

# **How-to Guide:**

National Institutional Frameworks for the  
Kyoto Protocol Flexible Mechanisms in Eastern Europe  
and the Commonwealth of Independent States



2006

Europe and the CIS Regional Support Centre  
Bratislava

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## Foreword

Entry into force of the Kyoto Protocol provided the countries in Eastern Europe and the Commonwealth of Independent States (CIS) with new opportunities for reducing their greenhouse gas (GHG) emissions and achieving other sustainable development objectives through participation in the Protocol's flexible mechanisms, the Clean Development Mechanism (CDM) and Joint Implementation (JI). The establishment of the required institutional frameworks, such as the Designated National Authorities (DNAs) and Designated Focal Points (DFPs) is one of the most important criteria to be met by the countries wishing to host CDM/JI projects.

In Eastern Europe and the CIS, progress in designing appropriate institutional frameworks for Kyoto-compatible mechanisms has been uneven. While the new EU member states and new accession countries (Bulgaria and Romania) have moved forward with creating their DFPs and mobilizing resources for capacity building, this process in the rest of the region has been rather slow, especially on the side of non-Annex 1 countries in Southeast Europe and the CIS. For most of the countries in the CIS and Southeast Europe, the absence of a fully defined DNA stems from a mix of factors, including lack of understanding of the requirements of the CDM, limited financial resources for training and allocating government personnel for project review, and an absence of significant technical assistance from the donor community.

The goal of this guide is to help national climate change policy-makers and UNDP country offices understand the requirements and processes for establishing national institutional frameworks for implementing the Kyoto Protocol and put in place transparent and efficient national governance structures for JI and CDM. It is based on the hands-on experience that has been accumulated to date by the East European and CIS countries, particularly in relation to the type of institutional structures, functions and roles that have been established and how well they have worked.

United Nations Development Programme (UNDP) has been actively involved in JI/CDM capacity development activities in over 20 countries across several different regions of the world. UNDP considers that the market instruments of the Kyoto Protocol, JI and CDM, can play a significant role in promoting sustainable development and increasing the flow of finances and sustainable technologies to the countries in transition. We believe that this Guide will help East European and CIS countries make this happen.

Vladimir Litvak  
*Regional Energy and Environment Practice Manager*  
*UNDP Regional Bureau for Europe and CIS*

### **Welcome to the How-to Guide on the Establishment of National Institutional Frameworks for CDM and JI in Eastern Europe and CIS!**

The goal of this Guide is to help national climate change policy makers and UNDP country offices understand the requirements and processes for establishing national institutional frameworks for implementing the Kyoto Protocol in Eastern Europe and the CIS. In particular the guide is designed to assist countries that will be hosting and approving Clean Development Mechanism (CDM) and Joint Implementation (JI) projects in designing the necessary procedures for project review and evaluation, including criteria for assessing a project's contribution to sustainable development.

#### **This guide can be used in two ways:**

- 1) If you are new to the subject, you can read the guide from beginning to end to gain an overview of the requirements of approving CDM and JI projects, and the procedures that governments may follow to establish a Designated National Authority (DNA) or Designated Focal Point (DFP) for issuing host country approval letters for CDM or JI projects.
- 2) If you are familiar with the issues but have specific questions (e.g., on a certain legal procedure or project evaluation function), you can simply check the relevant topic or topics. Even if you have worked with the establishment of DNA or DFPs before, you may wish to check the many case studies and Frequently Asked Questions to understand some of the more recent developments in how governments in Eastern Europe and the CIS authorize CDM and JI projects and organize their review.

This guide is designed as a hands-on document, and your comments and feedback can make it more responsive and helpful. We look forward to hearing from you.

*The RBEC Energy and Environment Team*

## Acknowledgements

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**List of Acronyms**

AIE	Accredited Independent Entity for validating JI projects
CDM	Clean Development Mechanism
CDM EB	Clean Development Mechanism Executive Board
CH <sub>4</sub>	Methane
CER	Certified Emission Reduction
CIS	Commonwealth of Independent States
CO <sub>2</sub>	Carbon Dioxide
COP	Conference of the Parties to the United Nations Framework Convention
DOE	Designated Operational Entity for validating CDM projects
DNA	Designated National Authority
EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
ERPA	Emission Reduction Purchase Agreement
ERU	Emission Reduction Unit
FDI	Foreign Direct Investment
GEF	Global Environment Facility
GHG	Greenhouse gas
HFC	Hydrofluorocarbon
IPCC	Intergovernmental Panel on Climate Change
JI	Joint Implementation
JI SC	Joint Implementation Supervisory Committee
LOA	Letter of Approval
MOP	Meeting of the Parties to the Kyoto Protocol
MOU	Memorandum of Understanding
N <sub>2</sub> O	Nitrous Oxides
PDD	Project Design Document
PFC	Perfluorocarbon
PIN	Project Idea Note
RBEC	UNDP Regional Bureau for Europe and CIS
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNDP CO	United Nations Development Programme Country Office
UNFCCC	United Nations Framework Convention on Climate Change

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## 1 INTRODUCTION

### 1.1 Objective and Overview of the Guide

The adoption in 1997 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC)<sup>1</sup> committed industrialized and some transition countries (Annex I countries) to attain legally binding greenhouse gas (GHG) reduction targets during the period between 2008 and 2012. The Protocol allowed these Annex I countries to meet part of their targets by reducing emissions anywhere in the world through two project-based cooperative mechanisms:

- *The Clean Development Mechanism (CDM)* – allows Annex I countries to invest in GHG reduction measures in developing and some transition countries (non-Annex I countries), provided that these projects also meet the sustainable development criteria of the country hosting the CDM project activity (i.e., host country). In return, the investing entity receives Certified Emission Reductions (CERs). Non-Annex I countries in Eastern Europe and the CIS that can host CDM projects include Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Montenegro, Serbia, Tajikistan, Turkmenistan and Uzbekistan.
- *Joint Implementation (JI)* – enables Annex I countries to claim credit for emission reductions achieved through investment in projects in other Annex I countries. Eastern European Annex I countries eligible for hosting JI include Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russian Federation, Slovak Republic, Slovenia and Ukraine.

The goal of CDM and JI is to stimulate international investment, support sustainable development objectives, and create new opportunities for cleaner and less carbon-intensive economic growth in developing and transition countries.

A prerequisite for a host country's participation in JI or CDM is the establishment of an institutional framework for evaluating and approving these projects. If this framework is used for the development and approval of JI projects in Annex I countries it is called a Designated Focal Point (DFP) for JI. Project-approval entities for CDM in non-Annex I countries are called Designated National Authorities (DNAs) for CDM. Because these entities act on behalf of their governments when approving JI or CDM projects, it is important that they are established and authorized by the national government or legislature according to the relevant legal procedures of the country in question. Because of this need for government authorization, DFPs and DNAs are usually hosted by a government department, except for a few cases where a government has authorized a non-governmental body to act on its behalf.

The main functions of a DFP or DNA include:

- 1) Establishing national rules for JI and CDM project eligibility, submission and approval;
- 2) Ensuring CDM project compliance with national sustainable development criteria;<sup>2</sup>

1) The UNFCCC was agreed at the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro, 1992. It aims to stabilize GHGs in the atmosphere at a level that would prevent dangerous changes to the climate. As part of the UNFCCC agreement, all developed (Annex I) countries agreed to voluntarily reduce their GHG emissions to 1990 levels by 2000. Only the United Kingdom and Germany met this goal, which is why the Kyoto Protocol was proposed to introduce binding reduction commitments on developed economies.

2) JI projects are not required to meet sustainable development criteria of the host country. Nonetheless, some JI host governments ask that JI projects must contribute to their country's sustainable development objectives.

- 3) Certifying JI/CDM project compliance with other country-specific eligibility criteria, such as the Environmental Impact Assessment (EIA); and
- 4) Issuing a host country approval letter for JI and CDM projects, including certification that the project is undertaken on a voluntary basis and that the country has ratified the Kyoto Protocol.

The DFP/DNA may also get involved in project outreach, training activities for potential project developers, creation of a database of potential CDM project opportunities, and promotional activities targeting international carbon investors and funds.

