FOIA Number: 2017-1093-F

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Collection/Record Group: Clinton Presidential Records

Subgroup/Office of Origin: Office of Environmental Initiatives

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Subseries:

OA/ID Number: 19509

FolderID:

Folder Title:
Climate Change International COP 6 [Conference of the Parties]: Mechanisms

Stack:	Row:	Section:	Shelf:	Position:
S	61	7	11	3

David Gardiner
08/14/2000 02:27:25 PM

Record Type: Record

To: Roger S. Ballentine/WHO/EOP@EOP

cc:

Subject: some German Greens endorse unlimited trading

To Paul?

State cable. Perhaps we can use this in EU media work.

RTTUZYUW RUEHRLA3143 2131444-UUUU--RUEAEPA.
ZNR UUUUU ZZH
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SENSITIVE
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E.O. 12958: N/A
TAGS: SENV, PGOV, PREL, PINR, GM
SUBJECT: CLIMATE CHANGE: CRACKS APPEARING IN GERMANY'S CONCRETE CEILING?
SENSITIVE BUT UNCLASSIFIED, PLEASE PROTECT ACCORDINGLY

SUMMARY
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1. (U) DOMESTIC SUPPORT FOR GERMANY'S AND THE EU'S PROPOSAL TO "CAP" USE OF THE KYOTO FLEXIBILITY MECHANISMS MAY BE WEAKENING. ANALYSIS BY SEVERAL GERMAN THINK TANKS HAS CONCLUDED THAT A "CONCRETE CEILING" WILL NOT ACHIEVE ANY OF ITS INTENDED OBJECTIVES (I.E., LIMITING "HOT AIR" AND ESTABLISHING ENVIRONMENTAL INTEGRITY). THE BERLIN BRANCH OF THE GREENS PARTY RELEASED A POSITION PAPER CALLING ON FULL-FLEDGED GERMAN SUPPORT FOR INTERNATIONAL EMISSIONS TRADING, AND URGING THE GOVERNMENT TO DROP THE CONCRETE CEILING IN RETURN FOR CERTAIN CONCESSIONS ON MARKET STRUCTURE BY OTHER PARTIES. GOVERNMENT INTERLOCUTORS (WITH NOTABLE EXCEPTIONS) SEEM TO INCREASINGLY VIEW THE "CAP" AS A NEGOTIATING TACTIC, RATHER THAN A SUBSTANTIVELY LEGITIMATE POLICY.

WE'VE COME A LONG WAY, BABY
----

2. (U) THE BERLIN BRANCH OF THE GREENS PARTY RELEASED A

POSITION PAPER ON JULY 3 THAT CALLS ON THE EUROPEAN UNION TO ABANDON ITS ATTEMPT TO INSTITUTE A "CONCRETE CEILING" ON USE OF THE FLEXIBILITY MECHANISMS, AS LONG AS THE INTERNATIONAL EMISSIONS TRADING SYSTEM IS STRUCTURED SO THAT:
-- THE PRIVATE SECTOR IS FULLY INCORPORATED INTO TRADING (ENTITY-LEVEL TRADING);
-- TRADING IS CONDUCTED EITHER EX POST OR WITH BUYER LIABILITY;
-- EFFECTIVE NATIONAL COMPLIANCE REGIMES FOR MONITORING EMITTERS ARE ENSURED;
-- PROCEEDS FROM THE SALE OF "HOT AIR" BE REINVESTED IN EMISSIONS-REDUCING PROGRAMS.
3. (U) THEY JUSTIFY THIS POSITION BY ARGUING THAT THE "CAP" CANNOT ACHIEVE ITS STATED GOALS. REGARDING "HOT AIR," THEY NOTE THAT THIS IS A PROBLEM THAT WILL GO AWAY BY ITSELF, AS SUCCEEDING COMMITMENT PERIODS INCREASE EMISSION-REDUCTION OBLIGATIONS. THE GREENS ALSO POINT OUT THAT THE "CONCRETE CEILING" COULD LEAD TO PERVERSE RESULTS SUCH AS MORE TRADE IN "HOT AIR:" IF ONE RESTRICTS EMISSIONS TRADING TO 50 PERCENT, THEN ONLY THE CHEAPEST 50 PERCENT -- THE HOT AIR -- WILL GET ONTO THE MARKET. THEY ALSO ARGUE THAT THE CAP CONTRIBUTES NOTHING TO ENVIRONMENTAL INTEGRITY (I.E. FORCING ECOLOGICAL LIFESTYLE CHANGES), BECAUSE MOST REDUCTION POSSIBILITIES WILL LIKELY BE CHEAPER THAN EMISSION CERTIFICATES, AND MOST WILL BE "NO-REGRETS." THEREFORE, EVEN WITH UNRESTRICTED EMISSIONS TRADING, MOST REDUCTIONS WILL TAKE PLACE THROUGH DOMESTIC MEASURES OF ONE KIND OR ANOTHER.
4. (U) THIS ANALYSIS MATCHES THAT PRODUCED IN SEVERAL REPORTS BY THE HAMBURG INSTITUTE FOR ECONOMIC RESEARCH, AN INFLUENTIAL ECONOMIC THINK TANK, AS WELL AS OTHER OBSERVERS SUCH AS THE GOVERNMENT'S OWN COUNCIL OF ENVIRONMENTAL EXPERTS. A STUDY COMMISSIONED BY THE ECONOMICS MINISTRY ARGUES EXPLICITLY AGAINST THE CONCRETE CEILING, FOR A VARIETY OF TECHNICAL AND POLICY REASONS.
5. (U) THERE ARE OTHER DOMESTIC FORCES OPPOSED TO THE CONCRETE CEILING. ORGANIZED BUSINESS REJECTS IT, ALTHOUGH ITS POLITICAL INFLUENCE IN THIS POINT IS LIMITED BECAUSE OF THEIR OPPOSITION TO A NATIONAL EMISSIONS TRADING SYSTEM, REDUCING ITS CREDIBILITY. A NUMBER OF PROMINENT ACADEMICS HAS ALSO COME OUT AGAINST THAT CAP.

