CARBON MARKET WATCH[1] RECOMMENDATIONS TO SBSTA-37

VERSION: 14 NOVEMBER 2012

This paper outlines key issues under discussion at the 37th Session of Subsidiary Body for Scientific and Technological Advice (SBSTA). Carbon Market Watch provides recommendations in particular to the following agenda items:

1. Agenda item 12 (a): **Carbon Capture And Storage (CCS)** under the Clean Development Mechanism (CDM)
2. Agenda item 12 (b): **LULUCF** issues in the clean development mechanism (CDM)
3. Agenda item 12 (d): Crediting of **new HCFC-22 facilities**

1. CARBON CAPTURE AND STORAGE (CCS) UNDER THE CLEAN DEVELOPMENT MECHANISM (CDM), AGENDA ITEM 12 (A)

Despite the decision by Parties in Cancun in 2010 to include CCS projects under the CDM, Carbon Market Watch remains opposed to this decision. However, we believe that it is important to ensure that projects are implemented as safely as possible and that loopholes in the current framework are closed immediately.

At CMP7, Parties adopted modalities and procedure for inclusion of CCS projects in the CDM. Two issues are being considered by the SBSTA in Doha:

(a) The eligibility of trans-boundary CCS project activities;
(b) The establishment of a global reserve of CERs for CCS project activities.

ADDRESS LOOPHOLES BEFORE ALLOWING TRANS-BOUNDARY PROJECTS

Carbon Market Watch believes that trans-boundary project activities should not be included before extensive experience has been gained with CCS project activities under the CDM that do not face trans-boundary issues.

Trans-boundary CCS project activities raise several legal issues, such as the clear assignment of liabilities, the assignment of the responsibility to replace CERs in the case of seepage from the reservoir, the transboundary approval of projects, etc. Addressing these issues without practical experience how the new rules work for CCS projects located in a single country is pre-mature.

Moreover, the current modalities and procedures have two important loopholes which should be addressed before the inclusion of trans-boundary project activities is considered:

1) **Monitoring requirements** of the geological storage site may, under some conditions, end 20 years after the end of crediting. This is too short to ensure the permanent storage of the CO2. The IPCC Special report states that CO2 seepage may occur "distant in time".[2] Once monitoring ends, no entity is responsible to compensate for the atmospheric damage from any seepage. In addition, the modalities do not explicitly require that the geological storage site has been appropriately sealed and closed before monitoring of seepage is stopped. The current

[1] Formerly CDM Watch

[2] IPCC Special Report "Carbon Dioxide Capture and Storage". Technical Summary. Page 46.

monitoring provisions need to be revised to require monitoring of potential seepage for a more appropriate time interval, but at for 100 year after the closure of the geological storage site.

2) Under the current rules, any type of Kyoto unit may be used to **compensate for seepage**. However, many of these units, in particular AAUs, are available in excess, also referred to as "hot air". Using such units to compensate for seepage from CCS projects will thus not actually compensate for seepage but de facto increase global emissions.

Carbon Market Watch urges Parties to address these important loopholes in the current framework. The global reserve of CERs for CCS projects, which will be discussed in Doha, could be one way to ensure that also long-term seepage is accounted for. Yet such a reserve should not create a disincentive for project participants to minimize seepage.

=> Carbon Market Watch calls upon Parties to

(a) decide to postpone considering modalities for trans-boundary projects until extensive practical experience has been gained with the implementation and monitoring of CCS project activities under the CDM that are located in one single country;

(b) revise the monitoring provisions of the current modalities and procedures to ensure that any seepage from the reservoir is monitoring and compensated for in the long-term;

(c) revise the provisions for cancellation of Kyoto units, ensuring that only units that represent real and additional emission reductions may be used to compensate for seepage;

(d) in considering the establishment of a global reserve of CERs for CCS projects to compensate for long-term seepage from the reservoir to ensure that project participants and Parties continue to have strong incentives to avoid any seepage.

2. LULUCF ISSUES IN THE CLEAN DEVELOPMENT MECHANISM (CDM), AGENDA ITEM 12 (B)

At CMP8, Parties agreed to consider:

(a) The inclusion of additional LULUCF activities under the CDM;

(b) Alternative approaches to addressing the risk of non-permanence under the CDM.

INCLUSION OF ADDITIONAL LULUCF ACTIVITIES

Carbon Market Watch believes that the inclusion of additional LULUCF activities could seriously undermine the integrity of the mechanism and have negative social and environmental impacts. Recently, the report of the CDM Policy Dialogue supported the inclusion of additional LULUCF activities as pilot activities under the CDM. However, the report identifies only a very limited set of risks associated with such projects and ignores key issues and risks discussed in the UNFCCC and relevant literature.

The following issues are of particular concern for new LULUCF activities in the CDM:

- **Carbon leakage:** Carbon leakage constitutes a major concern for REDD activities, in particular for a project-based approach: the protection of a forest on one side can easily result in the deforestation at another side, if the drivers for deforestation are not addressed. Such shifts in deforestation do not result in any net emission reductions and consequently the CERs issued would not represent real emission reductions.
- **Establishing credible baselines:** Establishing credible baselines can be difficult or impossible, given the high uncertainties of future changes in the carbon stocks. This holds in particular for countries where forests have

not yet been deforested and for forest management activities. Any calculated emission reductions are therefore highly uncertain and there is a significant risk that they do not represent real emission reductions.