In Eastern Europe and the CIS, progress in designing the appropriate institutional frameworks for JI and CDM has been uneven. While the new European Union (EU) member states and new accession countries (Bulgaria and Romania) that are also part of Annex I have moved forward with creating DFPs and have attracted significant investment in JI (Table 1), development of CDM projects in the region's non-Annex I countries has been minimal. At the time of writing, only four of the 213 CDM projects registered by the CDM Executive Board are from Eastern Europe and the CIS.<sup>3</sup> Major reasons for this low number of projects is lack of awareness regarding the benefits of the CDM and the relatively slow progress in establishing the required DNA's for issuing host country approval (Table 2). A few countries are still in the process of ratifying the Kyoto Protocol.

Table 1-1 Annex I Countries in Eastern Europe and the CIS Eligible for JI

Annex I Country	Ratified the Kyoto Protocol	Designated Focal Point for JI
Belarus	Yes	<i>In process.</i> Ministry for Natural Resources and Environmental Protection
Bulgaria	Yes	Ministry of Environment and Water
Croatia	No	--
Czech Republic	Yes	Department of Integrated Financing, Ministry of Environment
Estonia	Yes	Ministry of Environment
Hungary	Yes	Ministry of Environment and Water
Latvia	Yes	Ministry of Environment
Lithuania	Yes	Ministry of Environment
Poland	Yes	National Fund for Environmental Protection and Water; Ministry of Environment
Romania	Yes	Ministry of Environment and Water Management
Russian Federation	Yes	<i>In process.</i> Ministry for Economic Development and Trade
Slovak Republic	Yes	Ministry of Environment
Slovenia	Yes	Ministry of Environment and Spatial Planning
Ukraine	Yes	Ministry for Environmental Protection

3) UNFCCC, CDM Project Activities, 6 June 2006, <http://cdm.unfccc.int/Projects>. The referenced projects are: Nubarashen Landfill Gas Capture and Power Generation Project in Yerevan, Armenia, Moldova Energy Conservation and GHG Emission Reduction project, Moldova Biomass Heating in Rural Communities Project-No.1, and Moldova Biomass Heating in Rural Communities Project-No.2.

Table 1-2 Non-Annex I Countries in Eastern Europe and the CIS Eligible for CDM

Non-Annex I Country	Ratified the Kyoto Protocol	DNA Reported to the UNFCCC <sup>a</sup>	DNA Legal Framework
Albania	Yes	Ministry of Environment	<i>In process</i>
Armenia	Yes	Ministry of Nature Protection	<i>In process</i> . Ministry of Nature Protection
Azerbaijan	Yes	Ministry of Ecology and Natural Resources	Ministry of Ecology and Natural Resources
Bosnia and Herzegovina	No	--	--
Georgia	Yes	Ministry of Environment Protection and Natural Resources	CDM National Board
FYR Macedonia	Yes	--	<i>In process</i> . Ministry of Environmental and Physical Planning
Montenegro	No	--	--
Kazakhstan	No	--	<i>In process</i> . Interagency Committee on Climate Change (IACCC)
Kyrgyzstan	Yes	--	<i>In process</i> . Climate Change Committee
Moldova	Yes	State Hydro-meteorological Service, Ministry of Ecology and Natural Resources	National Commission (NC)
Serbia	No	Ministry of Environment	--
Tajikistan	No	--	<i>In process</i> . Ministry of Environmental Protection
Turkmenistan	Yes	--	<i>In process</i>
Uzbekistan	Yes	--	<i>In process</i>

<sup>a</sup> List of DNA's reported to the UNFCCC: "Designated National Authorities." <http://cdm.unfccc.int/DNA> accessed on April 4, 2006

This guidebook is produced to support national governments, UNDP country offices, and other stakeholders in Eastern Europe and the CIS to develop and strengthen the national institutional frameworks for CDM and JI. The guidebook focuses on the requirements and options for establishing, legalizing, implementing, and financing a DNA. The rules and procedures for operationalizing DFPs are also discussed and past experience with their establishment are highlighted to offer practical examples on institutional setups.

In Chapter 2, an overview of JI and CDM is provided along with a discussion of the key functions expected of DNAs and DFPs. Chapter 3 describes the steps involved in establishing a DNA, including institutional design, project review process, sustainable development criteria, outreach strategy and legalization. Chapter 4 presents options for making the DNA work over time and the appendices provide additional reference materials, including sample DNA and DFP legal documents.

This guidebook provides a comprehensive overview of the requirements of setting up national institutional frameworks for CDM and JI. Wherever possible, the document considers institutional issues specific to Eastern Europe and the CIS and provides recommendations for adapting the general guidance to the institutional setting of individual countries. Each stakeholder is asked to take into account its own circumstances in utilizing this guidebook.

## 2 PRIMER: DNA/DFP

### 2.1 Introduction to JI and CDM

JI and CDM, the two project-based mechanisms of the Kyoto Protocol, are designed to help Annex I Parties reduce the costs of meeting their emissions targets by achieving emission reductions at lower costs in other countries than they could domestically. Any such reductions should be supplementary to domestic actions in the Annex I countries. Recipient countries benefit from the increased investment flow and support for sustainable development goals. By the end of 2005, industrialized countries had committed more than €4 billion to JI and CDM carbon funds and governmental carbon credit purchase programmes,<sup>4</sup> a number which is expected to grow as many countries struggle to meet their Kyoto targets.

#### 2.1.1 Joint Implementation

JI provides for Annex I Parties to implement projects that reduce emissions or result in carbon sequestration in other Annex I Parties, in return for emission reduction units, also known as ERUs. JI projects must have the approval of all Parties involved, and must lead to emission reductions or sequestration that is additional to any that would have occurred without the project. Most JI projects take place in Annex I Parties with economies in transition, such as the Baltics, Bulgaria, Hungary, Poland, Romania, the Russian Federation, Ukraine and the Czech Republic. Although JI projects cannot start generating ERUs until 2008 and official JI rules and procedures need to be developed by a JI Supervisory Committee (JI SC) before final approval can be granted,<sup>5</sup> at least 110 projects have been submitted for validation by an independent entity.<sup>6</sup>

#### 2.1.2 The Clean Development Mechanism

The CDM is similar to JI except that it covers project activities that reduce emissions, or result in carbon sequestration, in developing countries and those transition countries that are not included in Annex I (non-Annex I Parties) in return for certified emission reductions, known as CERs. CDM projects must have written approval from all Parties involved, and must satisfy two broad criteria:

- *Sustainable Development*: CDM activities must contribute to the sustainable development process of the country hosting the project. Each host country may choose its own sustainable development criteria and assessment process.
- *Additionality*: CDM projects must reduce emissions below those emissions that would have occurred in the absence of the CDM project activity. The additional GHG reductions are calculated by comparing project emissions with a defined emissions baseline representing the business as usual scenario.

A CDM project must be validated by an accredited independent entity before it can be accepted (registered) with the CDM Executive Board (CDM EB), which is an international body established to implement the CDM and overseen by the Parties to the Kyoto Protocol. After project implementation, emission reductions must be monitored and submitted for certification by another independent entity before the CDM EB can issue the CERs. Small-scale projects<sup>7</sup> are

4) Bulleid, R., *The capital begins to flow*, *Environmental Finance*, London: Fulton Publishing, March 2006, pp. 16/17.

5) The JI SC is an international body established by the Parties to the Kyoto Protocol to oversee the implementation of the JI mechanism and accredit independent entities (AIEs).

6) The UNEP Risoe Pipeline Overview, April 1, 2006 [www.cd4cdm.org/Publications/CDMpipeline.xls](http://www.cd4cdm.org/Publications/CDMpipeline.xls).

7) The CDM Executive Board has developed simplified modalities and procedures for small-scale projects to avoid penalizing small projects through transaction costs. More information about the specific rules for small-scale projects can be obtained at: <http://cdm.unfccc.int>.

treated slightly differently in that the same independent entity can be used for validation and certification.

