



CLIMATE FOCUS

Memo

To: The International Emissions Trading Association (“IETA”), the Climate Group, the World Economic Forum Global Greenhouse Register (“WEF”)
From: Charlotte Streck, Adriaan Korthuis, Robert O’Sullivan, **Climate Focus B.V.**
Subject: Comments on the Voluntary Carbon Standard
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We welcome the initiative of IETA, the Climate Group and WEF to develop a standard for the voluntary carbon market. We are convinced that the volumes of verified emission reductions to be traded on the voluntary carbon markets will see a sharp increase in the coming years. The voluntary carbon market (i) provides the opportunity to entities not covered by mandatory emission regimes to off-set some or all of their greenhouse (“GHG”) emissions; (ii) bring new international and national actors into the carbon markets; (iii) provides room for the development of projects in categories currently not included in the Clean Development Mechanism (“CDM”); (iv) provides a potentially more cost-effective mechanism of bringing credits to the market from small projects where it may not be economical to register the projects as CDM projects. The creation of a standard for this market helps to set a benchmark for integrity and value.

We appreciate the opportunity to provide comments. We have summarized our comments and suggestions below which ought to be read with the understanding that our sole objective is to contribute to the wide spread success of the Voluntary Carbon Standard (“VCS”) without further delay.

These are our comments:

1. Scope.

Added value. In general, we consider the current version of the Voluntary Carbon Standard as too complicated and overly restrictive.

In its design the VCS appears to be closely modelled after the CDM. So closely, that it fails to grasp the opportunity to overcome the restrictions of the current mechanism. This raises the questions about the value-added of the current version of the Standard. Project developers having the choice between applying the CDM or the VCS will seek to maximize their benefits. Unless the application of the VCS shows clear advantages, they will apply the CDM to generate Certified Emission Reductions (“CERs”) which are traded at higher prices than verified emission reductions. In particular as the documentation needed to register emission reductions under the VCU go beyond the requirements for the CDM (eg separate monitoring plan, transfer certificate).

Advantages of the VCS compared to the CDM could consist in lowering transaction costs for small projects or in the applicability of the Standard to additional sectors or project classes.



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Additional value adding could also be achieved through verification and recording of additional co-benefits that are often associated with projects such as employment creation, wastewater treatment, or biodiversity conservation.

Other sectors. We regret the limited applicability of the Standard and believe that the Standard forgoes the opportunity to define credible ways to account for emission reductions currently not framed under the CDM, such as forest management, avoided deforestation, carbon storage, and emission reductions from aviation or non Kyoto gases. We consider it essential to create a benchmark Standard for all emission reducing project activities to create the incentive framework which triggers such emission reductions to be realized.

Requiring the cancellation of an AAU for each VCU in Annex I countries will also severely restrict or prevent the application of the Standards in Annex I countries.

The voluntary market is the place where knowledge is being created and projects being tested. Whereas it is important to account for emission reductions in a conservative manner to safeguard the integrity of the process, the VCS should open an opportunity for those that wish to undertake extra efforts to mitigate climate change. Within this frame, we consider it the role of Standard to define conservativeness without being exclusive in its scope.

Forestry. This is in particularly true for the forestry sector which accounts for the largest quantities in voluntary off-sets. Projects in the area of Land use Land-use-change, and Forestry (“LULUCF”) are under the CDM limited to afforestation and reforestation projects. Other project classes that entail significant sustainable development (sustainable agriculture, watershed management) or climate (avoided deforestation, forest management) benefits remain excluded. Projects developed in the excluded project classes are currently offering their emission reductions and removals on the voluntary markets. In order to avoid a second exclusion and allow these projects to apply the Standard and achieve VCU registration, we consider it important to open the Standard to a wider range of forestry projects. Issues relating to permanence could be solved in a similar manner as in the CDM by creating temporary carbon credits.

Additionality. The Voluntary Carbon Standard applies the concept of project additionality. This concept, a creation of the CDM Executive Board, introduces a subjective element in the project elevation (what made the investor invest?). The additionality criterion makes the project owner elaborate on his investment motivations; an elaboration which adds little to the debate, emission reductions, or the integrity of the mechanism. It is interesting to note that the interpretation of additionality in the Standards goes beyond the official position of IETA and the JI Supervisory Committee. We recommend applying the easier and verifiable concept of environmental additionality, which focuses on emission reductions rather than on motivations.