WHAT HAVE YOU DONE FOR ME, LATELY?

----

6. (SBU) ALTHOUGH THIS ASSESSMENT IS IMPRESSIONISTIC, IT SEEMS THAT GOVERNMENT INTERLOCUTORS ARE INCREASINGLY OPEN ABOUT VIEWING THE CAP AS A NEGOTIATING TACTIC DESIGNED TO EXTRACT CONCESSIONS FROM THE UNITED STATES. SUBSTANTIVE ARGUMENTS REGARDING THE ENVIRONMENTAL NECESSITY OF RESTRICTING THE FLEXMECHS HAVE BECOME RARE. DISCUSSIONS OF THE CONCRETE CEILING ALMOST INVARIABLY RESULT IN THE COMMENT THAT THE FRG IS WAITING FOR A U.S. COUNTER-PROPOSAL, AND THAT THE CAP WAS NEVER INTENDED TO BE PUT IN PLACE AS PROPOSED. UNFORTUNATELY, GOVERNMENT CONTACTS DO NOT REVEAL WHAT THEY WOULD ACCEPT IN PLACE OF A CAP. A CONTACT IN THE ECONOMICS

MINISTRY, FOR EXAMPLE, NOTED SIMPLY THAT WITH AMERICAN INGENUITY AND INITIATIVE, WE WOULD FIND A CREATIVE SOLUTION.
7. (SBU) GOVERNMENT CONTACTS HAVE ALSO SIGNALED THAT GERMANY WILL PULL OUT ALL THE STOPS TO GET THE U.S. INSIDE THE KYOTO TENT, AND SOME HAVE TOLD US THAT RATIFICATION CHANCES COULD BE STALLED EVEN HERE WITHOUT U.S. PARTICIPATION, AS BUSINESS INTERESTS WOULD REVOLT AGAINST THE LOSS OF COMPETITIVENESS THEY WOULD FACE IF THEY WERE BURDENED WHILE IMPORTANT INTERNATIONAL COMPETITORS ARE NOT.

COMMENT

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8. (SBU) WHILE IT MAY BE THAT THE CURE (PARTICULARLY BUYER LIABILITY) MAY BE WORSE THAN THE DISEASE, IT IS BECOMING MORE LIKELY THAT A U.S. PACKAGE ALONG THE LINES OF THE DEMANDS OF THE BERLIN GREENS COULD SHAKE THE FOUNDATIONS OF GERMANY'S CONCRETE CEILING PROPOSAL. WHILE IT IS UNCLEAR HOW MUCH INFLUENCE THE BERLIN GREENS WIELD, THEIR POSITION REFLECTS A BROADER TREND IN GERMAN SOCIETY, AND THE GOVERNMENT COULD PROBABLY SELL SUCH A MARKET STRUCTURE TO ITS CONSTITUENTS.
SNELL
BT
#3143
NNNN

- AUDTRAIL.TXT

John D. Gibson
07/19/2000 04:03:41 PM

Record Type: Record

To: Roger S. Ballentine/WHO/EOP@EOP
cc: David Gardiner/WHCCTF/EOP@EOP
Subject: cdm developments

baselines_071800.p

David and I attended an assistant secretaries meeting at State on Tuesday on CDM and wanted to give you a short summary.

Paul Stolpman (EPA) presented a concept he and others have been working on to cut down on the transaction costs of getting a CDM project approved. Premise is that the review process for additionality (in all its forms, financial, technology, emissions, etc.) could be a huge barrier. The proposal is to create 2 step process to bypass this. While it is hoped that the methodology can be applied to all or most types of CDM projects, the power sector was used to develop the concepts and is the only area where it has been fleshed out.

Step 1: Historical baseline as proxy for additionality.

Project would be presumed additional if it could beat some pre-determined standard set from actual historical emissions of similar plants operating in that country or region and built in the last "x" years (probably 5 or 10). Paul and others have suggested that the target be set as the the top quartile. For power plants there would be a specific target for each fuel type. For example, a clean coal plant in China might have to have an emissions rate that was cleaner than 75% all coal plants built in China for the past 10 years. For source types where there is little or no emissions (and therefore little emissions variability), such a renewables, it would be determined that all such projects meet the performance test and are "additional". If a project passes step 1, go to step 2 to determine the no. of credits the project will earn.

Step 2: Determining Credits.
Credits are determined by comparing actual emissions against a baseline
that is the higher of:
1. the average emissions rate of all plants in sector
2. the average emissions rate of all fossil fueled plants in the sector, or
3. the average of all plants in the sector using the same fossil fuel as the CDM project.
Note:
-- This approach ensures that all projects that make it to step 2 can earn some credits - in particular this approach ensures that any clean coal plant can earn credits in any country in the
world.
-- Approach also offers relatively larger rewards to projects in countries that are currently "dirtier" because their sector average and their fossil fuel average are going to
be higher than in a "cleaner" country using more renewables and natural gas.
-- Approach offers relatively larger rewards to clean plants using inherently cleaner fuels, such as natural gas. Of course the largest rewards would be for zero emitting plants.

(In connection with this last point, you should be aware that EIA is reported to have calculated that developed countries are going to be able to get about halfway towards their Kyoto targets just from currently planned nuclear and hydro projects in developing countries. This looms as an issue that will have to be revisited in the weeks ahead.)

On the Stolpman, et. al CDM proposal the group decided to include a discussion of this approach in our August submission to the Secretariat. We would present it as a concept that we hope to be able to apply generally but for which we would share how we think it would apply in the power sector.

Attached are the slides Stolpman used.