The valid generation of CERs began in 2000. Since then, 213 projects capable of generating around 420 million CERs by 2012 have been registered with the CDM Executive Board, and almost 600 additional projects are in the pipeline.<sup>8</sup> Most of these projects are located in Latin American and Asia-Pacific countries. Current prices for CERs range from €2-16 per ton of CO<sub>2</sub> equivalent, depending on the type of contract used and the involvement of financial intermediaries. Projects using standard off-take contracts, where sellers do their best to deliver a non-firm CER volume to the buyer, are offered between €7-12.50 per CER.<sup>9</sup> In the first three months of 2006, the average price of project-based emission reductions was reported at €9.1 per ton of CO<sub>2</sub> equivalent for the 79 million tons transacted during that time period. This corresponds to a value of nearly €0.7 billion.<sup>10</sup>

### 2. 2 Eligibility to Participate in JI

In order to participate in JI, Annex I Parties must meet the following criteria:

- Ratification of the Kyoto Protocol;
- Voluntary participation;
- Designate a national focal point in charge of approving JI projects;
- Establishment of the assigned amount (available emissions quota, AAUs) according to Article 3 of the Kyoto Protocol;
- National system for the estimation of GHGs;
- National emissions and transaction registry;
- Annual submission of a GHG inventory to the UNFCCC; and
- Accounting system for the sale and purchase of emission reductions.

As outlined in Tex Box 2-1, Annex I Parties have two options for JI, depending on whether they are in full or partial compliance with the outlined criteria. The second procedure, Track II, involves an international process that is similar to CDM.

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8) UNFCCC website, CDM Statistics <http://cdm.unfccc.int/Statistics/> 6 June 2006.

9) Arne Eik, "CDM-Market Comment," *CDM & JI Monitor*, 10 January 2006.

10) State and Trends of the Carbon Market – 2006. IETA and the World Bank. Washington DC, May 2006.

*Text Box 2-1 Two Track Procedures for Hosting JI Projects*

**JI Track I** may be applied when the Annex I Party hosting the project fully meets all eligibility requirements to participate in the mechanisms. In this case, the host Party may apply its own national rules to the selection of JI projects and the estimation and verification of emission reductions. The host Party may also issue ERUs and transfer them to project participants.

**JI Track II** can be used if the host Party does not meet all eligibility requirements. In such cases, the project and the quantity of ERUs it generates must be verified under rules and procedures supervised by the JI Supervisory Committee, which is an international body established under the Kyoto Protocol. The rules include independent determination of the emissions baseline and monitoring plan and independent certification of the monitored reductions before ERUs can be issued. The details of the JI procedures are still being elaborated, including the project design document (PDD), but they will likely be similar in scope to those of the CDM. In the past, JI project developers have used approved CDM baseline and monitoring methodologies for the development of their projects. All JI projects developed to date have followed Track II JI procedures.

Track II allows JI projects to begin operation before the host Party meets all eligibility requirements. However, before it may issue ERUs, the host Party must meet the eligibility requirements relating to establishing its assigned amount and its national registry. A host Party which is eligible for Track I may still choose to carry out projects under Track II.

### 2.3 Eligibility to Participate in CDM

To invest in CDM, Annex I countries must also comply with the criteria for JI projects outlined in Section 2.2 above.<sup>11</sup> However, non-Annex I countries that would host the CDM projects must meet only three basic requirements:

- 1) Voluntary participation;
- 2) Establishment of a CDM Designated National Authority (DNA) for host country approval and authorization of project participants, and;
- 3) Ratification of the Kyoto Protocol.

By April 2006, 97 nations had established DNAs (79 in non-Annex I countries), representing almost two thirds of the 158 Parties that had ratified the Kyoto Protocol.<sup>12</sup> However, many of these DNAs, particularly in Eastern Europe and the CIS, have yet to adopt procedures for hosting and approving CDM projects.

11) According to the Marrakesh Accords an Annex I Party shall be considered "to continue to meet the eligibility requirements .... unless and until the enforcement branch of the compliance committee decides that the Party does not meet one or more of the eligibility requirements, has suspended the Party's eligibility, and has transmitted this information to the [UNFCCC] secretariat." The Marrakesh Accords & The Marrakesh Declaration, November 2001, [http://unfccc.int/cop7/accords\\_draft.pdf](http://unfccc.int/cop7/accords_draft.pdf).

12) Designated National Authorities (DNAs) reported to the UNFCCC. 11 April 2006 <http://cdm.unfccc.int/DNA>.

## 2.4 The CDM and JI Track II Project Cycles

The following provides a brief summary of the CDM project cycle and highlights areas of particular interest to national CDM authorities. Figure 2-1 provides a graphic overview of the project cycle. More guidance on CDM project design can be obtained from the publications *The Clean Development Mechanism: A User's Guide*<sup>13</sup> and *CDM Information and Guidebook*<sup>14</sup> authored by UNDP and the United Nations Environment Programme (UNEP), respectively. As described below, the JI Track II project cycle for the most part resembles that of the CDM, except for the final approval step, so the general guidance provided here will also be applicable to JI Track II projects.

### 2.4.1 Project Design

The CDM and JI Track II project cycles start with the project proponent designing the project concept, exploring initial financing options, and preparing a Project Idea Note (PIN) which is a brief preliminary project proposal that can be circulated to the Host Party and potential investors and carbon funds for initial endorsement. There is no standard format for this PIN document. DNAs typically develop their own format, or allow project developers to use the PIN format used by the carbon fund that supports the project. For example, the World Bank Carbon Finance Unit has a common PIN for all its different carbon funds, which can be accessed at <http://carbonfinance.org>.

Once the project developer has received the initial endorsement and has decided to go ahead with the project, a more detailed Project Design Document (PDD) must be prepared. Among other requirements, the PDD must include a GHG emissions baseline representing the reference case against which project emissions are assessed, and a monitoring plan for tracking emission reductions once the project has begun operation. Final approval by the independent validators, the Parties involved, the CDM Executive Board, and carbon investors is granted on the basis of the information presented in this PDD. The CDM Executive Board has developed a standard PDD format that project developers must use.<sup>15</sup> To streamline the evaluation process this standard PDD format should also be used by DNAs for their approval process.

The Executive Board has already approved a number of baseline and monitoring methodologies for different project types that can be used in the PDD for CDM projects.<sup>16</sup> If the proposed CDM project does not match one of these methodologies, a new methodology must be developed by the project proponent, evaluated by the CDM Methodology Panel, and approved by the CDM Executive Board before the PDD can be completed and submitted to the Executive Board for registration.

### 2.4.2 Host Country Approval

CDM projects must be approved at the national level, in the form of a written letter, before they can be submitted for review and registration by the CDM Executive Board. The approval letter is submitted to the Executive Board by the independent entity that validates the project, along with a report certifying that the baseline and monitoring methodologies are correctly applied. Failure to obtain this letter means that the project cannot proceed any further in the CDM process and is listed as one of the major pitfalls that slow down the validation process.<sup>17</sup>

<sup>13</sup> This can be downloaded from the UNDP website: [www.undp.org/energy/docs/cdmuserguide-2003.pdf](http://www.undp.org/energy/docs/cdmuserguide-2003.pdf).

<sup>14</sup> Myung-Kyoon Lee, Jürgen Fenhann, Kirsten Halsnæs, Romeo Pacudan, and Anne Olhoff. *CDM Information and Guidebook*, Second edition, developed for the UNEP project 'CD4CDM.' June 2004 [www.cd4cdm.org/Publications/cdm%20guideline%202nd%20edition.pdf](http://www.cd4cdm.org/Publications/cdm%20guideline%202nd%20edition.pdf).

