

# The governance of the Clean Development Mechanism: the case for strength and stability

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## Introduction

The Kyoto Protocol's Clean Development Mechanism (CDM) is a critical element of the global carbon market. The CDM supplies cost-efficient emission reductions to private and public entities that face greenhouse gas (GHG) emission restrictions. With trades representing a value of more than US\$5 billion, the CDM is after the European emission trading system the second largest segment of the global carbon market.<sup>2</sup>

The demand for CERs from CDM projects evidences the Mechanism's unprecedented success. Beyond meeting demand, the CDM is also conceptually important as it is the only operational Mechanism that involves developing countries in international GHG mitigation efforts. As we say in our introductory article, in defining the so-called 'Kyoto Mechanisms', the Kyoto Protocol is both innovative and ground-breaking. There is no other treaty which defines a new international commodity; sets the rules on how this commodity can be created, transferred, used; harnesses market forces by creating supply and demand through binding targets; and finally involves the private sector in the implementation of the Mechanism. The Kyoto Protocol makes us embark on an international market experiment, involving a great number of actors who have no or limited experience with or access to international markets. At the same time, the CDM is also becoming more and more the benchmark for the design of international off-set projects and programmes. It serves as a benchmark standard for voluntarily created emission reductions as well as for off-set mechanisms designed under emerging emission trading schemes in the US or Europe. Taking into account the effort put into the development of methodologies and the Mechanism's infrastructure combined with its support and success in industrialized as well as developing countries, it

is likely that the idea of the CDM, or the Mechanism itself, will form part of a post-Kyoto climate regime.

Meijer and Werksman<sup>3</sup> describe in this Special Issue the complex relationship between the CDM and the environmental integrity of the Kyoto Protocol. While they are correct that there is always a risk that such a Mechanism has the potential of lowering the overall environmental effectiveness of the treaty, in practice however the CDM has become a key element of many country and company compliance strategies.<sup>4</sup> The credibility of the Mechanism depends on the environmental, methodological, and institutional safeguards built into the design and governance of the Mechanism. Provided that the inherent risks of the CDM are well managed, the Mechanism provides a legitimate compliance tool for Annex I countries.

Because it constitutes an important model for the future expansion of the international carbon market, its environmental integrity as well as its efficiency is crucial for the overall evaluation of the CDM's success. The CDM started operations in 2001. After more than five years of implementation, there is a considerable body of experience and of decisions of the CDM Executive Board (EB), the Conference of the Parties (COP) to the UN Framework Convention on Climate Change (UNFCCC) and the Meeting of the Parties (MOP) to the Kyoto Protocol.

This article will focus its analysis on the administrative functions of the CDM. The first section will describe the governance structure of the CDM and review the current decision-making practice of the COP/MOP and the CDM Executive Board. Section 2 looks at procedural demands of a due process and the CDM. Finally, the paper will review particular areas of concern with respect to the administrative implementation of the CDM and develop suggestions for a reform of the Mechanism.

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2 Market data from 'State and Trends of the Carbon Market – 2006' The World Bank and IETA. [http://carbonfinance.org/docs/Carbon\\_Trends\\_2007-\\_FINAL\\_-\\_May\\_2.pdf](http://carbonfinance.org/docs/Carbon_Trends_2007-_FINAL_-_May_2.pdf) (accessed 7 May 2007).

3 E Meijer and J Werksman (see pp 81–90).

4 The National Allocation Plans prepared by EU countries for the 2008–12 period of the trading system (NAP II) include summaries of the compliance strategy of the countries. The NAP II documents can be accessed on the official website of the EU Commission at [http://ec.europa.eu/environment/climat/2nd\\_phase\\_ep.htm](http://ec.europa.eu/environment/climat/2nd_phase_ep.htm).

## I. CDM: the conceptual framework

Joint Implementation (JI) and the CDM provide for the transfer and acquisition of emission reduction credits based on project activities in developing countries (CDM) or countries with economies in transition (JI). JI permits Annex I countries to meet their commitments through the acquisition of emission reductions from carbon abatement projects in another Annex I country. The CDM operates in a similar way. However, since CDM host countries are developing countries, the CDM establishes an interface between Annex I and non-Annex I countries.