Crediting Period. The Standard applies a 10 year crediting period. A project should be able to generate credits for the life of the project rather than for an arbitrary crediting period. There is no reason why a project that reduces emissions or sequesters carbon should not be able to generate credits for longer than 10 years – particularly forestry projects that may not generate the bulk of their credits in such a short time period. Placing an artificial cap on the



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period of time a forestry project can generate credits creates a perverse incentive to harvest the forest as soon as the VCU credit income stops.

2. Applicability.

Clarity. The current version of the Voluntary Carbon Standard leaves significant room for interpretation. Through a complicated system of referencing and integrating of several other standards, the VCU is not promising to be cheaper or less bureaucratic than the CDM in its application.

The Standard takes its concepts from a variety of existing Standard and criteria, such as the CDM, the PCF/IETA GHG Protocol, various ISO Standards, and the WBCSD-GHG protocol. Through referencing the Standard import parts of these different Standards into the VCS. While there are clear advantages to build on existing work and experiences, the VCS would gain in transparency and clarity if it would replace the reference to that Standard by a transposition of the concepts and criteria into the standard instead of relying on references. The current system of referencing makes the Standard difficult to understand and even more cumbersome to apply.

Additionally, the current version of the Standard appears to use the concepts and terms of the various existing standards inconsistently. A thorough review of the terms used, better compendium or glossary of the applied terms, would be useful to define terms and clarify their applicability. In some instances it is sufficient to review the terminology (eg (P)(p)roject (O)(o)wner, project developer, project proponent); in others clarification in substance would be useful:

Validation of a project or verification of emission reductions. It is not clear whether the “VCU Registration Process” refers to the registration and verification of a *project* or the registration and verification of *emission reductions*. On one hand, the document mentions that validation would be recommended (section 2.1.), but not obligatory. On the other hand the Standard refers in several instances to the “certification” of project design and compliance (eg sections 1.2 or 2.3, in the Verification Criteria). Such a project certification would correspond to the CDM validation. Finally, to make things even more confusing, the Standard defines in 2.1.(2) the “*registration of forward streams of VCUs*” as validation. In the same section under (6) “validation” and in the table summarizing the steps of the registration process, the term “validation” is being applied in the CDM-manner, as validation of a project (design).

It would be useful to clarify whether the verification looks only at the emission reductions (traditionally: verification) or also at the project design (traditionally: validation). If both steps are foreseen, then procedures for both steps should be formulated. If on the other hand, the verification of the emission reductions is considered as sufficient, the document should throughout refer to the verification of the emission reductions, not of the project. In this case, a registration and verification of the project (validation) would not be considered necessary.



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Documentation and processes. There is ambiguity with respect to the procedural steps and required documentation. It is not clear whether documentation to be produced by the verifier includes both a “verification report” and “certification statement” and whether the latter would be sufficient. Section 2.1. suggests that both documents (verification report and certification statement) are to be produced, while section 2.3 describing the scope of work of the verifier limits his task to the issuing of a certification statement.

Similarly the relationship between the Project Design Document (PDD) and the monitoring plan should be clarified. In the CDM the monitoring plan forms part of the PDD. The monitoring data are summarized in a monitoring report. In the case of the VCS, a separate monitoring plan has to be submitted together with a PDD to achieve registration (certification?) of the VCUs. It would be clear how this monitoring report should differ from the one included in the PDD.

The sequence of steps in the registration process would benefit from clarification. The table suggests that the project owner issues a VCU title and Transfer Form (in some instances also referred to Title Certificate and Transfer Form, which suggests 2 forms rather than 1) after verification, while the main body of the text (section 2.1.) states that a Title Certificate and Transfer Form constitutes a condition for verification.

3. Legal Issues

A number of the requirements of the VCU raise legal concerns and questions:

Title certificate. The Standards require the project owner to issue a “VCU Title Certificate and Transfer Form” (also referred to as “Title and Transfer Form”). The certificate shall “prove and warrant” the ownership of emission reductions.

In most jurisdictions the ownership of emission reductions is not defined. In the absence of such definition, lawyers have tried to define ownership – or at least some sort of proprietary right – by applying the principles of general law of the respective jurisdiction. Such exercise resulted in different interpretations depending on the jurisdiction – and the lawyer applying the principles.