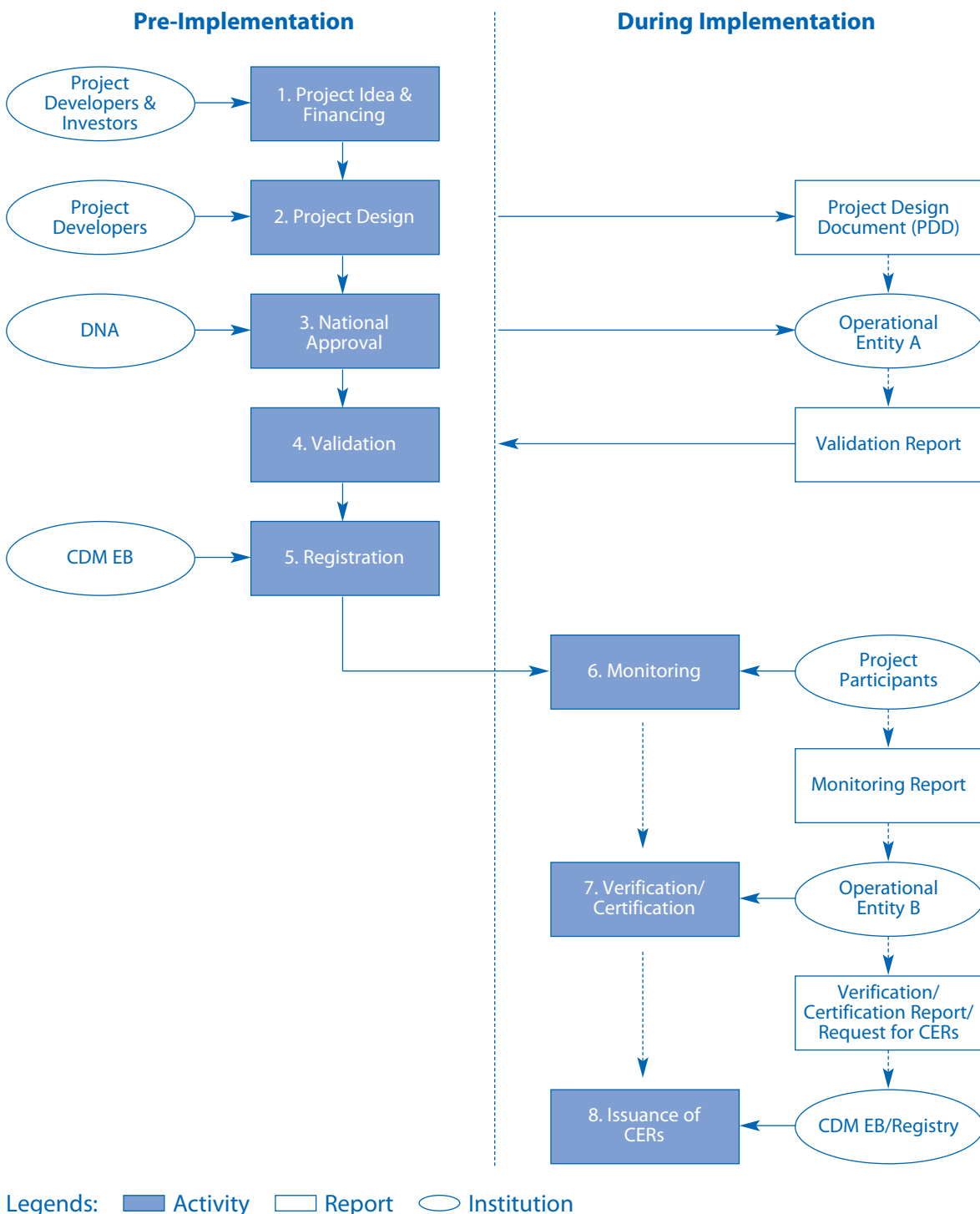
<sup>15</sup> The PDD template for CDM projects can be obtained from the CDM Executive Board at: [cdm.unfccc.int/Reference/Documents](http://cdm.unfccc.int/Reference/Documents). The PDD for JI projects is being developed by the JI Supervisory Board. In the meantime, project developers have used the PDDs of individual carbon funds.

<sup>16</sup> At the first meeting of the Parties to the Kyoto Protocol (COP/MOP1) in November 2005, Parties decided that methodologies approved for the CDM can also be used for JI Track II.

<sup>17</sup> UNEP Risoe Centre. *Clean Development Mechanism PDD Guidebook: Navigating the Pitfalls*. November 2005.

The steps involved in host Party approval differ for JI and CDM. In the case of JI, Parties involved make the final decision on whether or not the project is additional and results in 'real and measurable' emission reductions. The JI Supervisory Committee does not get involved in project evaluation. The JI host Party therefore needs to make sure that the technical aspects and the GHG estimates of the project are sound in order to avoid later problems in meeting its overall target. Typically, the rules of the JI carbon funds are designed to ensure that the claimed emission reductions are real.

Figure 2-1 Overview of the CDM Project Cycle



### 2.4.3 Validation and Registration

The baseline and monitoring methodologies used for both CDM and JI Track II projects must be validated by an independent entity. The validation of CDM projects is undertaken by independent companies known as Designated Operational Entities (DOEs). Validators of JI projects are called Accredited Independent Entities (AIEs). The DOEs and AIEs make the PDD publicly available for 30 days, receive comments, and address these in the validation report. Some host countries require that a CDM project must be validated prior to the DNA evaluating the project and issuing an approval letter.

In the case of CDM, the CDM Executive Board reviews the validation report that examines the additionality, GHG emission estimate, and monitoring plan presented in the PDD and makes the final decision on whether the project will qualify for CERs and can be 'registered' as a CDM project. Because GHG estimates presented in the PDD will be evaluated by the DOE and the Executive Board, the CDM host Party does not necessarily have to get involved in evaluating the GHG baseline and monitoring aspects of the project. The DNA may instead choose to only undertake the steps which are required under the Kyoto Protocol; that is, confirming the voluntary participation of the Party and assessing whether the project meets the sustainable development criteria of the host country. This distinction is important if a country is small and/or otherwise lacks the technical staff and financial wherewithal to undertake extensive CDM baseline and monitoring methodology review.

### 2.4.4 Project Implementation

During project implementation, the project proponent is required to monitor emission reductions and seek independent verification of the claimed emission reductions before the CERs can be issued by the CDM Executive Board and transferred to the project participant(s)' account(s) in the CDM Registry. JI Host Parties are required to track the transferred ERUs in their national registry, while CDM Host Parties do not have to maintain a national registry and/or keep records of transferred CERs. However, CDM Host Parties can set up an account in the CDM Registry and may choose to track issued CERs on a voluntary basis. Most countries in Eastern Europe and the CIS with a DNA in an advanced stage have developed, or plan to develop, a database for tracking proposed and accepted CDM projects.

## 2.5 Key Functions of the DNA

A prerequisite for a developing country's participation as CDM project host is the establishment of a DNA for issuing written approval of CDM projects and serving as a single contact point for project developers. The Kyoto Protocol provides only limited guidance on how such a DNA should be established. Therefore, individual Host Party governments can use different strategies for defining the scope and institutions of these entities.

The responsibilities of the DNA can be divided into two categories: 1) core functions required under the Kyoto Protocol; and 2) optional functions to facilitate CDM project development.

Core responsibilities of the DNA include:

- 1) **Establish national rules for project eligibility, submission and approval.** This includes elaboration of external documents for project developers describing application procedures, proposal requirements, expected timeframes for project review, and sustainable development criteria, and internal documents outlining review process and criteria for the DNA members to evaluate submitted projects. Extra review criteria may be added, such as financial and legal stability of the companies involved in the proposed project.

- 2) **Confirm compliance with national sustainable development criteria** by evaluating whether the CDM project meets the host Party's sustainable development criteria.
- 3) **Issue host country approval letter**, including confirmation that the Party has ratified the Kyoto Protocol, that the project meets national sustainable development criteria, and that it is undertaken on a voluntary basis. Extra language may be added authorizing the project participants and approving the transfer of CERs outside the country.

Throughout the year, representatives of the DNA must also be available to respond to requests for clarification from potential project developers and DOEs seeking to validate individual projects. Failure to communicate quickly and responsibly with validators slows down the validation process and could increase transaction costs if additional time has to be used for tracking down relevant government officials and/or data. If an Annex I Party or carbon fund wishes to negotiate a Memorandum of Understanding (MOU) with the Host Party to collaborate on CDM projects, the DNA would most likely represent the Host Party government during these negotiations.

Many DNAs also issue initial endorsement letters to project proponents based on information provided in the PIN. The endorsement letter indicates that, in principle, the proposed project meets the requirements of the Host Party and represents an invitation to submit a full project proposal in the form of a PDD. By screening out clearly unacceptable projects and providing an endorsement letter, the risk to the project proponent of developing a full PDD is reduced. Providing suggestions for improving the project proposal along with the endorsement letter would also help project developers in drafting the PDD. Such assistance is important in many countries in EE and CIS where there is little experience with CDM procedures.

Not all countries have adopted the same functions and procedures for CDM project screening and approval and their procedures vary according to the needs and resources of individual countries. Most countries with a DNA in place have established DNA functions that go beyond what is required to just issue a Letter of Approval. Text Box 2-2 provides, as an illustrative example, an overview of the functions and role of Morocco's DNA. Text Box 2-3 describes features required to make the DNA operate successfully.