The objective of the CDM is to generate cost-efficient emission reductions through investment in developing countries that reduces GHG emissions and the compliance costs for Annex I Parties, and to promote sustainable development in developing countries. The CDM thus establishes a scheme of joint implementation between industrialised and developing countries and provides an important tool for involving developing countries in the Kyoto Protocol processes. As the participation in the CDM requests ratification and compliance<sup>5</sup> from all participating Parties, the CDM provides also an initiative to ratify and a tool for ensuring compliance with the Protocol.

### The regulatory framework of the CDM

The CDM emerged as the 'Kyoto surprise'<sup>6</sup> in the wee hours of the last negotiation day. Based on the proposal of a 'Clean Development Fund' put forward by Brazil, the CDM was created to satisfy developing countries' demands for financial transfers while allowing Annex I countries additional efficiency gains and flexibility in meeting their emission targets. Few, if any, of the negotiators present in Kyoto foresaw the impact of the Mechanism that was being created on international emission trading. Experienced in negotiating multilateral environmental agreements, most negotiators came from environmental ministries and had little experience in dealing with international trade issues and markets. Economic or energy ministry officials were not considered necessary to negotiate something that was seen as a predominantly environmental problem.

When designing the CDM the negotiators drew on examples of financial mechanisms from other multilateral

environmental agreements rather than looking at how global market regulation functions. With the Executive Board for the CDM the UNFCCC COP created a structure similar to the Montreal Protocol's Executive Committee to oversee the implementation of the Mechanism and with the 'additionality' requirement under JI and CDM, a concept closely related to the incremental cost principle of the Multilateral Fund of the Montreal Protocol and the Global Environment Facility.

However, the CDM is more than a simple burden sharing Mechanism where industrialized countries cover compliance costs of developing countries and offer financial aid and technology transfer. The CDM is an off-set Mechanism which provides entities from Annex I countries with an intrinsic incentive for investments in non-Annex I countries. As emission reductions of GHG of the same quality and effect can be generated anywhere in the world, this is one way of addressing the problem of global warming on an international level through Mechanisms based on the principle of trading emission off-sets.

Whereas the integrity of the JI depends on the host country's ability accurately to establish and account for its Assigned Amount Units (AAUs), the integrity of the CDM depends on the rules governing the independent verification and certification of emission reductions. The oversight over the CDM has been entrusted to internationally accredited auditors. These auditors are accredited by the COP/MOP. The day-to-day oversight over the Mechanism lies with an executive board which is assisted by a number of subordinated panels and working groups as well as by the UNFCCC secretariat.<sup>7</sup>

### Legal characteristics of CERs

The Kyoto Protocol has given rise to the first international market in a 'regulatory' commodity.<sup>8</sup> The right that is created through the Kyoto Protocol is of a regulatory nature, and the market is a 'permit' market.<sup>9</sup> The market depends on governments allocating and recognising regulatory

5 Compliance with 'the methodological and reporting requirements under Article 5, paras 1 and 2, and Article 7, paras 1 and 4, of the Kyoto Protocol' is a participation requirement for countries participating in the CDM (see FCCC/KP/2008/8/Add.1 Decision 3/CMP.1 (Modalities and procedures for a Clean Development Mechanism as defined in Article 12 of the Kyoto Protocol) Annex No 5).

6 E Meijer, J Werksman (n 3).

7 M Netto and K-U Schmidt 'CDM Project Cycle and the Role of the UNFCCC Secretariat' in D Freestone and C Streck (eds) *Legal Aspects of Implementing the Kyoto Protocol Mechanisms* (OUP Oxford 2005) 175–90.

8 C Streck and X Zhang 'Implementation of the Clean Development Mechanism in China: Sustainable Development, Benefit Sharing, and Ownership of Certified Emission Reductions' in O K Fauchald, J Werksman (eds) *Yearbook of International Environmental Law* (Vol 16 OUP Oxford 2005, 2007) 259, 264.

9 Most of the markets that exist today do not trade in private property; rather, they trade in regulatory property. See B Yandle 'From Local to Global Commons: Private Property, Common Property, and Hybrid Property Regimes: Grasping for the Heavens: 3-D Property Rights and the Global Commons' (1999)