Multi-Project Baselines for the Power Sector

Office of Atmospheric Programs
Paul Stolpman
July 18, 2000

OBJECTIVES

- Limit transaction costs
- Encourage investments in cleaner technologies
- Provide an *objective* determination of additionality & BAU

…. While reducing global GHG emissions

APPROACH

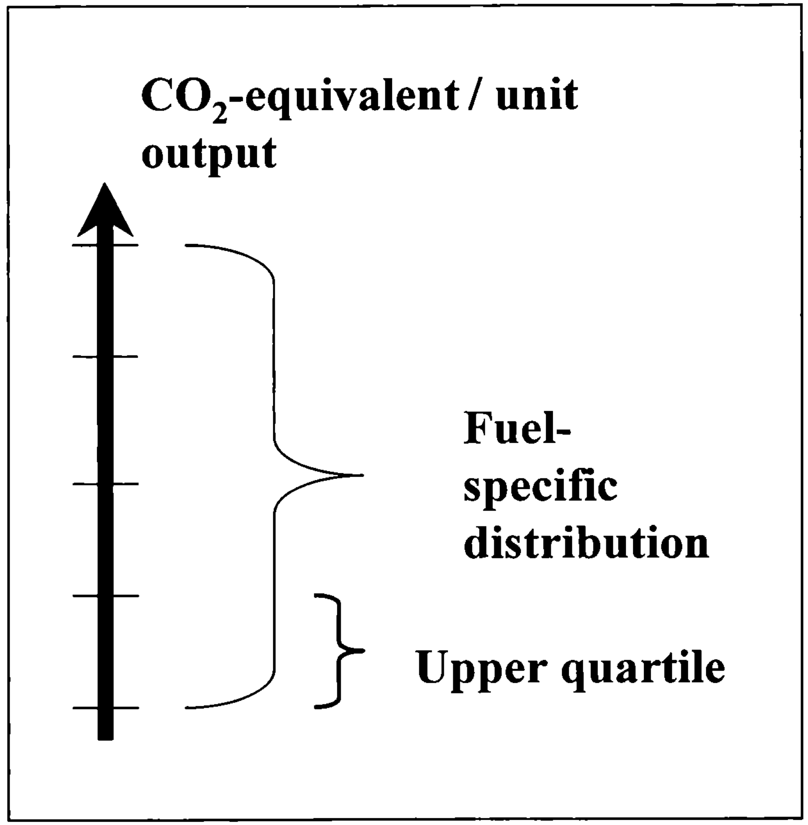
- Avoids case by case determination of baselines:
    - surrogate for additionality = quartile test
    - country or region specific data used to construct baseline
    - linked to sustainable growth
    - 3 baselines for determining additionality & CERs , which avoids under/over crediting resulting from a single baseline
    - data set could be adjusted temporally (eg recent x years) and spatially (eg geo region) to provide statistically valid sample
    - baselines are adjusted at some interval to account for country's circumstances

APPROACH

- Avoids case by case determination of baselines
  - surrogate for additionality = percentage (e.g. quartile) test
  - country or region specific data used to construct baseline
  - linked to sustainable growth
  - 3 baselines for determining additionality & CERs - which avoids under/over crediting resulting from a single baseline
  - data set could be adjusted temporally (eg recent x years) and spatially (eg geo region) to provide statistically valid sample
  - baselines are adjusted over some interval to account for country's circumstances

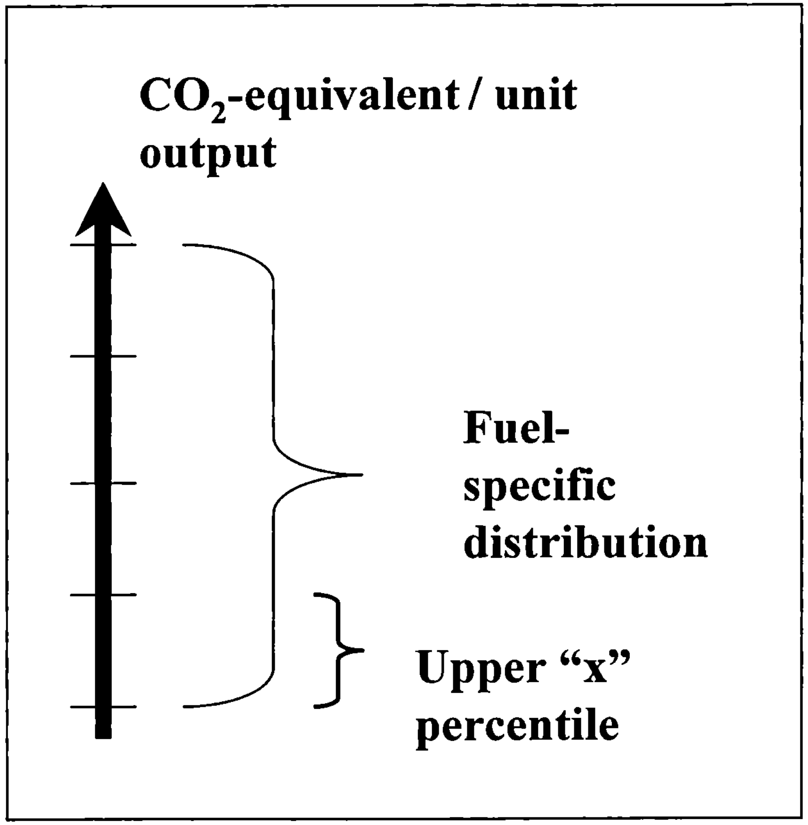
QUARTILE TEST

- Project must fall among the upper quartile of the emissions rate of recent projects



PERCENTILE TEST

- Project must fall among the upper x percentage (e.g. quartile) of the emissions rate of recent projects



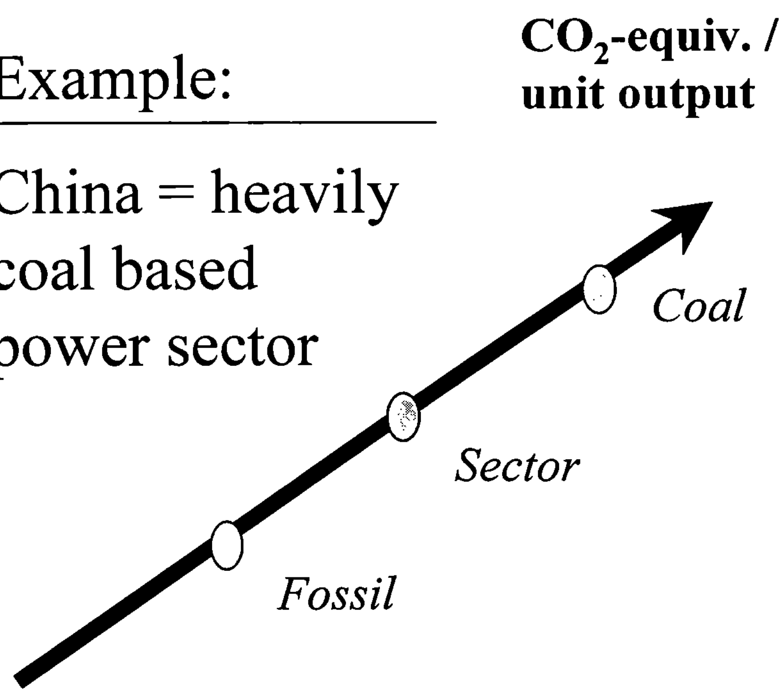
BASELINE CALCULATION

Weighted average:

1) Sectoral
2) Fossil-fuels
3) Fuel-specific

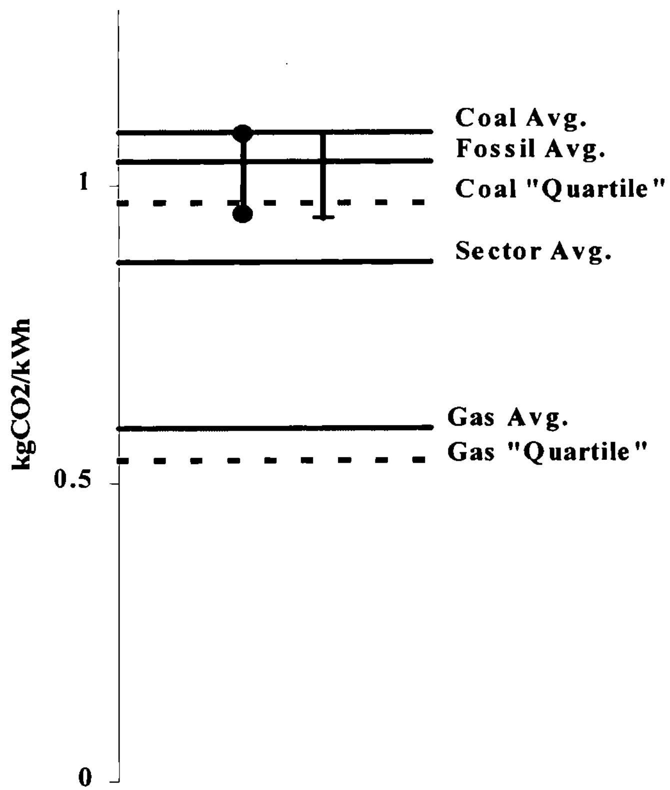
Example:

China = heavily coal based power sector

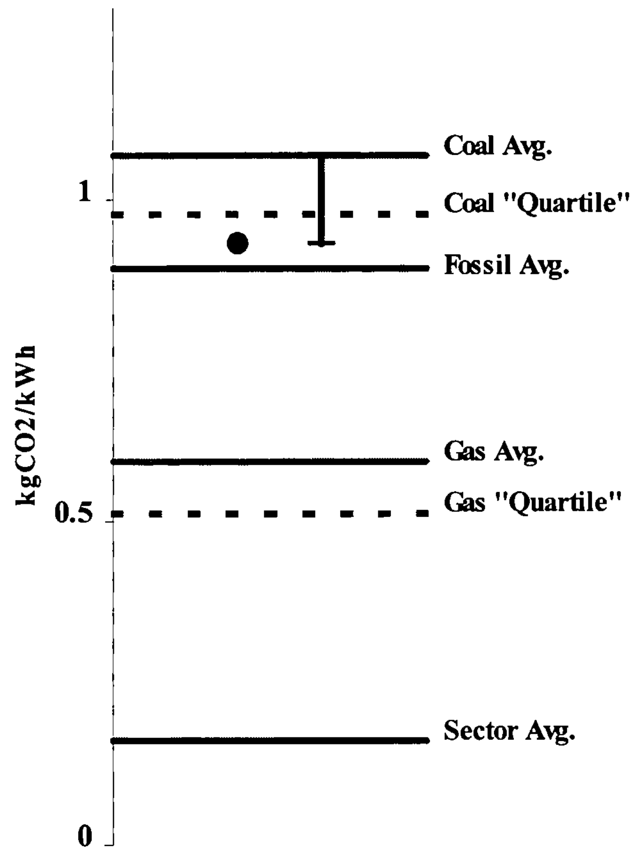


EXAMPLE 1 : NEW COAL PLANT

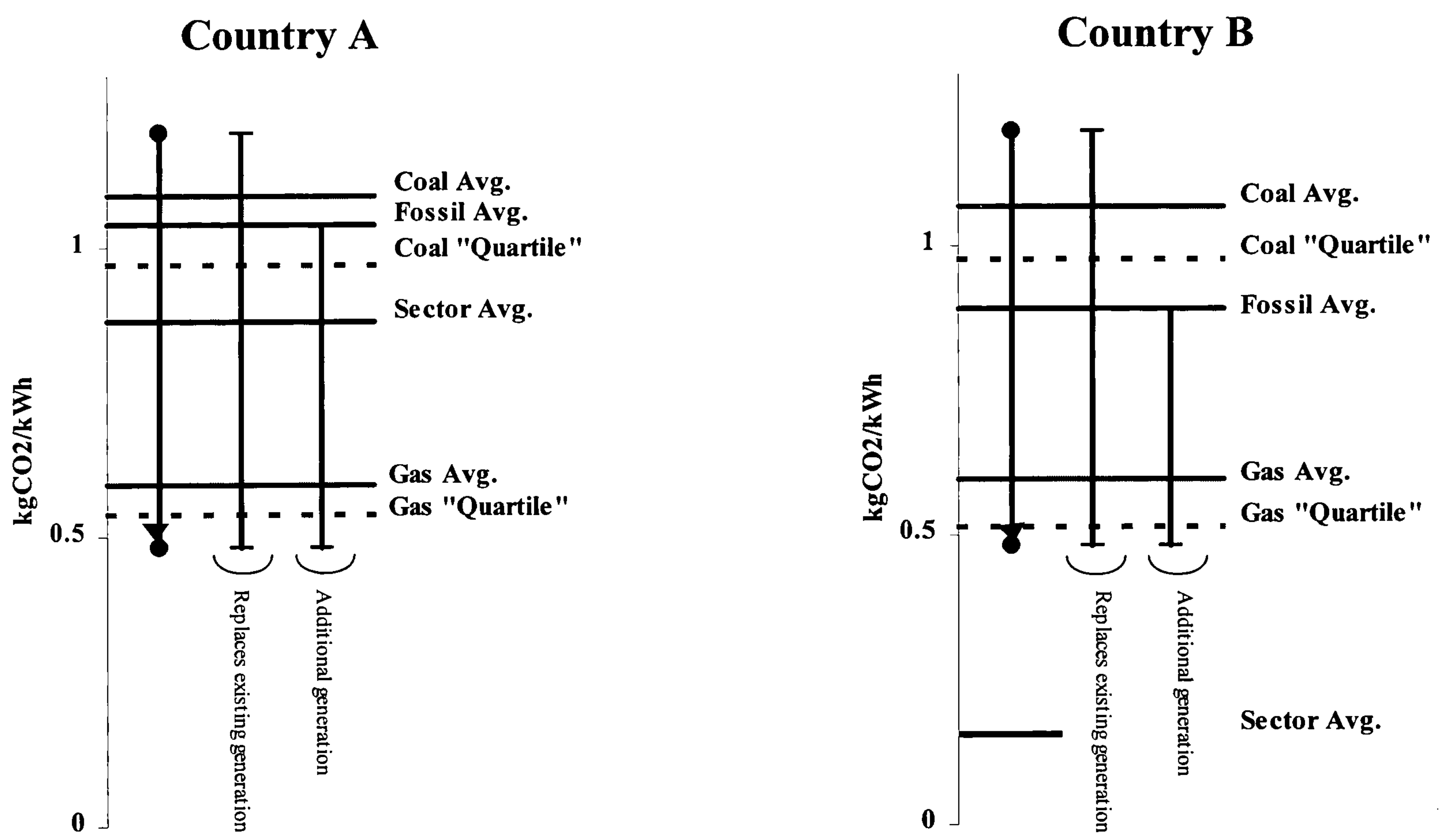
Country A:
Heavily dependent upon coal,
with some gas and zero-emission.



Country B:
Dominated by zero-emission generation,
& substantial NG generation.



EXAMPLE 2: Retrofit of Coal -
(fuel switch, WITH additional generation)



OTHER SECTORS

- Energy Intensive Industry
- Carbon Sequestration
- Other Gases

OTHER ISSUES

- Crediting Lifetime
- Project Boundary
- Leakage

Sustainable Development and the CDM

Issues

1. Whether to support international sustainable development criteria for projects?
2. Whether to include/exclude certain project categories?

Background

The question of whether the CDM is consistent with broader sustainable development and environmental objectives is likely to become increasingly prominent in the negotiations. To date, we have said that it is up to the host country to determine whether a project furthers its sustainable development objectives. While most countries have taken a similar position (in particular, the Umbrella Group and G-77), a few countries have proposed addressing the issue of sustainable development in one (or both) of two ways:

(1) Through internationally-agreed environmental and sustainable development criteria that would apply to a broad variety of projects.
(2) By excluding certain project categories (specifically nuclear) or giving priority to other types of projects (e.g., renewable energy or energy efficiency)

Issue 1: General international sustainable development criteria for projects

Most countries (including the UG and G-77) have taken the position that the determination of whether a proposed activity contributes to the host Party's sustainable development priorities should be made solely by that Party. The EU and a few other countries (e.g., Switzerland) are supporting general sustainable development criteria for all projects.

Potentially, rules to address the issue of sustainability could be of two general types:

(1) Procedural requirements on host countries, for example, to scrutinize projects and certify that they are consistent with national sustainable development strategies and objectives and/or relevant international agreements (for example, the Biodiversity Convention). So long as these procedural requirements were met, the determinations by the host country could not be second-guessed by the CDM institutions.

(2) Substantive requirements relating to sustainable development, which would be applied by the CDM institutions directly – for example, by OEs, the EB, or the COP/moP.

In its mechanism submissions, the EU has proposed requiring that the host Party provide in writing that a proposed project:

- is consistent with all relevant international agreements relating to sustainable development to which the Parties involved are Party;
- assists in achieving sustainable development, taking into account (a) a Party's economic, environmental and social conditions, (b) the need to minimize adverse environmental, social and economic effects; and (b) existing guidance for sustainable development;
- contributes to the ultimate objective of the Convention.

The Swiss have also proposed that the CDM rules include sustainable development criteria. Under the EU proposal, it appears (although it is not clear, since the EU has not made its position on registration entirely clear) that operational entities would substantively review a proposed project's consistency with sustainable development criteria. The Swiss have proposed that all aspects of the project proposal, including sustainable development, be subject to EB review.

The UG has proposed a decisionmaking framework for CDM involving OE decisionmaking, but with a right of appeal to the EB. Building sustainable development criteria into that framework would mean that NGO comments and Party appeal could involve issues of sustainable development as well as environmental additionality. Because sustainable development issues are likely to be more subjective than those associated with environmental additionality, inclusion of sustainable development criteria would place a greater burden on OEs. The EB review process of OE decisions could help address this problem; however, it may mean that more EB reviews would be necessary, thereby creating a potential bottleneck.

Under the Swiss proposal, all projects would go to the Executive Board for approval, with an opportunity for NGO comment. Again, given the non-technical nature of many comments, if there were sustainability criteria, the EB may be the most appropriate venue for comments relating to sustainable development.

Issue for decision:

Should the US change its current position to support either:

(1) procedural requirements that host countries assess and report on the consistency of proposed projects with the host country's sustainable development objectives; and/or
(2) substantive requirements that CDM projects be consistent with internationally-defined sustainable development criteria, along the lines of the EU proposal?

Pros:

- Either approach would help address concerns that the CDM could work against broader environmental goals.