*Text Box 2-2 Functions of the Moroccan DNA***1- CDM DNA Role and Status****The CDM DNA-Morocco:**

- Is the official State CDM representative vis-à-vis the organizations and national operators involved or having a relationship with CDM;
- Is the official State CDM representative vis-à-vis the international organizations in charge of CDM, in particular the CDM Executive Board;
- Delivers written approval which confirms that participation by the Party is voluntary and that the project conforms to national criteria and contributes to the country's sustainable development.

**2- CDM DNA Activities****CDM DNA-Morocco has two types of activities:**

- A regulation activity to set the CDM project evaluation and approval rules and procedures (prerequisites for subsequent validation and certification). This activity is necessary for the country to be able to conform to the international rules;
- A promotion activity centered on capacity building (in the fields of: project identification and formulation; baseline definition; emission quantification; and project performance monitoring) and marketing (developing a diversified and high quality CDM project portfolio for a highly competitive market).

**3- CDM DNA structure****CDM DNA-Morocco is composed of:**

- A CDM National Council (CDM NC);
- A Permanent Secretariat of the National Council (CDM PS) operating as the Climate Change focal point.

**Source** [http://www.mdpmaroc.com/English/cdm\\_dna.html](http://www.mdpmaroc.com/English/cdm_dna.html)

*Text Box 2-3 Features of a Successful DNA*

As long as the principal CDM project review and approval functions of the DNA are established, host countries have the freedom to design their DNAs according to their individual sustainable development objectives, resources, and skill sets. Regardless of which functions that are adopted it is important that:

- There is a clearly established contact point within the DNA for project developers to contact;
- The DNA can facilitate effective and efficient CDM project approval; and
- The DNA can facilitate internal government coordination so that any inter-government requirements and approvals necessary to enable the issuing of host country approval letters can be obtained without delay.

Optional responsibilities of the DNA include:

- Certify compliance with other country-specific regulations and criteria, such as an EIA. It is up to the host country government to determine the extent to which the DNA should get involved in the review of compliance with other regulations. Many DNAs limit this to a review of whether national requirements for undertaking an EIA have been satisfied.
- Outreach to project developers, such as through a website describing application guidelines and approval procedures both in English and the national language, project development workshops for sectors with high CDM potential, training on PDD development, and creation of a database of potential CDM project opportunities that can be posted on an external website;
- Technical assistance to project developers for the preparation of project proposals;
- Outreach to financial lending institutions to facilitate investment in CDM projects;
- Advise project proponents during contract negotiations with investors;
- Attract donors for capacity building for CDM projects and financing; and
- Promotional activities targeting international carbon investors and funds.

Some DNAs also monitor CDM projects once they have been implemented to determine whether the projects comply with sustainable development goals. The DNA may also track issued CERs in a national database.

If resources and staff are limited, outreach to potential project developers and development of a website should be emphasized and initiated as soon as possible. The other activities can wait until the DNA has gained more experience with the CDM.

The DNA is not required to evaluate the GHG baseline and monitoring methodologies of the proposed CDM project since the DOEs are responsible for this task. However, the DNA may still choose to undertake such reviews if it has the resources and staff available. For example, Georgia has one DNA staff which is a former member of the CDM Executive Board and another DNA staff on the CDM Methodology Panel. The DNA can draw on their CDM experience to evaluate the proposed CDM projects. However, most other non-Annex I governments in Eastern Europe and the CIS have minimal experience with CDM project design and assessment and may have to send the projects for review by external experts in order to assess baseline and monitoring methodologies voluntarily. However, doing so costs money and may strain already limited

government budgets. As a result, the DNA may choose not to get involved in this part of the project review, at least during the start-up phase when it is more important to focus on establishing a streamlined and effective process for assessing sustainable development and issuing an approval letter. An efficient and transparent review process is crucial for attracting potential investors.

## **2.6 Key Functions of the DFP**

The responsibilities of a DFP are similar to that of a DNA, except that DFPs are not required to certify that the project contributes to sustainable development. The different procedures stem from the fact that JI was set up to promote trading in GHG certificates (ERUs) between Annex I countries while CDM is for investment in non-Annex I countries without a binding GHG target. During the Protocol negotiations, policy makers in developing and transition economies emphasized that any investment in CDM projects in these countries should contribute to sustainable development in addition to offsetting emissions in Annex I countries. Although the sustainable development requirement is only specified for CDM, some DFPs including those in Bulgaria and the Czech Republic have elected to evaluate whether the proposed projects meet certain pre-specified development goals. For example, Bulgaria assesses the environmental, social, financial and technical contributions of the project.

Contrary to national CDM authorities, DFPs are required to track transferred ERUs in their national registry. DFPs may also need to be more heavily involved in evaluating the GHG baseline and monitoring methods of the proposed JI projects. This is because JI countries may fail to meet their national Kyoto targets if the ERUs are not environmentally sound and fail to reduce emissions as expected. In general, JI countries have to design and adopt considerably more regulations and institutions to implement the Kyoto Protocol than do non-Annex I countries. Text Box 2-4 describes recent regulatory and institutional developments to develop a Kyoto framework in Russia.

*Text Box 2-4 National Action Plan for Implementing the Kyoto Protocol in Russia*

Russian participation in the Kyoto Protocol requires solution of a number of tasks for institutional compliance. The Russian government approved the National Action Plan of Russia (NAPR) in February 2005. The plan is comprehensive and covers requirements for the Kyoto mechanisms, including compliance, the national GHG accounting system, historical GHG inventories since 1990, registry and reporting procedures, and sectoral tasks and responsibilities for future negotiations.

The responsibilities are clearly defined in the NAPR. The first agency on the list for each task can be regarded as the lead agency for that individual task (see Table 2-1). For example, the Ministry of Economic Development and Trade (MEDT) is responsible for the Kyoto mechanisms and for reporting to domestic bodies, including the Russian Government and the State Duma (Russian Parliament). Roshydromet continues to be the lead agency in the area of GHG inventories, international reporting, international negotiations, and preparation of the National Communication. The Ministry of Natural Resources will play a key role in LULUCF and any other forestry tasks. This Ministry also develops the national registry and already nominated one of its research organizations (Federal Centre of Geoeological Systems) to act as the National Registry on a temporary basis. Meanwhile, sectoral tasks related to agriculture and energy were allocated to the specialized ministries and agencies.

Beginning in 2005, a new Inter-Agency Commission (IAC), led by MEDT and chaired by the MEDT's Deputy Minister, is working to facilitate cooperation between ministries related to the Kyoto Protocol. At its first meeting in the summer of 2005, the IAC adopted the NAPR.

At the IAC meeting held on 14 November 2005 the Commission formally confirmed the responsibilities of all stakeholder ministries and agencies and considered two critical issues:

- The first issue was the development of a concept for a federal law on regulation of GHG emissions. In May 2005, an initial practical attempt was made when environmental fees for methane emissions were increased up to 1000 times!
- The second problem refers to the necessity to make appropriate changes to current provisions on responsibilities of the ministries and agencies – stakeholders. All the ministries and agencies mentioned above are only responsible for development of regulatory proposals but are not authorized to implement the Kyoto Protocol provisions. The IAC recommended that the MEDT should discuss this with other ministries and agencies and submit a proposal to the Russian Government on the required changes in the provisions for the ministries and agencies.

The November 2005 IAC meeting also endorsed three draft Governmental decrees on approval of:

- Provisions on Development, Approval and Control of the Implementation of Investment Projects under Article 6 of the Kyoto Protocol;
- Provisions on the National Registry;
- Provisions on the National Greenhouse Gas Accounting System.

All three documents are still being considered by the ministries and the Russian Government.