10 Duke Env L & Pol'y F 13, 1.

Table 1: CDM institutions

Institution	Members Constitution	Policy Guidance	Decision-making	Advice/Comments
COP/MOP	Assembly of all Parties to the Kyoto Protocol. Convenes annually	The COP/MOP is the ultimate authority over the CDM and the governing body over the Kyoto Protocol	COP/MOP decisions are formally not binding (and much less are those of constituted subsidiary bodies)	The COP/MOP acts only as formal legislature in the limited cases in which the treaty has conferred such authority
Executive Board	10 members and 10 alternate members (1 from each of the regional groups of the United Nations, 2 from Annex 1 Parties, 2 from non-Annex I Parties and 1 from small island developing states)	The Marrakesh Accords give the EB the authority to supervise 'under the authority and guidance of the COP/MOP', to whom it shall be 'fully accountable', the implementation of the CDM. <sup>10</sup> Interpretation of the decisions of the COP/MOP	Issuance of CERs. Approval of projects and baseline and monitoring methodologies. Review of small scale project procedures. Accreditation DOEs	Prepares technical and decision papers for review and adoption by the COP/MOP
Subordinated Panels	Nominated experts (call for expression of interests by the UNFCCC Sec), nomination by the EB	Assist the EB in the execution of its tasks. To date it has created 3 of the panels: the Accreditation Panel (AP), the Methodologies Panel (MethP) and the Small Scale Panel (SSc Panel) [from April–August 2002]	The expert panels do not take decisions. Instead they undertake the technical assessments and submit recommendations to the EB	AP: prepares DOE accreditation. MethP: develops guidelines for methodologies for baselines and monitoring plans. Reviews new baseline and monitoring methodologies. SSc Panel: recommended draft simplified modalities and procedures for small-scale CDM project activities
Working Groups (WGs)	Same as for Subordinated Panels	Consultative bodies	The WGs review submissions from stakeholders and undertake technical assessments	The EB established the Afforestation and Reforestation WGs and the Small Scale WG

10 Decision 3/CMP.1 Annex para 5.

Institution	Members Constitution	Policy Guidance	Decision-making	Advice/Comments
Review and Issuance Team (RIT)	Same as for Subordinated Panels. Panel members are not accredited by the COP/MOP	Consultative body	The RIT assists the EB in verifying the decisions of the DOEs (below)	Recommends to the EB project activities that require review as well as any requests for issuance of CERs that require review
DOEs	Environmental auditors accredited by the COP/MOP	The delegation of responsibility by the COP/MOP (COP) to DOEs implies that the accreditation process implemented by the EB needs to be a thorough and detailed one including the possibility of spot checking <sup>11</sup>	COP/MOP delegates responsibility: propose methodologies to the EB – project validation – verification and certification of emission reductions	The DOEs are to be neutral and are not authorised to take any decisions beyond the individual project
UNFCCC Sec	UN professional staff	The UNFCCC secretariat is directly or indirectly to support and link the various actors participating in the CDM	None	The UNFCCC secretariat prepares the minutes of meetings and drafts decisions and guidelines
DNAs	Designated National Authorities of Parties to the Kyoto Protocol	Influence CDM policies through the UNFCCC focal point the national decision teams	Approve CDM projects	
Project Participants	Private and public entities	Develop CDM project activities	None	Prepare submissions to the EB. React to call of ideas/ hearings
Public	Private and public	Participates in EB/ COP/MOP sessions through accredited observers	None	Lobbies national governments and EB members through business and environmental NGOs

11 M Netto and K-U Schmidt (n 7) 175, 180.

property. In the case of the CDM, CERs are treaty based rights which exist only in the context of the Kyoto Protocol. Host country approval is as much a condition for CERs to come into existence as is the approval of the EB and international registration. Without host country approval CERs cannot be created, and the concrete legal recognition and definition of CERs depends on national legal systems. However, the direct involvement of a party in the CDM at the international level is limited to approving the project (normally through a fairly standardised letter of approval).<sup>12</sup> Regulating the technical details of a CDM project as well as the final approval is incumbent on the various bodies created under international law.

### *CDM Institutions*

The COP/MOP acts as supreme body of the Kyoto Protocol and supervises, among others, the CDM. However, except in the few cases where the Kyoto Protocol confers decision-making power on the COP/MOP,<sup>13</sup> the decisions of the COP/MOP are not formally binding on any of the Parties. The acceptance of COP/MOP decisions is founded in a Party's consent rather than through the legislative authority of the COP/MOP.<sup>14</sup> Even where the CDM modalities and procedures adopted by the COP or COP/MOP do not have any formally binding effect on the Parties participating in the Mechanism, there is general agreement among the Parties that the COP/MOP decisions affect their position under the Mechanism.

