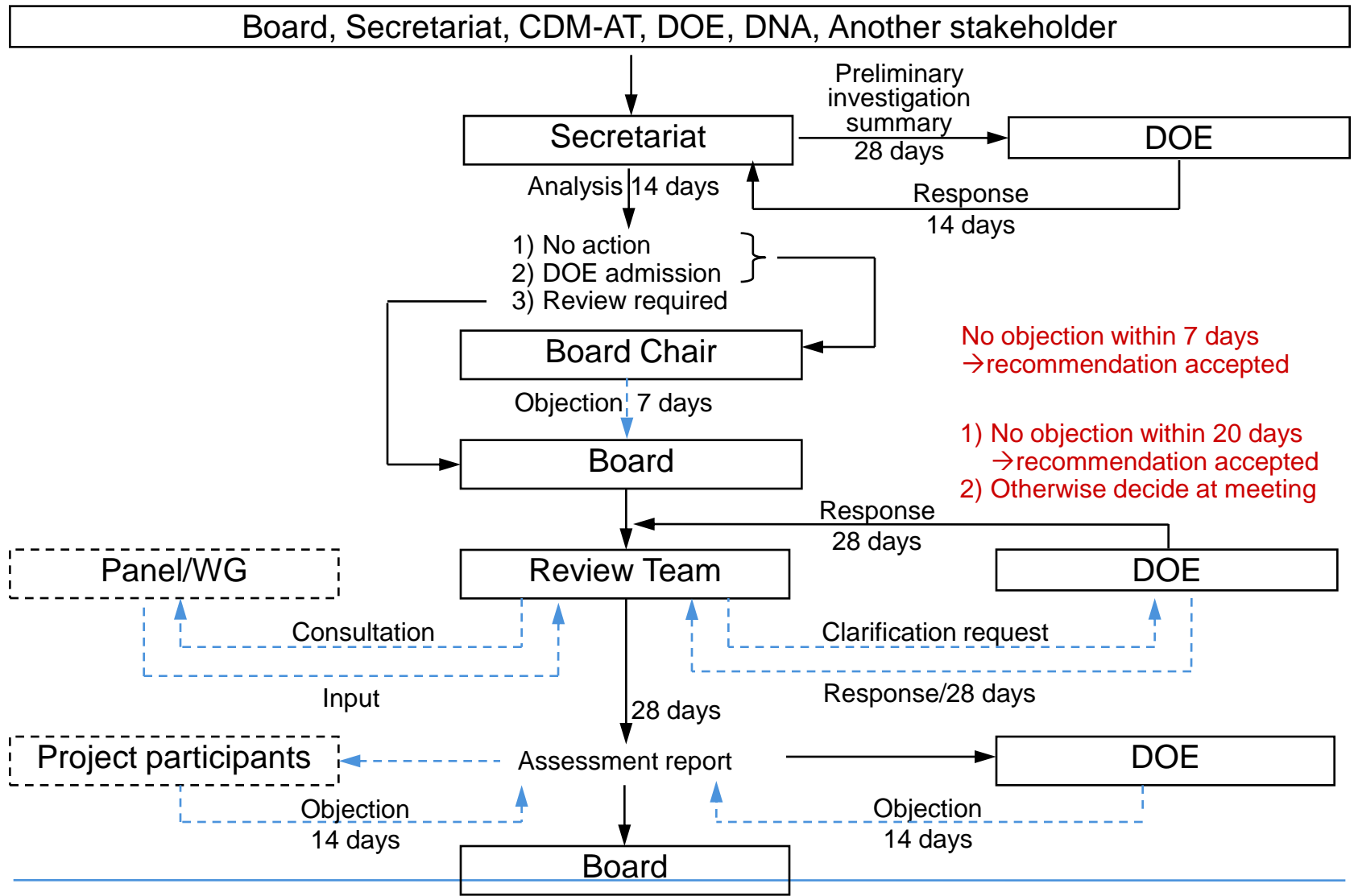
- A. Assessment of significant deficiencies
- B. Consideration of assessment of significant deficiencies

V. Consequences arising from finding of significant deficiencies

- A. Corrective action and compensation
- B. Failure to comply with secretariat's direction
- C. Costs of review



Significant deficiencies identification and review cycle



- 1) No objection within 20 days
→ recommendation accepted
- 2) Otherwise decide at meeting

Main elements of procedure (1)