*Contributed by Vladimir Berdin*

Table 2-1 National Action Plan for Russia: Main Tasks, Schedule and Responsible Agencies

Task	Schedule <sup>18</sup>	Responsible agencies
<b>Kyoto mechanisms</b>		
Preparation of legislation on implementing Kyoto mechanisms	2006	MEDT
Preparation of national JI administration	2006	MEDT
Negotiations on JI and IET with international financial organizations and foreign investors	N/A	MEDT, MIA
Preparation of guidelines for Russian companies implementing CDM projects	2006	MEDT
<b>GHG inventory and registry</b>		
Preparation of legislation on the establishment of GHG registry	2006	MNR with MEDT
Establishing a system for inventory of GHGs and sinks	2006	Roshydromet with MNR and other related agencies
Implementing inventories for 1990–2004 and submitting them to UNFCCC	Mid-2006 – and then annually	Roshydromet with MNR and other related agencies
<b>National and internal reporting</b>		
Preparation of National Communications to the UNFCCC	2006	Roshydromet with MEDT and other agencies
Effective cooperation of agencies: reporting back to government and Duma on implementation of Kyoto	Reporting annually, from 2005	MEDT leading, sectoral agencies assist on reporting
Reporting back to the Duma on implementation of the Kyoto mechanisms	Annually	MEDT with other relevant agencies
<b>Sectoral tasks</b>		
Market reform: reduction or removal of market structures that do not support emission reductions	Various	Sectoral agencies: Minregion, Rosstroj, FAS, MIE
Energy sector: emissions, efficiency improvements etc.	Various	MIE
Forestry and agricultural sinks	Various	MNR with forestry organizations and Ministry of Agriculture
R&D on emission reduction and CO2 capture technologies	Various	MES, Rosnauka, sectoral agencies
<b>International negotiations</b>		
Representing Russia in UNFCCC COP/MOPs	N/A	Roshydromet, MNR & MIE
Negotiating with other Parties on specific issues	N/A	Relevant government organization
<b>Future commitments</b>		
Preparation of Russian position on second commitment period	2006	Roshydromet, MIA, MIE
Preparation of emission scenarios up to 2020	End of 2007	MEDT

Source: Plan of combined activities to implement the Kyoto Protocol and UNFCCC in Russia. See also Korppoo et al. 2005

Key: Ministry of Economic Development and Trade (MEDT); Ministry of Industry and Energy (MIE); Ministry of Natural Resources (MNR); Ministry of Education and Science (MES); Ministry of International Affairs (MIA); Federal Agency for Science and Innovation (Rosnauka); Federal Anti-monopoly Service (FAS); Ministry of Regional Development (MinRegion); Federal Agency of Construction and Housing (Rosstroj).

<sup>18</sup> The dates were corrected by the IAC in summer 2005; these dates account for potential extension of the schedule.

## 2.7 FREQUENTLY ASKED QUESTIONS AND ANSWERS

### 1. What is the United Nations Framework Convention on Climate Change?

The United Nations Framework Convention on Climate Change – UNFCCC – was agreed at the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro, 1992. This agreement aims at the stabilization of GHGs in the atmosphere at a level that would prevent dangerous changes to the climate and represents the first treaty by the international community to address the issue of climate change. All countries have the commitment to address the climate change problem, but are divided into two groups with different levels of commitment: Annex I Parties and non-Annex I Parties. There are also Parties included in Annex II (members of the OECD in 1992, of which there are 24) which have a special obligation to provide “new and additional financial resources” to developing and transition countries to help them tackle climate change. As part of the UNFCCC agreement, all Annex I countries agreed to voluntarily reduce their GHG emissions to 1990 levels by 2000. Only the United Kingdom and Germany met this goal, which is why the Kyoto Protocol was proposed to introduce binding reduction commitments for Annex I countries.

### 2. What is the Kyoto Protocol?

The Kyoto Protocol is a Protocol to the UNFCCC adopted at the third Conference of Parties (COP 3) to the UNFCCC in Kyoto, Japan in 1997. The Protocol sets binding commitments for 39 developed and transition countries. These countries are listed in Annex B of the Protocol, but are typically referred to as Annex I countries because they were originally listed in Annex I of the UNFCCC. The 39 countries agreed to reduce their GHG emissions by an average of 5.2 percent compared to 1990 levels during the first commitment period of 2008 to 2012. The Protocol came into force on 16 February 2005 following ratification by Russia in November of 2004. As of April 2006, a total of 163 countries have ratified the agreement, representing over 61.1 percent of emissions from Annex I countries.

### 3. What are the Kyoto flexible mechanisms?

Because mitigation costs could be high for some Annex I Parties, the creators of the Kyoto Protocol established the flexible mechanisms that can be used to achieve the objectives of the Protocol in a cost-effective and flexible way. These mechanisms are International Emissions Trading, Joint Implementation, and the Clean Development Mechanism.

### 4. Why is the CDM important for transition economies in Eastern Europe and CIS?

Carbon intensity – the ratio of greenhouse gas emissions to economic output – is high among East European and CIS economies, a feature they inherited from their socialist past. High carbon intensity implies that there exists considerable potential for more cost-effective reduction of GHG emissions than would be possible in developed countries. By participating in JI and CDM, countries in Eastern Europe and the CIS can capitalize on their GHG reduction potential and attract much-needed capital and technology for modernization of their energy and industrial sectors.

### 5. What is a host country (Party)?

A host country is a Party not included in Annex I to the UNFCCC on whose territory the CDM project activity is physically located. A project activity located in several countries has several host Parties. At the time of CDM project registration, a host Party must meet the requirements of the Kyoto Protocol, including 1) voluntary participation in the CDM, 2) establishment of a CDM DNA for host country approval, and 3) ratification of the Kyoto Protocol.

### 6. What is the difference between CDM and JI?

The Clean Development Mechanism (CDM) and Joint Implementation (JI) differ with respect to the target nations. The CDM targets non-Annex I countries, while JI concerns only Annex I

countries. A more important distinction arising from this issue is that CDM contributes to GHG emission reductions outside the group of countries with binding emission targets, as non-Annex I nations are not subject to emission caps, while JI only results in the exchange of allowances between two Annex I economies. The rules between JI and CDM are also slightly different. This is because Annex I countries who fail to ensure the environmental credibility of their JI projects will still have to make good on the reductions in some other fashion to meet their overall GHG targets. Non-Annex I countries, on the other hand, do not have the same incentive to ensure that the reductions or sequestration resulting from CDM project activities are environmentally sound and lead to additional reductions. As a result, the technical evaluation and validation process is more stringent for CDM projects. Moreover, the Kyoto Protocol explicitly requires CDM projects to contribute to sustainable development of the host country. This requirement is not included for JI projects although many JI hosts still include it as a prerequisite for project approval.

### **7. What are registration, validation, and verification?**

Registration is the formal acceptance by the Executive Board of a validated project activity as a CDM project activity. Registration is the prerequisite for verification, certification, and issuance of CERs related to that project activity. Validation is the process of independent evaluation of a Project Design Document (PDD) by a DOE against the requirements of the CDM set out by decisions of the Parties to the Kyoto Protocol. Verification is the periodic independent review and ex post determination by a DOE of monitored reductions in GHG emissions that have occurred as a result of a registered CDM project activity during the verification period (i.e., the crediting period of the project).

If a CDM project implemented during the period of 1 January 2000 and 14 November 2004 is successfully registered with the Executive Board by 31 December 2006 it can include any emission reductions generated during that early period in its total estimate of CERs generated. This early implementation of CDM projects was allowed, because Parties to the Kyoto Protocol recognized that it would take a while for the Kyoto Protocol to enter into force and for the CDM Executive Board to establish appropriate registration procedures, and that this delay could prevent eligible emission reduction activities from being implemented right away.

### **8. What is the difference between the UNFCCC Focal Point and the DNA/DFP?**

The UNFCCC Focal Point is the person or entity appointed by UNFCCC parties to deal with matters related to obligations under the UN Framework Convention on Climate Change. This includes issues such as national GHG emissions inventories, national communications, and technology transfer. The DNA/DFPs were established specifically under the Kyoto Protocol to the UNFCCC to deal with the issue of providing national approval of JI and CDM projects. Countries that have ratified both the UNFCCC and the Kyoto Protocol may choose to appoint the same person to be the UNFCCC Focal Point and the contact person for the DNA or JI unit. However, because of the workload involved in both appointments many countries appoint two separate people to fill these roles.