The main regulatory body of the CDM is the EB. The board takes decisions on methodologies and projects, mandates reviews and revisions. It is assisted in this task by its various expert panels. However, the recommendations of the expert panels are not binding and increasingly the board's decisions do actually diverge from the recommendations of the panels. In the process of

interpreting the Kyoto Protocol and subsequent COP/MOP decisions the EB engages in subsidiary law-making both through rule-making and adjudication.<sup>15</sup> If the COP/MOP decisions do not display any clear legally binding effects on the Parties to the treaty, this is far less the case for the decisions of the EB. However, it appears from the last five years of CDM implementation that while the decisions of the board do not have a formally binding effect on the Parties to the Protocol, their effect has been accepted as de facto binding on entities that participate in the CDM, which includes both Parties to the Protocol and private and public sector legal entities.

The EB prepares annual reports for the COP/MOP. The COP/MOP responds to requests of the EB and provides guidance to the board on its operations.<sup>16</sup> The COP/MOP thus decides over broader policy guidance and on the strategic development of the CDM. However, it is the EB which translates these decisions to the project level, that interacts with private project participants and that acts as the market regulator.

The credibility of the CDM market depends on the robustness of this regulatory framework. The DOEs that serve as validators and verifiers of projects and emission reductions and the Executive Board are the public interface with the private entities that do not have access to the COP/MOP. There are very few other examples of mechanisms where private entities come into such intimate contact with the sphere of international law. In the interaction with the EB, private entities cannot rely on the intermediation of their national governments. At the same time, other than under national law, private entities do not have access to a tested body of constitutional and administrative rights when interacting with the board.

## II. Due process requirements for the CDM

If the CDM and similar market-based global regulatory systems are to succeed, they must provide investors with a degree of regulatory and legal certainty, including opportunities for appeal decisions and timely resolution of disputes.<sup>17</sup> If project participants lose confidence that at the end of the costly project development and CDM approval process CERs will be issued, they will not take the risk of investing in potential CDM projects. Equally, if

12 Parties involved in CDM projects have a number of other rights, such as requesting the review of a project. In addition, Parties can influence the CDM system through their representation in the COP/MOP.

13 Article 21 of the Kyoto Protocol foresees a process of adopting or amending annexes to the Kyoto Protocol which extend legally binding consequences even without ratification of the Parties to the Kyoto Protocol. However, a Party has the right to refuse the acceptance of such amended annex. This procedure is without much effect in practice, as art 21(7) makes it clear that any amendments to Annex A (listing the relevant sectors and GHGs) and Annex B (listing the emission limitations of Annex I countries) need to follow the formal amendment procedure set out in art 20 of the Kyoto Protocol.

14 For a detailed review of the law-making by COPs, see Jutta Brunnée 'COPing with Consent: Law-making Under Multilateral Environmental Agreements' 15 *Leiden Journal for International Law* (LJIL) (2002) 1–52, 32.

15 See also R B Stewart 'U.S. Administrative Law: A Model for Global Administrative Law?', 68 (2005) *Law & Contemp. Probs.* 63–109, 91.

16 Please refer to the COP/MOP section in the UNFCCC CDM website for the list of decisions on guidance by the COP to the Executive Board (<http://cdm.unfccc.int>).

17 Stewart (n 15) 63–109 fn 11, p 91.

they do not expect to be treated with fairness and certainty, they will consider the risk of being exposed to random and unfair treatment as too high to engage in the CDM. It is therefore crucial that the CDM applies commonly accepted principles of administrative law and due process to guarantee fundamental fairness, justice and respect for property rights. Going beyond these basic principles, the governance structure of the CDM must respond to the increasing technical complexity of the Mechanism.

The CDM is an example of the increase of global administrative law, which is characterised by a vast increase in the reach and form of transgovernmental regulation.<sup>18</sup> The EB approximates the domestic law concept of a regulatory agency and if actions similar to those of the EB were performed by national agencies, there would be little doubt of their administrative and regulatory character. It is therefore only appropriate to apply commonly accepted principles of administrative law such as the requirements of transparency, participation, rights to review and accountability to the EB and the CDM in general.

The need to provide for the administrative due process requirements has been recognised by the UNFCCC negotiators and is reflected in the Marrakesh Accords and in other decisions of the COP/MOP. The Marrakesh Accords provide for the independence of the EB,<sup>19</sup> for open sessions and participation in CDM EB meetings<sup>20</sup> and the rules of procedure for the EB including participation in requests for review initiated by the EB.<sup>21</sup> However, practice shows that there are a number of areas of concern with respect to the operations of the CDM, as discussed below.