Cons:

- Sustainable development is country dependent; therefore, it is hard to come up with international criteria that are sufficiently objective to be meaningful at the international level.
- Substantive requirements would likely require greater centralization of the project process, since OEs could not be expected to make determinations on sustainable development issues.
- We can expect strong G-77 resistance. This currently is one of the few issues, likes sinks in the CDM, on which we are closer to the G-77 than the EU.
- We could not expect UG support for proposing substantive requirements, so we would have to go it alone (as we have with respect to unilateral CDM projects). Agreement on procedural requirements may be easier to achieve.

Other:

- G-77 likely to insist that the same requirements be imposed on JI projects.

Issue 2: Exclusion of, or priority for, certain project categories

Nuclear power is currently employed in many developing countries, including China and India. However, different countries clearly have different capacities for managing nuclear power in a manner that is safe and does not pose proliferation concerns. The fact that CDM rules might not be able to distinguish between "safe" and "unsafe" projects poses a potential problem for CDM, both in the short and long term.

Thus far, AOSIS is the only group on record against nuclear power. Germany and some other European countries oppose nuclear projects, while the UK strongly supports its inclusion. It appears likely that the EU will come to a formal decision in the coming months. The Commission has asked us to consider joining them in opposing nuclear projects, perhaps in exchange for inclusion of sinks projects in the CDM. In the Umbrella Group, Canada and Japan appear to be actively supporting nuclear's inclusion, and we understand that Japan is considering building nuclear power plants in China. Both the nuclear power industry and environmental NGOs have also been strongly engaged on this issue, for and against.

There are tactical considerations associated with our position on nuclear power. If the EU comes out against it, and Japan and Canada are strongly in favor, then we may be able to hold a middle position. As we get closer to COP-6, we can continue to gauge the merits of moving off this position (i.e., what would we get in return? what are the politics of holding onto the position?).

In addition to nuclear power projects, large hydro and clean coal projects are other project types likely to draw NGO attention, and about which the US has weighed in elsewhere. At present, however, we are not aware of any governments proposing controls on large hydro projects under the CDM.

Rather than rule out certain types of projects altogether, another option would be to impose international sustainable development criteria on disfavored project types. This approach might be difficult to negotiate if proposed too early, but might be successful as a compromise later in the negotiations.

The notion of giving priority to, or only including, certain project categories - in particular renewables -is supported by AOSIS. WWF has been pressing to include only renewable and energy efficiency projects in the CDM, and appears to be making some headway in Europe. We were told by our Portuguese interlocutor that they may support giving priority to these types of projects.

As a practical matter, it is unclear what it would mean to give priority to certain project categories, unless this meant implicitly excluding other categories. One possibility would be to give priority to certain project categories in the development and approval of baselines. Methodological work to establish baselines for other types of projects (for example, clean coal and sinks) could be put on a back burner.

Issue for decision: Should we change our position, either to:

(1) Exclude certain project categories, such as nuclear?
(2) Accord priority to certain project categories?

Pros:

- Either approach would help address concerns that the CDM could work against broader environmental goals.
- Exclusion of nuclear would help address concerns that nuclear CDM projects would work against broader non-proliferation goals.

Cons:

- Clean coal and sinks projects are the kinds of projects that some U.S. companies (in particular EEI) are looking to undertake. Disadvantaging these project categories would be a major change in position, and could make ratification more difficult.
- Because such projects are likely to generate more credits than most renewables projects, excluding them would likely mean that the CDM would be smaller.
- A change in our position would be interpreted by our Umbrella Group partners as a sign that the U.S. is moving away from them.

Sinks in CDM

Issue

What special rules, if any, are needed for inclusion of sinks in the Clean Development Mechanism (CDM)?

Background

We have strongly supported the inclusion of land-use, land-use change and forestry (LULUCF) projects in the CDM, including both:

(1) Projects that *enhance sequestrations* in forests or agricultural soils, such as afforestation or improved forest management;
(2) Projects that *reduce emissions* from land-use change, such as forest conservation (also sometimes referred to as "avoided deforestation").

Our position in favor of including sinks in the CDM has been supported by the Umbrella Group, many developing countries (including most African and Latin American countries), and some environmental NGOs (in particular, the Nature Conservancy and Environmental Defense). Article 12 of the Kyoto Protocol does not expressly include, but also does not preclude, sinks projects under the CDM.

AOSIS, the EU and many environmental NGOs have strongly opposed the inclusion of sinks in the CDM, arguing that (1) the potential for sinks projects is so large (particularly for avoided deforestation) that sinks projects could swamp other types of CDM projects; and (2) sinks projects are inferior to other types of CDM projects, due to the problems of reversibility and leakage. At the recent IPCC meeting, Brazil was particularly vociferous in opposing the inclusion of avoided-deforestation projects in CDM.

In elaborating our position on sinks in CDM, we will need to address the following issues, among others:

(1) Permanence
(2) Leakage
(3) Implications for sustainable forest management
(4) Potential EU proposals to limit to the amount of CERs that could be generated by sinks projects.

The leakage issue is common to all project-based activities and is not unique to sinks; the permanence issue, in contrast, is particularly pronounced for sinks projects. Because sinks projects implicate other environmental and sustainable development issues (for example, protection of biodiversity), the relationship between sinks in the CDM and the ongoing work concerning sustainable forest management also needs to be considered.

<u>Permanence</u>

The climate benefits of sinks projects are potentially reversible due to:

- human activities (e.g., deforestation of land that had previously been afforested or conserved);
- natural disturbances (e.g., forest fires); or
- environmental change, including climate change (some climate models indicate that global warming will lead to significant emissions from terrestrial ecosystems).

Although avoided fossil fuel emissions can also be reversed – for example, if an oil field is later burned or if a renewable energy project is later replaced by a coal-fired power plant – the problem of permanence is particularly pronounced for sinks projects.

Several approaches have been proposed to address the permanence/reversibility issue:

(1) The CDM rules could specify a *minimum duration* for sinks projects (for example, 100 years, in order to reflect the IPCC's 100 year reference time-frame for calculating global warming potentials; or a time-frame similar to the typical duration of energy or transportation projects).