- **Non-permanence:** Addressing the non-permanence of the emission reductions can be particularly challenging for forest management and REDD+ activities. Forests that are protected today may be deforested well after the crediting period (e.g. in hundreds of years in the future), leading only in temporary shift but no permanent reduction of the emissions.
- **Additionality:** the additionality of many types of new LULUCF activities is questionable as they are often economically highly attractive and barriers to their use do not apply. This applies in particular to forest management activities, such as proposed by Brazil as "forests in exhaustion". In the case of REDD activities it is impossible to conduct an additionality assessment with reasonable certainty, given the political, institutional and social factors driving deforestation.
- **Stakeholder consultation:** The rules and modalities for stakeholder consultation and participation in CDM projects are poorly defined. In many cases, impacted stakeholders have neither been informed nor consulted about CDM projects. In many other cases, the concerns of stakeholders were simply ignored. This is of particular concern for LULUCF activities which can have considerable negative social and environmental impacts as they may threaten the livelihood of current users of the land. Rules for stakeholder consultation and participation under the CDM have been considerably improved before any new CDM project types should be considered.

Finally, the use of carbon markets as instrument can make project developers focus on the creation of tradable assets. Carbon markets provide incentives to maximize carbon stocks rather than to holistically evaluate the impacts of a project. In order to maximize credit generation, impacts on biodiversity, ecosystems, or access to land may be ignored. This holds in particular for forest management activities which often establish and maintain monoculture plantations. Including such activities in the CDM could moreover generate very large volumes of questionable credits which would exacerbate the imbalance in supply and demand, driving CER prices down and discouraging investments in clean technologies.

ALTERNATIVE APPROACHES TO ADDRESSING THE RISK OF NON-PERMANENCE UNDER THE CDM

Carbon Market Watch believes that there is scope for improving or amending the current approaches to address the risk of non-permanence under the CDM. A major drawback of the current approaches is the limited fungibility of lCERs and tCERs and hence there limited use, including in relevant ETS. If designed appropriately and if local stakeholders are sufficiently involved, small-scale afforestation and reforestation project activities could contribute to achieving sustainable development and improve the regional balance in the CDM.

In considering new approaches to deal with non-permanence, the following principles are important:

- **Regular monitoring.** Monitoring at regular intervals is a key prerequisite to detect any non-permanence. Carbon Market Watch believes that the current maximum interval of 5 years should be kept.
- **Full accounting of non-permanence.** Any reversal of carbon to the atmosphere should be fully accounted for by removing an equivalent number of units that represent real emission reductions. Using excess units ("hot air from AAUs") to compensate for any non-permanence will not actually balance the atmospheric impact of reversals of carbon. It is therefore vital that such units cannot be used to compensate for emissions due to non-permanance.
- **Long-term monitoring and accounting.** The current provisions for tCERs and lCERs ensure that any reversal is addressed in the long-term because all tCERs and lCERs need to be replaced at the end of the last crediting period when monitoring is terminated. In contrast, the provisions under CCS require monitoring and

accounting for non-permanence for only a limited period of time. Any long-term seepage is neither monitored nor compensated for. This major loophole in the CCS modalities and procedures must immediately be addressed and should not be repeated for LULUCF activities.

- **Polluter pays principle.** The project developers should be the first entity that is responsible to compensate for any non-permanence. This ensures that project developers have economic incentives to design projects in a way that minimize the risks of non-permanence.
- **State liability.** Project developers may go bankrupt or may for other reasons not be able to compensate for non-permanence. In such case, a country should be liable to compensate. This could in principle be the country holding the CERs (buyer liability) or the country where the project is located (host country liability). Only in the latter case would the CERs be fully fungible. The current approach for LULUCF activities involves buyer liability. However, only in the case of a host country liability the CERs are fully fungible with CERs from project types that do not involve the risk of non-permanence.
- **Additional safeguards.** Next to the liability for project developers and countries, additional safeguards should be introduced to minimize associated risks. This may include the establishment of a reserve or financial provisions, such as under the modalities and procedures for CCS projects, or the introduction of mandatory insurance.

3. CREDITING OF NEW HCFC-22 FACILITIES, AGENDA ITEM 12 (D)

The CDM has proven ineffective in addressing HFC-23 emissions. Without delivering any development benefits, credits from this project type have flooded carbon markets. Flaws in the crediting methodology for HFC-23 destruction projects allowed project participants to game the system and to artificially increase production to maximise profits. The CDM Executive Board suspended the methodology 2010, an in at its 65th meeting in November 2011 approved a revised methodology for HFC-23 destruction projects under the CDM (AM0001 version 6.0.0) Although more stringent, the revised methodology is still not rigorous enough and continues to give countries hosting CDM HFC-23 projects considerable incentive to delay shutting down those plants in the course of the planned HCFC-22 phase out under the Montreal Protocol. The new methodology also does not apply to projects until they apply for the renewal of their crediting period. An additional 187 million credits could be issued under the old severely flawed rules. The CMP must call on the CDM Executive Board to stop issuing carbon credits under the old rules with immediate effect.

The crediting of new facilities would undermine efforts under the Montreal Protocol to phase out HCFCs, could create perverse incentives for operators, and would further flood the market with questionable credits. As this agenda item has been considered since years without any progress, Carbon Market Watch recommends Parties to close this item.

=> Carbon Market Watch calls upon Parties to

(a) Decide that no more CERs be issued to HFC-23 destruction projects under AM0001 version 5.2;

(b) Request the CDM Executive Board to apply AM0001 version 6.0.0 to all currently registered HFC-23 destruction projects

(c) Decide not to further consider this agenda item.