### Independency

The EB and the DOEs need to be neutral and independent. Any potential conflicts of interests need to be avoided, independently of whether these interests are of a financial, political or personal nature.

Although EB members are nominated by constituencies and elected by the COP/MOP they act in their personal capacities. According to the CDM modalities they do not represent any country or constituency. They have to be properly qualified and without interest in any project. Members of the EB serve under oath. At the beginning of

each meeting, the members of the board confirm that they do not have any interest in any project or operational entity.<sup>22</sup> Affected entities can raise objections regarding this confirmation.

In practice the interpretation of conflicting interests is de facto reduced to the question of financial conflict of interest. While it can be assumed that no EB member has a pecuniary interest in the CDM projects he/she reviews, political conflicts of interest are common, and in some instances those conflicts appear to dominate the board's decision practice. EB members are often at the same time UNFCCC/KP negotiators for their country, representing the designated national authority for the CDM, or managers of large government CDM purchase programmes. Although there may well be no financial conflict of interest, many EB members are entangled in a complicated web of different interests which is tolerated by the COP/MOP and the members of the board.

### Transparency

The increasing exercise of public power on the international level has given rise to concern about legitimacy and accountability. Transparency implies accountability as well as openness for dialogue. In the international arena where well defined administrative rights are missing, transparency is of particular importance. The CDM needs to rely on transparent decision structures to enhance the acceptability of the Mechanisms and the accountability of its institutions.

The EB is an example of a body which exercises regulatory functions but is not directly subject to control of national governments or national legal systems. Transparency and public participation counterbalance the missing legal control and provide for accountability and review of decisions taken. As Meijer and Werksman point out in their contribution to this Special Issue, the public scrutiny of the CDM is supposed to play a central role in decision making.<sup>23</sup> The CDM project cycle provides the possibility of public participation at the project level: the project developer has to seek comments from local stakeholders when designing the project, and the validator has to make the final Project Design Document available for international public comments before finalizing validation. At the same time the EB meetings 'shall be open to attendance, as observers, by all Parties and by all UNFCCC accredited observers and stakeholders,

18 On the concept of 'global administrative law', see B Kingsbury, N Krisch and R B Stewart 'The Emergence of Global Administrative Law' 68 (2005) 3 *Law & Contemp. Probs.* 15–61; N Krisch, B Kingsbury 'Global Governance and Global Administrative Law in the International Legal Order' 17 (2006) 1 *European Journal of International Law* 1–14.

19 Decision 3/CMP.1 Annex para 8(c) and (f).

20 Decision 3/CMP.1 Annex paras 16 and 17.

21 Decision 3/CMP.1 Annex para 8(j), (k) and (o).

22 Decision 3/CMP.1 Annex para 8(f).

23 E Meijer, J Werksman (n 3).

except where otherwise decided by the Executive Board'.<sup>24</sup> According to rule 14 of the EB rules and procedures<sup>25</sup> the chair of the board can decide over the opening and closing of EB meetings without giving reasons for his/her decision. In addition the EB may decide 'in the interest of economy and efficiency, to limit attendance at its meetings to members, alternate members and secretariat support staff'.<sup>26</sup> The public is not allowed to attend the meetings of the expert panels (not even the influential Methodology (Meth) Panel) nor the meetings of the Working Groups.<sup>27</sup>

As a result, not even those entities that are directly affected by the decisions of the EB have access to the board meetings. Little help is provided by the assurance that where the public remains excluded, the 'Executive Board shall take all practicable steps to accommodate in other ways the interests of Parties, non-Parties to the Kyoto Protocol that are Parties to the Convention and accredited UNFCCC observers and stakeholders to observe its proceedings, except when the Executive Board decides to close all or a portion of a meeting'. In practice there is a clear tendency to limit attendance to EB meetings and to close sessions. Recently it occurs more and more often that over half of each EB meeting take place behind closed doors.

### Efficiency

Consistent with the aim of ensuring environmental and social integrity, the CDM process should minimise: (1) the duration of the review; (2) the transaction costs for project developers; and (3) the administrative costs of the international process. The review procedures should be as streamlined as possible.

Reality does not live up to this aim. The CDM process is lengthy and cumbersome. The approval of new methodologies can take between six months and two years; different interpretations by the MethP and the EB lead to delays and even the mandatory 90-day period for a submitted project to be registered is set back in practice.<sup>28</sup>

24 Paragraph 16 of the Annex to decision 3/CMP.1 on modalities and procedures for a CDM, document FCCC/KP/CMP/2005/8/Add.1.