### **9. Who administers CDM projects internationally and domestically?**

Internationally, the Conference of the Parties (COP) to the UNFCCC, serving as the Meeting of the Parties to the Kyoto Protocol (COP/MOP), has authority over and provides guidance to the CDM. The MOP is autonomous from the COP because it includes only those Parties that have ratified the Protocol. The MOP establishes the CDM rules and procedures which are implemented by the CDM Executive Board at the international level. The first meeting of the COP/MOP took place in December 2005 after the Kyoto Protocol entered into force earlier that year. The CDM Executive Board has two key functions: to provide registration approval for CDM projects which will be considered valid after eight weeks (four weeks for small-scale projects) if no request for review is

made; and, to approve certification reports from DOEs concerning verified emission reductions from a registered CDM project activity and to issue CER units accordingly.

Domestically, Parties participating in the CDM establish the CDM Designated National Authority for approving CDM projects. This includes both those Parties hosting CDM projects as well as those investing in CDM projects in other countries.

#### **10. What is the Difference between a DNA and DOE?**

A Designated Operational Entity, or DOE, is either a domestic legal entity or an international organization accredited and designated by the COP/MOP to validate proposed CDM projects as well as verify and certify reductions after the project has been implemented. As such, the DOEs are overseen by the international system set up to implement the Kyoto Protocol. DNAs, on the other hand, are established by their respective host governments and are responsible for authorizing CDM projects on behalf of the host Party by issuing a host country approval letter.

DOEs are responsible for approving the technical and legal aspects of the proposed CDM project, including the project's justification for additionality, the GHG emissions baseline, and the monitoring plan. DNA's main responsibility is to certify that the proposed CDM project meets the sustainable development criteria and other relevant laws of the host country, that the project is undertaken on a voluntary basis, and that the host country has ratified the Kyoto Protocol. During the validation process the DOE may contact the DNA if it has concerns about the approval letter or has questions about country-specific data and/or sources used in the PDD. It is very important that the DNA staff respond to such questions in a timely manner in order to avoid costly delays in the CDM project cycle.

#### **11. What is the role of the DNA vis-à-vis the Global Environment Facility, Green Investment Schemes, or renewable energy certificates?**

The role of the DNA is to provide host country approval of GHG emission reduction projects that are targeted for participation in the CDM. The DNA also ensures that the proposed CDM projects meet local sustainable development criteria and other regulatory requirements of the host country.

The Global Environment Facility (GEF), established in 1991, helps developing and transition countries fund projects and programmes that protect the global environment, including activities that reduce GHG emissions. In order to access GEF resources, Eastern European and CIS countries have appointed a GEF Operational focal point who is responsible for reviewing and endorsing GEF projects. It is possible, that some governments may delegate DNA functions to the same person who is also acting as the GEF Operational Focal Point (e.g. Minister of Environment).

Some countries, such as Romania, Bulgaria and Russia are considering the establishment of Green Investment Schemes as a mechanism for Annex I countries to purchase the excess GHG emission reduction allowances in exchange for the funding of GHG mitigation or other environmental projects in those countries with excess AAUs. These schemes are being developed in order to make sure the revenues from the sale of excess allowances in Russia, Romania and Bulgaria are directed to environmentally sound purposes in the host countries. GIS is not applicable for non-Annex I countries, thus DNAs would not get involved in the operation of such a scheme.

Many countries in the EU have introduced trading in renewable energy certificates to encourage the development of new renewable energy sources. Although these programmes indirectly

support the implementation of the UNFCCC and Kyoto Protocol by reducing reliance on carbon-based fuels, they are not considered one of the Protocol's flexible mechanisms. Renewable energy certificates can therefore not be interchanged with CERs or ERUs generated by the CDM and JI. Likewise the DNA is not required to get involved in their development and evaluation.

### **12. Can Official Development Assistance (ODA) be used for the Purchase of CERs and/or Capacity Building?**

According to the rules of the Kyoto Protocol, Annex I parties should not divert official development assistance (ODA) to CDM projects. The Marrakesh accords specify that *“public funding for clean development mechanism projects from parties in Annex 1 is not to result in the diversion of official development assistance and is to be separate from and not counted towards the financial obligations of Parties included in Annex 1.”* However, it is not entirely clear what signifies a diversion of ODA funds. In many cases, ODA is used for capacity building but is typically not used for the purchase of the underlying project-CERs. It is possible that some CDM projects may have received some financing from other potential ODA sources and activities that lead to GHG emission reductions. However, due to the additionality requirement of the CDM, the emission reductions generated from such ODA financing are usually not claimed as CERs under the CDM.

The CDM Executive Board asks project participants to affirm in the PDD that the project does not result in the diversion of ODA, but does not have any procedures for how to respond in case a donor country confirms that ODA was used. Because it is the prerogative of the host country to assess whether a project activity assists in achieving sustainable development, the host country will need to approve each project, including the source of financing, and could therefore object to a project if it finds that ODA is inappropriately used for generating and purchasing CERs.

To provide more clarity on the use of ODA, the OECD developed recommendations for how to account for ODA in relation to CDM projects.<sup>19</sup> Existing OECD reporting guidelines specify that ‘ODA expenditures must be net of any funds earned by the ODA expenditure’. The proposed approach for the treatment of ODA reporting is that ‘the value of CERs generated from ODA investment in a CDM project must be deducted from reported ODA finance’. This means that ODA funds cannot be used to pay for CERs and/or if ODA funds are used to invest in a project that produce CERs, the value of the CERs generated must be deducted from the ODA expenditure of the donor country. In short, ODA can be used to facilitate the development of host country capacity, both in the public and private sector, but should not be used to invest in actual project infrastructure and pay for CERs.

### **13. Does DNA approval mean that the project can start generating CERs right away?**

The CDM project cannot be officially recognized as a CDM project until it has been registered with the CDM Executive Board. Host country approval, executed via the DNA, is a prerequisite for requesting registration with the EB and is therefore not enough to get a project approved for CDM participation. The final registration comes from the CDM Executive Board.

**14. How is the JI/CDM project review process related to EIAs?** Some host countries may have existing laws in place that require environmental reviews and impact assessments of projects. A CDM project must still meet all these requirements, even if it has received approval by a DNA, and the project participant is responsible for ensuring that all such requirements are met.

The Kyoto Protocol rules, i.e., the Marrakesh Accords, state that, as part of the validation process, project participants must submit documentation to the DOE that show that the environmental

<sup>19</sup> ODA Eligibility Issues for Expenditures under the Clean Development Mechanism (CDM): Proposal by the Chair. DAC/CHAIR (2004)4/Final, 30 April 2004.

impacts of the project, including transboundary impacts, have been analyzed. If those impacts are considered significant by the project participants or the host Party, the project participants must show that they have undertaken an environmental impact assessment in accordance with procedures as required by the host Party. Thus, it is the responsibility of the DOE to verify that all the required operating permits/approvals and environmental reviews of the host country have been met. Before the DOE issues the validation letter, the DOE will confirm that the required EIA has been completed successfully by examining relevant documentation provided by the project participant(s). The DOE does not undertake the EIA and does not require any additional EIAs beyond those specified in existing laws.

Because the DOE already examines whether the appropriate host-country requirements for EIAs have been met, the DNA does not have to do that either. Regardless, some DNA's have opted to ask project participants to submit proof along with the PDD that any necessary EIAs have been completed.

#### **15. Can the DNA initiate and develop its own projects?**

The Kyoto Protocol does not specify whether or not the DNA can originate its own CDM projects. In principle, the assessment of a project's contribution to sustainable development objectives should be made on an impartial and transparent basis and conflicts of interest may arise if the DNA is also tasked with developing such projects. However, because of the low awareness of CDM in most East European and CIS countries, some DNA's do get involved in identifying and originating projects. In these cases, the DNA is not listed as a project participant. In Georgia, for example, the technical staff of the DNA Secretariat works with the private sector to identify projects and provides some technical assistance for the development of PDDs. To avoid conflicts of interest, the decision-making body of the DNA (the CDM National Board) does not get involved in project development. Its role is only to evaluate and approve projects.

Although the DNA itself has to be careful about how it deals with potential conflicts of interest, other government bodies and public institutions could, if so desired, put forward a CDM project for the DNA to approve. The DNA may approve or reject any of these projects, depending on whether they meet the requirements of the host country.

### 3 DESIGNING AND ESTABLISHING THE DNA/DFP

A key element for attracting CDM or JI investment is the host country's application of quick and transparent procedures for screening, evaluating and approving projects. To achieve this goal the national CDM or JI authority should implement a standardized system for project review and make sure that all key stakeholders understand and support this project review process.