If a project did not last as long as the required time frame, and the GHGs sequestered by the project were emitted to the atmosphere, *then liability or insurance arrangements* could be used in order to ensure that an equivalent number of credits are returned to the system.

(2) An alternative approach would be to issue CERs, not based on the actual carbon stock changes associated with a sinks project, but using what has been referred to as "tonne-year accounting." Tonne-year accounting is quite complex, but attempts to compute the climate benefits of sequestration on a yearly basis, rather than assuming that a ton of carbon sequestered will be kept out of the atmosphere for the entire 100-year average atmospheric lifetime of carbon dioxide. The result of tonne-year accounting is that sinks projects would generate very few credits in their early years, and more credits towards the end of the time-frame used for the accounting system.

(3) Projects could also be designed in order to provide other socio-economic benefits to local communities, in order to create incentives to maintain projects.

Leakage

The problem of leakage is not unique to sinks projects, but may be more pronounced, to the extent that deforestation is driven by global demand for wood products. The IPCC Special Report discusses several approaches to address the problem of leakage, including:

(1) Incorporating components in projects that supply the resource needs of local communities (e.g., establishing fuelwood plantations to reduce pressures on other forests).

(2) Expanding the project boundaries, for example, to the national level.

(3) Quantifying the level of leakage (for example, by monitoring key indicators or using standard risk coefficients developed for project types and regions), in order to recalculate the emission reduction credits attributable to a project.

Sustainable management issues

Sinks projects can have substantial co-benefits – for example, forest conservation can help protect biodiversity and improve air and water quality. Critics argue, however, that some sinks projects can also have negative impacts – for example, through the replacement of native forests by intensively-managed, monoculture plantations.

Proposals to address these potential issues relating to sustainability fall into two general categories:

(1) Procedural requirements on host countries, for example, to scrutinize projects and certify that they are consistent with sustainable development goals and/or relevant international agreements (for example, the Biodiversity Convention). So long as these procedural requirements were met, the determinations by the host country could not be second-guessed by the CDM institutions.

(2) Substantive requirements relating to sustainable development, which would be applied by the CDM institutions directly – for example, by OEs, the EB, or the COP.

Thus far, we have opposed EU proposals to include substantive sustainability criteria in the CDM. We have not taken a strong position, as yet, concerning procedural requirements.

One possible procedural approach for sinks projects would be to require host countries to assess proposed projects using the criteria and indicators (C & Is) developed internationally to assess sustainable forest management. There are now various international C & I's for sustainable forest management. The US is an active participant in the Montreal Process, which addresses boreal and temperate forests, and includes Argentina, Australia, Canada, Chile, China, Japan, Korea, Mexico, and Russia. In 1995, the Montreal Process countries adopted the Santiago Declaration, which sets forth a comprehensive list of seven criteria and 67 indicators for the conservation and sustainable management of temperate and boreal forests. These C & I's could be used by host countries to assess proposed projects. This could enhance transparency and help ensure that host countries focus on sustainable management issues in their project approval process. In deciding whether to adopt a C & I approach for sinks projects, consideration would also need to be given to the possible implications for other types of CDM projects.

Draft – Deliberative Document – Do not quote or cite
4/18/99

Transparency Issues in CDM

Issue

What opportunities should CDM processes provide for third party input?

Background

The CDM will contain two levels of oversight: 1) Operational Entities (OEs) act to ensure that emission reduction units have occurred, through assessment of baselines, project monitoring, and certification of emission reductions; and 2) the Executive Board (EB) accredits and reviews OEs for competence and integrity, and to promote consistency in decisions. Some have noted that, despite this two-tiered oversight structure, there remains an inherent confluence of interests among CDM participants to overestimate credits, as well as a problem of ensuring consistency across OEs. Transparency has been identified as an important check against such ~~a tendency~~problems. The U.S. has stated that it sees transparency as important, but we have not been specific to this point.

One area where the IWG (and presumably most countries) has agreed is that meetings of the EB will generally be open to observers and accredited NGOs. To the extent that the EB sets general CDM policy, accredits OEs, and approves baseline methodologies, NGOs will have an opportunity to provide their views. The IWG has also agreed on some form of input into the OE review/re-accreditation process. The question has been whether this is sufficient. In this context, Options 2 and 3 should be considered as add-ons to Option 1.

Option 1) OE Accreditation/Review: The EB would notify that an OE is under review, and provide for comment by accredited NGOs. Pros/cons address whether Option 1 is sufficient.

Pros.

- Would likely significantly enhance OE accountability.
- Provides mechanism for NGO input into CDM processes.
- Has less potential for bottlenecks or delays than options below.

Cons

- No review of OE project-level decision-making before CERs are issue~~Problems generally identified only after CER generation~~; could undermine CDM credibility.
- Alone, reaccreditation focus would emphasize punishing OEs, rather than fixing projects; problems more difficult to fix once CERs have been issued; raises profile of "bad" CERs.

Option 2) Require notification and comment during the registration and certification phases of the project. Information on projects could be made available through a website early in the registration and certification phases, and a period of comment (e.g., 30-60 days) could be provided to Parties and/or NGOs. ~~could be provided.~~ OEs would have authority to deal summarily with comments that are legally irrelevant or that have already been addressed. ~~C~~Relevant and non-repetitive comments ~~w~~could be considered by the OE in making the registration or certification determination. Combined with Option 1, OE responsiveness could be a factor (either implicitly or perhaps explicitly) in review and reaccreditation. Combined with Option 3, OE responses would be considered in dispute resolution.

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Option 2(a) Parties and ~~accredited~~ NGOs accredited by the Convention~~.~~

Pros
- Helps allow problems to be identified before they contribute to bad CERs.
- To extent that OE is responsive, promotes credibility in system.

Cons
- Without rules for summary treatment of irrelevant or repetitive comments, ~~P~~potential for capricious or otherwise problematic comments to slow down projects.
- Compared with option 3, NGOs and Parties can't actually stop bad projects.
- Could necessitate more guidance about confidentiality rules if project information was to be made public – some risks involved, and difficult to achieve by COP-6.
- Puts OE in a potentially difficult position, since NGO comments are likely to have policy/political implications. If linked with reaccreditation and/or liability for "bad" CERs, this approach could result in overly conservative decisions, and/or fewer OEs in the system.