25 At its first session, the COP/MOP (COP/MOP1) adopted the Marrakesh Accords as well as all draft decisions recommended by the COP since the 'Prompt start of the CDM' in 2001, which included Rules of Procedures for the Executive Board. <http://cdm.unfccc.int/Reference/COPMOP/08a01.pdf#page=31>.

26 *ibid* Rule 27.

27 The newly created 'Review and Issuance Team' (RIT) has been created without any clear legal basis and, although it is highly influential, there is no international process of selecting and appraising of its members; nor are the meetings of the team open to the public.

28 The UNFCCC secretariat has introduced the practice of counting the 90-day period not from the moment of submission of

It is true that the EB is confronted with an increasing workload both relating to the scope of guidance sought by project participants as well as to the sheer number of projects presented for registration. It is also true that the EB consist of extraordinary committed and hard working individuals. However, the individuals serve on the board in addition to their full-time jobs and for part-time volunteers it is almost impossible to keep up with the workload presented by the EB.

In addition the EB is confronted with an increasing number of technical issues which lie beyond the expertise of its members. While the EB members would be qualified to exercise an oversight function, they are overwhelmed with technical details of various project classes. The requirements of daily micro-management of project and methodology related issues leads to delays in the approval of projects and review of methodologies.

### Predictability and certainty

Decisions of the EB (and DOEs) should be consistent and thus predictable. The various rules and decisions have to be applied in a consistent manner to ensure the fair treatment of all project participants.

In reality the decisions and interpretations of the EB are often unpredictable.<sup>29</sup> Lack of predictability may, to a certain extent, be the logical consequence of ambiguous COP/MOP decisions which lie outside of the control of the EB. However, there are a number of issues that increase the risk of inconsistent decisions practice: (i) the lack of institutional memory and the rotation of the EB members;<sup>30</sup> and (ii) insufficient technical expertise. The issues presented to the EB are of increasing technical complexity which goes beyond the training and expertise of the EB. In addition, political interests and horse-trading may play an additional role in influencing EB decisions.

### Review

Where rights of private entities are affected by EB decisions those entities need to be granted the right to review a decision that they wish to contest.

the documents but from the moment the secretariat and the RIT consider the documents to be complete. Misspellings or other minor issues can thus lead to significant delays in the registration process.

29 IETA 'Strengthening the CDM' Position Paper for COP 11 and COP/MOP 1, 5. <http://www.ieta.org/ieta/www/pagesgetfile.php?docID=1132>.

30 This point is partly being addressed by an increasing number of professional UNFCCC secretariat staff. However, currently the UNFCCC staff is still new and does not possess the required institutional memory.

It is a condition for a fair administrative procedure that those entities that are affected by the decisions of a regulatory body have access to a full and fair review of the decision. The COP/MOP decisions foresee a review procedure of some contested decisions when a decision improperly affects a Party's interest. The review is conducted by the enforcement branch of the Protocol's Compliance Committee.<sup>31</sup> However, these procedures do not extend to non-Party participants in CDM projects. Under the existing guidelines, procedures and rules, the procedural rights of private parties are very limited. Under the current regime, affected project participants are afforded no opportunity for review of board decisions.

The CDM is dominated by private sector interests. Without being granted procedural rights and access to appeal and review of EB decisions, private sector participants may turn to domestic courts as a forum of redress when global administrative bodies are seen as infringing their rights.<sup>32</sup> While national courts may address the lack of accountability at the international level, a review of CDM procedures by national courts would seriously put at risk the coherence of the Mechanism that would be unable to survive as a global Mechanism if it were the subject of various interpretations and litigation in the different Party States of the Kyoto Protocol.