- Definitions of “deficiency” and “significant deficiency”, including possible threshold
- Defining principles of liability (under which circumstances a party is liable), including:
 - a) Possible extension of liability to PPs in case of fraud
 - b) Limitation to past [5 years]
- Defining who can identify potential significant deficiencies, including:
 - a) Board and the secretariat during the project cycle process
 - b) CDM-AT during an accreditation assessment
 - c) Another DOE during carrying out a verification/certification
 - d) DNA that authorized the PPs
 - e) DOE self-declaration
 - f) Another stakeholder [directly concerned]
- Preliminary investigation by the secretariat
- Less cumbersome process for DOE self-declaration or admittance cases (skipping of review)



Main elements of procedure (2)

- Review by “Independent” review team
- Possible consultation with relevant panel or working group
- Final decision by the Board
- Consequences:
 - a) Correction of validation/verification/certification reports by the responsible DOE
 - b) Transfer of credits to cancellation account of the CDM registry by the responsible DOE within 90 days
 - c) Payment of the cost for review by the responsible DOE
 - d) [PP fraud case: Correction of validation/verification/certification reports by a DOE contracted, and
 - **Option 1:** Transfer of credits to cancellation account of the CDM registry by the PPs within the timeframe decided by the Board; forwarding CERs for future issuance to cancellation account until the transfer is made
 - **Option 2:** Deduct CERs from future issuances
 - **Option 3:** No future issuances of CERs]



Main elements of procedure (3)

- Consequences (cont.):
 - e) Resume issuance of CERs if no significant deficiencies determined or corrections to validation/verification/certification reports are made
- DOE fraud case and if DOE fails to comply with (a)-(b) above: suspension of accreditation of the DOE
- Costs for review are to be born by the responsible party



Key areas for consideration by the Board

1. Whether to extend liability to PPs and types of penalties to PPs
→ Careful consideration based on legal input required
2. Whether to set a threshold (minimum quantity or proportion or CERs) to call “significant deficiencies”
3. Whether to set a financial ceiling to liability
4. Whether to limit to types of stakeholders to identify potential significant deficiencies
5. Appropriate backward time limitation for the investigation
6. Sequence and timeframe of the entire process



Extending liability to project participants

- Legal input -



Legal input on extending liability to project participants (1)

1. Principles of liability of PPs

- The liability approach in the Marrakech Accords is to correct environmental harm caused by excess issuance of CERs by requiring DOEs to transfer Kyoto units for cancellation, and requiring the correction of affected reports to avoid further environmental harm.
- If the procedure is extended to include PPs, the rationale for imposing liability on PPs requires clarification. Would it be to correct environmental harm resulting from excess CERs or to dissuade bad faith conduct? If the latter, the EB may wish to consider whether this procedure is the appropriate place for implementing that approach.



2. Different principles that apply to PP liability as compared to DOE liability

- Imposing liability on PPs is different to the case of DOEs: PP liability may only be imposed if a CMP decision extends scope of procedure to include PP, because PP liability was not foreseen in CMP.1 decision (or CMP.6 decision)
- The principle of non-retroactivity means PPs may only incur liability for acts or omissions (however defined) that occur AFTER the date of such a CMP decision
- The EB has a direct relationship with DOEs (accreditation). The EB does not have a direct relationship with PPs (they are authorised by DNAs). This means that enforcement options may, in some cases, be of limited effectiveness.



Legal input on extending liability to project participants (3)

3. The Board may wish to consider **what type/level of PP behaviour should trigger liability** (when it results in significant deficiencies):
- Any behaviour (i.e. "strict" liability)
 - Negligence based
 - "Knowingly providing false or misleading information" (or similar concepts): usually a non-criminal domestic law offence, often with serious penalties and usually backed by strong enforcement powers
 - "Fraud": a domestic/national criminal law concept usually backed by strong enforcement powers



Legal input on extending liability to project participants (4)

4. The Board may wish to consider **what the penalty/sanction for a finding of PP liability should be** for:
- Excess CERs issued:
 - Requirement to acquire and transfer equivalent number of Kyoto units
 - Withholding of equivalent number of Kyoto units
 - Correction of reports:
 - Requirement on DOE to correct
 - Requirement on PP to arrange correction
 - Dealing with project activities that would not otherwise have been registered
 - No further issuance?



Legal input on extending liability to project participants (5)

5. The Board may wish to take note of **potential enforcement aspects**

- If the financial value of the liability to compensate Kyoto units exceeds the remaining economic interest in the CDM, PP may make rational economic decision not to comply.
- Parties regulate the PPs and the project activity through domestic law and in some cases breach of CDM rules may be mirrored by national law breaches.
- Each PP is authorised by at least one DNA to participate in the project activity and this relationship could support enforcement.