While most legal experts would agree that an owner and operator of a project is authorized to sell carbon credits, the question of ownership is often more complex and involves multiple entities and complex company and project structures. Under the CDM, the host country approval and the authorization to sell the CERs of a project has an enforcing character, although the host country approval alone hardly can be seen as prove of ownership. In the current market, the recognition of ownership and the right to sell is further evidenced through the contractual relationships between the various entities involved in the project. However, whereas these measures reduce the risk of litigation they do not (or not always) establish a defensible property right. A prudent project owner will therefore be reluctant to “issue” an ownership certificate. Not only can he not be sure whether indeed he holds the full ownership right, moreover the legal value of such self-issued certificate is questionable as it is unlikely to hold in court.



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Generally ownership is a private law issue; it is therefore not clear why establishing ownership to the carbon rights should be a requirement of registration of a VCU. Property rights and ownership positions are generally something being established and transferred by private law contracts.

We therefore suggest deleting the requirement to issue a Certificate of Ownership from the Standards. This is not only advisable from the legal point of view, it also makes sense commercially: Requiring an ownership certificate at the time of registration would make it impossible for project owners to sell emission reductions under a forward contract as he would create a contractual claim to the emission reductions. Often the selling of at least part of the emissions reductions under a forward contract is crucial for the project owner to raise capital for the project.

Double counting: AAUs. In order to avoid double counting of emission reductions, the Standard requires for emission reductions in an Annex I country a certificate from the local authorities confirming that the country has cancelled an amount of AAUs that corresponds to the VCUs certified.

Double counting should certainly be avoided. The requirement to bring an official certificate from the hosting nation confirming the cancelling of AAUs however raises a number of legal concerns, such as

- The cancelling of an AAU constitutes a sovereign act. Private participants have no right to request such action without a formal right being granted.
- The cancelling of an AAU results in a transfer of value from the country to the private entity, which would have to be evaluated in the context of administrative and state aid procedures of the country.
- Such requirement would discriminate against voluntary action in Annex I countries and would favour activities in Non-Participant countries (US, Australia) or developing countries.

Taking into account that there are no legal grounds on which basis a private entity could require its government to cancel AAUs, we consider this requirement as not practical as it will be impossible to comply with for most Annex I entities.

Double counting: RECs. The Standard requires further that there is proof that the VCUs do not result from an activities implemented to achieve a renewable energy target or for which Renewable Energy Certificates have been or will be issued.

Most countries by now have renewable energy targets. In the majority of countries the investment in renewable energy is stimulated by additional financial incentives such as Renewable Energy Certificates or feed-in tariffs. However, these policy instruments are not directly rewarding emission reductions; they are subsidy schemes like many others.

Regarding the overall renewable energy targets, it is important to note that they normally apply to the country or a particular sector, but not to a particular project. We are not aware of any country that would mandate a particular investment in the energy sector. The subsidy



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schemes designed to reward renewable energies come in various forms. The issuance of Renewable Energy Certificates is only one of these schemes. It is therefore not clear why the Standard should discriminate against Renewable Energy Certificates, but tolerate preferential tariffs or investment subsidies. In this context it is also important to keep in mind that the promotion of renewable energy pursues multiple objectives, the issuance of Renewable Energy Certificates are therefore not targeted payments for emission reductions.

Criteria 9 of the Standard. Criteria 9 of the Standard requires the Certification Entity to check the compliance of the project with environmental and social legislation of the host country. Given the complex and wide-spread social and environmental rules and obligations, such compliance check would be very expensive. The Certification Entity would also hardly be qualified to undertake such check. Further if the certification would include a confirmation of compliance, the Certification Entity would expose itself to potential liabilities.

4. Smaller comments

Name. Emission reductions and removals are currently traded as “verified emission reductions” or “VERs” on the voluntary market. Is it necessary to create a new unit given that there is already a proliferation of units on the Kyoto and regulated markets?

Clause 2.2.: Designated Operational Entities and Accredited Independent Entities under the CDM and JI respectively are accredited by the COP/MOP not the Executive or the Supervisory Board.

Project owner, project developer and project proponent are terms that are used interchangeably. The use of the words should be clarified or the various terms be defined.

It is not clear what “*other mitigation programmes*” under section 1.4 means

Throughout the document, the Standard uses terms in *capitalized terms* (eg Endorsed project categories, Performance Standard, etc) that are not introduced, explained or defined in the document. If necessary, these terms should be defined, otherwise it would make the Standard more reader-friendly to avoid un-defined terms in capital letters.

In order to ensure the integrity of the project periods and standards for *public consultation* periods should be defined (section 2.7).