### III. Suggestions for strengthening the CDM

In its daily operations the EB clarifies and interprets the application of the decisions of the COP/MOP. The EB serves as the main administrative body under the Kyoto Protocol. It approximates the domestic law concept of a regulatory body<sup>33</sup> and its decisions or its omissions to decide have important financial consequences for any project participant, regardless of whether it is a party or a private legal entity participating in a particular CDM project.<sup>34</sup> The CDM Executive Board exercises the power to develop and apply subsidiary rules considered binding upon both private and public entities.<sup>35</sup> But the

CDM does not provide entities affected by decisions of the EB with procedural rights comparable to domestic administrative law regimes. Such absence may undermine the confidence of private entities in the functioning of the CDM and eventually lead to their withdrawal from the Mechanism. In addition, the absence of a formal review or appeal procedure increases the risk that members serving on the EB may be held personally accountable for decisions of the board in domestic courts.<sup>39</sup>

If the CDM is to survive the first commitment period of the Kyoto Protocol it is essential that it undergoes a number of changes in order to lift the CDM process to the level of an administrative procedure that meets normal national standards. These changes are of technical rather than of substantive nature and they are relatively easy to enact. Taking into account the areas of concern listed above we consider the following points as being crucial elements for CDM reform.

#### Professionalising the EB

The current EB is more a UN committee than a market regulator. The majority of its members have a background in international environmental negotiations rather than in market regulation. For this reason, the considerations of the board often relate more to agendas raised during the international negotiations than to the sorts of issues that businesses need to create an efficient and credible international market.

In order to address the current situation, the EB should be staffed with full-time salaried individuals whose collective expertise spans the entire range of sectors and is grounded in practical project level experience and knowledge of the CDM. EB members would be selected on the basis of their technical expertise and their ability to deal thoroughly and fairly with the request brought to them. The right of the various geographical constituencies to nominate EB members would remain untouched; however, the nominations should be supported by a clear statement of expertise of the proposed new member. The existing EB members have to approve the selection of a new member of the board. The members would be formally hired as employees of the UNFCCC secretariat; however, they would directly report to the COP/MOP. The UNFCCC secretariat would assign staff to support the EB members in the fulfilment of their function. A precondition for such

31 Decision 27/CMP.1 Annex, Procedures and mechanisms relating to compliance under the Kyoto Protocol ss IX and X.

32 Kingsbury, Krisch and Stewart (n 18) 30.

33 R B Stewart (n 15) 63–109, 91.

34 The conception that non-state actors are the regulated entities presents an evolution of international regulation away from a state-centric mode and towards a conception of global regulation of market actors, with states serving an intermediate position. R B Stewart (n 15) fn 11, p 96; other examples can be found in the context of the WTO and the Montreal Protocol.

35 R B Stewart (n 15) 63–109, 99.

36 Privileges and immunities for individuals serving on constituted bodies established under the Kyoto Protocol. FCCC/SBI/2006/21.

change in the EB constitution is the availability of sufficient and predictable long-term funding.<sup>37</sup>

### Installing a review process

The COP/MOP should establish an appeal process which gives standing to individuals that are granted rights and obligations under the CDM and guarantees a full review of EB decisions. The appeal body could consist of a small number of individuals nominated by the COP/MOP competent to hear cases and pass judgment upon claims alleging the violation of procedural or substantial rules governing the CDM. The appellate body would adopt rules of procedure that would itemise the formal requirements of submissions and hearings as well as other matters regarding the functioning of the Mechanism. The decisions of the appeal process would have to be final. The appellate body would be supported in its activities by the UNFCCC secretariat. Its proceedings as well as the considerations for any judgment would be publicly available.<sup>38</sup>

### Enhanced transparency and the right to be heard

Private entities affected by decisions of the EB should have the right to be heard before a final decision is taken. Such right can be granted in writing or by a hearing. The tendency of the EB to deal with an increasing number of issues behind closed doors or limit the attendance of the meetings<sup>39</sup> gives grounds for concern. The EB meetings should be embedded in an open, transparent process that gives stakeholders a right to petition and engage in dialogue with decision-makers. A lack of predictable, objective, routine interaction combined with insufficient communications between the EB, project participants and stakeholders has resulted in frustration and inefficiencies.<sup>40</sup>

### Compiling CDM Rules

Anyone who is not spending a significant amount of his/her time in trying to understand the functioning of the CDM (including many project participants) is inevitably lost in

the thicket of decisions and interpretations relevant for the CDM. In order to allow a fair and transparent application of all CDM relevant rules, the UNFCCC secretariat should make available a compilation of all rules governing the CDM. These rules consist of three layers: (i) the Kyoto Protocol; (ii) COP/MOP decisions; and (iii) EB decisions that are currently spread over uncountable documents and their annexes. The rules should be thematically organised, referenced and indexed.

The official compilation of CDM rules should be maintained and updated by the UNFCCC secretariat. The EB should review the rules periodically and present the updated compilation annually to the COP/MOP for endorsement. If a dispute arose in which there is more than one version of a rule, the latest effective version on file with the division was considered the correct, current version.