Option 2(b) Parties only: Any NGO comments would need to come through Parties.

Pros:
- Would allow for comments prior to key decision points, but limit capricious comments.
- Gives U.S. more influence in policing system to ensure credibility.

Cons:
- Might limit appropriate comments from NGOs from some countries
- More resource intensive than 2(a); Parties would need to arbitrate their NGO comments.
- Same issues with confidentiality above.

Option 3. Project Dispute Resolution ~~Third Party Challenge.~~ The current Umbrella Group position acknowledges the need for a process to resolve disputes arising in the registration or certification stages. Presumably, this would involve a limited period of time (e.g., 30-60 days) to take disputed OE registration or certification decisions to the Executive Board or to some body operating under its aegis. Although most UG members see this as a procedure involving project participants and perhaps Host Parties, it would also be possible to allow third parties (either Parties or accredited NGOs) to raise challenges to the Executive Board as well.

Option 3(a) Parties and accredited NGOs

Pros
- Provides high degree of transparency and public input, which would be consistent with the environmental objective of the CDM (as well as Article 12)
- Compared to Option 2, takes some burden off OEs to make calls about decisions that could have policy/political ramifications.

~~This option envisions a different approach to the scope of OE responsibility than recent UG submissions. The UG draft envisions that an OE would undertake all functions relating to registration and certification, except in cases in which a project proponent proposes a new baseline methodology or multi-project baseline. Since the choice of baseline methodology will often~~

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~~involve considerations that are inherently subjective or political, we have proposed that new baseline methodologies or benchmarks be approved by the EB. NGOs could weigh in on these decisions. OEs would approve any baseline using a methodology already approved by the EB.~~

~~This approach takes from the OE the most subjective aspect of CDM projects, and helps promote consistency among decisions. However, it also carries the danger of an EB bottleneck, and we have been discussing ways to minimize these without an entirely satisfactory answer.~~

~~The following alternative approach has been proposed. Instead of requiring all new baseline methodologies to go through the EB, OEs would be allowed to make provisional determinations of the baseline, as well as all other aspects of registration and certification, on their own. These provisional determinations would be made publicly available on a website, and could be challenged within a certain period of time (again, either by Parties or by accredited NGOs). If not challenged by the end of the period, decisions would stand. If challenged, determinations would be made by the EB on aspects that are challenged. Consistency would be achieved over time through an evolution in EB determinations.~~

~~**Option 3(a) Parties and accredited NGOs**~~

~~Pros~~
~~Eliminates need to have EB approve baselines~~

Cons
- Would necessitate relevance and repetitiveness criteria to preclude capricious challenges; even so, could lead to delayed projects, since projects could be questioned on many grounds.
- Likely that UG will not accept.

Option 3(b) Parties only

Pros
- Provides ~~somewhat less transparency and public input~~a significant opportunity for input into projects, which would be consistent with the environmental objective of the CDM (as well as Article 12).
- Puts the "burden" of raising issues on Parties. Since the U.S. is more likely to engage in serious technical review of projects than other Parties, we would likely carry the stigma of frequently raising issues.
- Less likelihood of capricious delays than option 3(a), and could find favor on the basis that it eliminates need for EB approval of baselines.
- Project information still transparent (as with Option 2 and 3(b))

Cons
- While dynamics would likely be different than 3(a), this new approach to baselines would still be less effective way to achieve consistency than our current position.
- Delays still possible compared with current approach (although uncertainty likely to be greatly reduced.
- Would likely be less difficult to negotiate than 3(a), but will be considerable resistance from UG and others.

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Pre-commitment Period Review of Eligibility Requirements

Issue: Whether to initiate the eligibility requirements for the mechanisms before the commitment period?

Background

We have long advocated compliance with Articles 5 and 7 as an eligibility requirement for participation in the Kyoto Mechanisms. We have also taken an "innocent until proven guilty approach" under which a Party would be deemed eligible to participate unless the compliance body determined it to be in non-compliance with Articles 5 and 7.

The European Union and various environmental groups have expressed the concern that under the US approach, eligibility requirements would not get reviewed until after the commitment period begins. This presents the possibility that a Party could begin trading without meeting the basic eligibility requirements of 5 and 7. The earliest that a non-compliance body could find 5,7 non-compliance and suspend eligibility would be 2010 – the middle of the commitment period.

Discussion

This problem could be resolved by advancing the date of the mechanism eligibility requirements to a date prior to the commitment period. For instance, by 2006[1], any Party that wishes to participate in the mechanisms would be required to have:

- A national system for ghg estimation under Article 5.1;
- A national registry for tracking assigned amount under Article 7.4; and
- An inventory/annual report prepared in accordance with criteria in Articles 5.2 and 7.1;

Parties' implementation of these requirements would be reviewed under the normal Article 8 review process, and reports forwarded to the non-compliance body. If the non-compliance body does not find a Party to be in non-compliance with 5 and 7, then that Party would be eligible to trade. We anticipate that the length of time between submission and completion of the review/compliance process will be less than one year.

<u>Pros</u>

- Promotes environmental integrity by preventing Parties from participating without having met eligibility requirements;
- Would increase the likelihood of securing an innocent until proven guilty approach, and seller liability; with the EU;
- Allows trading to begin prior to the commitment period;
- More certainty for the market, because any country that meets the eligibility requirements up front, would have a high likelihood of remaining in compliance through the commitment period.

<u>Cons</u>

- Would create a one-year difference between when mechanism-using Parties are required to implement obligations and when non-mechanism-using Parties are required to meet the same obligations.

Recommendation: For the above reasons, we propose that the US support pre-commitment period review of eligibility requirements for the mechanisms, and that this issue be raised for discussion at the Umbrella group meeting in May.

[1] Note that a 2006 date would provide sufficient time for eligibility to be reviewed prior to 2008. Parties wishing to begin participation in the mechanisms prior to 2008 could voluntarily undergo review at an earlier date.

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