

## CHRISTOPH SUTTER welcomes the recently approved rules for programmatic CDM, but finds they may not be exactly what project developers expected

# Will it fly?

After several rounds of discussions, the Executive Board (EB) of the Clean Development Mechanism (CDM) agreed in late June on the basic rules for a Programme of Activities (PoA) to qualify to earn carbon credits under the CDM. This is a major achievement and will open the way for a new class of CDM activities.

A PoA – which is also referred to as ‘Programmatic CDM’ – is a set of an unlimited number of CDM Programme Activities (CPAs) that can be registered as a single CDM project. It entails measures coordinated by a private or public entity that reduce greenhouse gas emissions and which are not related to any mandatory and enforced policy. An example could be the country-wide programme in India to replace standard light bulbs with Compact Fluorescent Lamps (CFLs) through the CDM, as was announced earlier this month in India.

Programmatic CDM, as defined by the EB, has a maximum duration of 60 years for afforestation and reforestation projects and 28 years for all other project types. The coordinator is responsible for project development and the UN registration of a programme design document, which will define eligibility criteria for the projects that want to participate in the PoA. The EB decided that PoAs can use already approved CDM methodologies, although, the use of small-scale methodologies is subject to further guidelines that have yet to be released.

Over the past two years, while the concept of Programmatic CDM was being avidly discussed, many potential participants built up high and diverging expectations regarding this new CDM concept. We now have the first set of rules for the programmatic game, but it will most probably look slightly different from what many participants had hoped for.

In fact, the EB’s definition of a PoA is, in several aspects, close to a bundle of CDM project activities. For example, for a PoA and bundle of projects, one needs to define and document single activities – the CPAs – that need to follow an approved CDM methodology. However, the key innovations of the PoA are:

- i) That single project activities can be added to the PoA at any point in time during the lifetime of the PoA through a simple procedure; and
- ii) Only a sample of the project activities need to be periodically verified for emission reductions according to a defined sampling procedure.

These innovations will bring more flexibility to CDM project developers and will reduce CDM-related transaction costs.

### Increased transaction costs?

However, the Board built in two key requirements that might actually raise transaction costs.

First, the independent validator – the Designated Operational Entity – that adds a CPA to the PoA is 100% liable for this decision. At any point in time after the inclusion of a CPA in a PoA, it can be challenged by a member of the CDM Executive Board. The Board then decides whether the activity should be excluded *ex post*. In such a case, the independent entity has to provide Certified Emission Reductions (CERs) to cover all CERs issued so far for the excluded CPA. This is a stronger liability than the one in place for standard CDM

projects and is transferring additional risks to the independent entities, given that a challenge by the EB could come many years after the inclusion of a CPA in a PoA. These liabilities are likely to be reflected in the price for independent validation services.

Second, a PoA has to be revalidated every time its baseline methodology is revised. Given the high frequency of methodology revisions for conventional CDM projects, this could lead to a significant workload for PoA coordinators, validators and the CDM Executive Board.

Furthermore, the EB decided to limit the use of methodologies for PoAs to one single CDM methodology. Such a regulation is stricter than the regulation for individual CDM projects – for example, many registered small-scale biomass power generation projects use two methodologies in the same Project Design Document, one for power generation and another for methane avoidance from avoided anaerobic decay of biomass. This means that several project categories currently developed under the CDM will not be eligible for PoAs, because they use more than one single CDM methodology.

### Conclusions

In principle, the programmatic approach to the CDM is a suitable concept for several project categories, especially for small- and micro-scale activities, as it brings flexibility for bundling and the potential to reduce transaction costs.

However, the coming months will show whether the concept will fly in practice. In particular, the new liabilities for independent validators and the related risk premiums that might eat up any of the savings from reduced transaction costs. Innovatively structured risk solutions will be one of the key success factors for PoAs. This might be easier for large PoAs managed by government administrations, such as the afore mentioned Indian CFL PoA, than for smaller PoAs without government involvement.

It will be imperative for programmatic CDM developers to carefully analyse the pros and cons of PoA structures in order to avoid any unpleasant surprises in the future. From a project developer’s point of view, I am convinced that the general concept of a PoA can help facilitate projects with a high contribution to sustainable development and therefore the company is currently developing several PoAs.

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