A number of these points have already been made at the occasion of the first session of the COP/MOP and have led to a number of changes in the CDM governance.<sup>41</sup> This shows that the CDM is not immune to proposals for reform. It is – and given its innovative nature has to be – a Mechanism which is able to learn and adapt.

## IV. Conclusion

The Kyoto Protocol CDM is arguably the most innovative experiment of international law to date. It creates a new framework for private-public partnerships which supports the objectives of the Protocol and the participants' compliance with its obligations. The success of the CDM makes it likely that the Mechanism will survive the first commitment period of the Kyoto Protocol.

The CDM EB is the centrepiece of the regulatory framework governing the CDM. Ever since it was created it has triggered discussions and controversy. Industry considers the decisions of the board as often too strict emphasising 'rigor at the expense of pragmatism' with such rigour stifling 'projects with good environmental and development benefits from being implemented'.<sup>42</sup> On the other hand, a fair number of NGOs criticise the CDM for not being sufficiently strict.<sup>43</sup> Whichever side one takes in

37 Taking into account the amount of CERs to be issued by the EB, it is likely that the administrative expenses will be covered by the 'share of proceeds' paid by project developers. The fee amounts to US\$0.1 for the first 15,000 CERs issued each year and US\$0.2 for any subsequent CERs. Decision 7/CMP.1 (Further guidance relating to the clean development mechanism) No 37. FCCC/KP/CMP/2005/8/Add.1; as well as Annex 35 of the Report of the 23rd Meeting of the Executive Board.

38 Privileges and immunities for individuals serving on constituted bodies established under the Kyoto Protocol. FCCC/SBI/2006/21.

39 It is important to note that from a participative point of view there is a difference whether stakeholders are present in the room or whether the meetings are transmitted by webcast.

40 IETA (n 29).

41 Decision 7/CMP.1 (Further guidance relating to the clean development mechanism) No 9–18.

42 IETA (n 29).

43 See The Corner House, Sinks Watch and Carbon Trade Watch, 'Memorandum to the Inquiry into the International Challenge of Climate Change: UK Leadership in the G8 and EU' (2004). See <http://www.thecornerhouse.org.uk/item.shtml?x=86000> as well as for further references <http://www.carbontradewatch.org/> (both accessed 17 April 2007).

this discussion, it remains without doubt that the EB is made up of highly motivated individuals. These individuals, working chronically long hours, managed to get the CDM off the ground and to enable the board to register more than 500 projects by March 2007. The success of the CDM can be attributed to the commitment of these individuals as well as the responsible UNFCCC staff.

However, if we are serious about our commitment to a carbon market, as recommended by the Stern Report,<sup>44</sup> it is time to replace the EB with a professional regulatory body.

Today the decisions of the EB are not always predictable and often come as a surprise to project participants and technical project experts. Most of the board members are public officials without any particular technical expertise of the functioning of global markets in general or the sectors in which the CDM projects happen in particular. It is also not unusual that the same individual represents a country in the UNFCCC negotiations and on the EB, or is in another way involved in setting climate and CDM policy for his or her country. Such double responsibilities result often in a complicated situation of various conflicting interests. At the same time the missing administrative process rights of

private entities affected by the rulings of the EB put at risk the survival of the Mechanism. Desperate for recourse and compensation, private entities may turn to national courts. Domestic courts may decide to seek to review the legality, procedures and substance of international regulatory and other administrative decisions taken by the EB that directly affect the claimants. Such review may lead to a wide variety of different national interpretations of the CDM and its procedures, putting at risk the coherence and international acceptance of the Mechanism.

There are very few mechanisms that pioneer the emerging legal discipline of international administrative law in such a perfect manner as the CDM. The CDM regulates a market dominated by private players who depend, for the creation of the market's underlying asset, on a UN committee that approves calculation methods and projects. Such a Mechanism must be governed by strong institutions independent of any political interference. Only if it relies on a code of rules that regulate the rights and obligations of the private entities affected by the decisions of the market regulator, will the CDM make true the promise that is inherent to its design: the creation of the first global environmental market Mechanism.

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44 N Stern 'Stern Review on the economics of climate change' (2006) Part VI ch 22 [http://www.hm-treasury.gov.uk/independent\\_reviews/stern\\_review\\_economics\\_climate\\_change/stern\\_review\\_report.cfm](http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm) (accessed 17 April 2007).