The key question is what the mandate of the CDM or JI authority should be. The first thing policy makers may do to start the process towards a CDM authority is to organize a working group for all interested parties. As outlined in Text Box 3-1, this working group should be used as a vehicle to obtain consent and support for a CDM or JI strategy. A stakeholder group would also be useful for consulting with other policy makers to ensure that the CDM strategy is linked with the relevant sustainable development objectives of the country.

*Text Box 3-1 Stakeholder Working Group(s) for DNA/DFP Design*

#### **Broad Stakeholder Group**

To ensure broad participation during the design of the DNA, the government could organize a working group consisting of all key stakeholders to discuss the various options for a DNA/JI framework. The CDM/JI is a multi-disciplinary concept which potentially could touch on most sectors of the economy. Thus, the development of an institutional set-up for CDM and JI will involve a broad range of stakeholders, including sectoral and financial ministries, NGOs, academia, lending institutions, and business groups. Inclusion of a broad range of stakeholders will facilitate greater participation and support for the development of CDM and JI projects in the long run, and will enable integration of the CDM strategy with national sustainable development goals and objectives. It will also serve as a means to educate potential DNA users of the rules and requirements of project development.

The government may choose to organize such stakeholder meetings on its own or could do so under various CDM or sustainable development-related capacity building activities provided by donor programmes in the country.

#### **Internal Government Working Group**

The government may also wish to develop an internal working group, consisting of experts from relevant ministries, who can address specific inter-ministerial issues and procedures related to review procedures, financing, and institutional arrangements. This working group should also be able to iron out potential institutional rivalries regarding who should control and implement the DNA.

The design of the DNA's scope and functions can be organized into five parts. These parts are described below and summarized in Table 3-1 on the following page.

- **Select the Institutional Framework.** The first part involves selecting the institutional framework of the DNA or DFP including designating a secretariat for day-to-day

administrative tasks and a decision-making body for final project approval and signature of approval letters. Section 3.1 of this paper describes different types of institutional set-ups that can be used by DNAs.

- **Establish the Project Review Process.** The second part involves establishing the project review cycle, deciding on public participation, designing evaluation documents and a template approval letter, and determining the process for providing technical assistance to project developers. This project review process may be codified via legislative procedure, either as separate legislation, or, as an annex or amendment to the first legislation establishing the DNA. Section 3.2 describes issues related to establishing a project review process.
- **Design Sustainable Development Criteria.** Third, the sustainable development strategy for using CDM must be established by the government and evaluation criteria and indicators must be designed. Section 3.3 discusses different options for developing sustainable development criteria as part of the creation of a DNA.
- **Develop an Outreach and Implementation Strategy.** The fourth part involves design of an implementation and outreach strategy for the DNA. As described in Section 3.4, this should include a strategy for reaching out to potential project developers inside the country and for attracting donors and project investors to the country.
- **Legalize the DNA.** The government must legalize the DNA, including the institutional set-up and the project review procedure. The process of legalization should take into account existing laws and regulations that may influence participation in CDM and the transfer of CERs outside the country. As described further in Section 3.5, legalization of the DNA can be staged to start with the institutional set-up and later address specific project review criteria and procedures.

Table 3-1 Steps in Designing and Establishing a DNA

Select Institutional Framework	Establish Project Review Process	Design Sustainable Development (SD) Criteria	Develop Outreach Strategy	Legalize the DNA
<b>4 models:</b> <ul style="list-style-type: none"> <li>- Single ministry</li> <li>- Inter-ministerial</li> <li>- New government entity</li> <li>- Independent entity</li> </ul>	<b>Decide on:</b> <ul style="list-style-type: none"> <li>- Evaluation cycle</li> <li>- Public participation</li> <li>- Application documents</li> <li>- Approval letter template</li> <li>- Technical assistance</li> </ul>	<b>Select:</b> <ul style="list-style-type: none"> <li>- Broad SD policies</li> <li>- SD criteria for CDM</li> <li>- Indicators for SD criteria</li> </ul>	<b>Target Groups:</b> <ul style="list-style-type: none"> <li>- Domestic project developers</li> <li>- Foreign investors</li> <li>- Decision makers</li> </ul>	<b>Three steps:</b> <ul style="list-style-type: none"> <li>- Legalization of DNA</li> <li>- Links to other laws</li> <li>- Improve investment laws</li> </ul>

If time and resources are limited, the individual parts in the establishment of the DNA (listed in Table 3-1) can be implemented in stages. The most important steps to undertake immediately are to agree on an institutional setup and to define the sustainable development and other evaluation criteria against which the project must be assessed. The outreach strategy can be designed and financed over time while the DNA is in the early stages of implementation.

### 3.1 Selecting the Institutional Framework of the DNA/DFP

The Kyoto Protocol does not specify how and within which agency the DNA or DFP should be established, but leaves it to each country to determine the best institutional structure for the entity. The decision as to how the DNA should be established is likely to be influenced by the allocation of existing responsibilities for the UNFCCC and other environmental and foreign affairs matters within the host country.

Because the Kyoto Protocol requires host Party approval (i.e., government approval) of the project, it is important that the proposed entity is an effective agent of the host government, such as a single ministry, a decision-making inter-ministerial body, or an independent entity with explicit government authority to approve projects. If, at any point, some concerns arise regarding the legitimacy of the DNA or DFP, the risk to the investor will increase. Therefore, a main objective should be to design a DNA structure that is sustainable in the long-term.

Most of the DNAs and DFPs that have already been established throughout Eastern Europe and the CIS have been located within the Ministry of Environment because of their prior involvement in climate change, sustainable development, and environmental impact assessment.<sup>20</sup> However, a few DNA's in other regions have been established within other ministries, such as the Ministry of Energy, an Energy Agency linked to the Ministry of Economy, or within a hydro-meteorological department.

In most cases, the secretarial and administrative functions of the DNA are placed within the government office that is already responsible for climate change activities, including the UNFCCC Focal Point. This ensures that the DNA can draw on staff members already experienced with climate change. This setup also ensures that coordination among all climate change activities is optimized.

Table 3-2 Legal Structure of DNAs in Eastern Europe and the CIS

Country	DNA Reported to the UNFCCC <sup>a</sup>	DNA Legal Structure	DNA Administrative Unit/Secretariat
Albania	Ministry of Environment	<i>In process</i>	Climate Change Unit, Ministry of Environment
Armenia	Ministry of Nature Protection	<b>Ministry of Nature Protection</b>	<i>Working group to be established.</i> There are 2 contact points in the Ministry of Nature Protection: 1) UNFCCC Focal Point/Head of Environmental Protection Department, and 2) Head of International Cooperation Department
Azerbaijan	Ministry of Ecology and Natural Resources	<b>Ministry of Ecology and Natural Resources.</b> <i>Procedures are under development.</i>	The Centre for Ozone and Climate Change and the Department of International Affairs
Bosnia and Herzegovina	–	–	–

20) Ellina Levina. Overview of JI Secretariats in Eastern Europe and CIS. UNDP/RBEC/RSF Office, February 2005; and Jette Findsen. CDM Institutional Frameworks in Southern Europe and CIS. UNDP/RBEC/RSF Office, February 2005.

Country	DNA Reported to the UNFCCC <sup>a</sup>	DNA Legal Structure	DNA Administrative Unit/Secretariat
Georgia	Ministry of Environment Protection and Natural Resources	<b>CDM National Board</b> of high level officials from sectoral ministries and headed by the Min. of Environment.	Climate Change Office in Ministry of Environment Protection and Natural Resources
Kazakhstan <sup>b</sup>	–	<i>In process.</i> <b>Interagency Committee on Climate Change (IACCC)</b> approves CDM/JI projects. Consists of 12 ministries. Observer status to NGO, parliament, international donor, and industry representatives.	The Climate Change Coordination Centre, which is a non-governmental organization, acts as the Executive Body (secretariat) of the IACCC.
Kyrgyzstan	–	A 2005 government decree established a <b>Climate Change Committee</b> chaired by the Deputy Minister of the Ministry of Nature Protection and Emergency Situation. A restructuring of the ministry into two (Ministry of Emergency Situation and State Agency for Nature Protection and Forestry) put the DNA on hold until a new chair has been selected.	The Climate Change Centre (co-funded by UNDP and the Ministry of Nature Protection and Emergency) to act as the secretariat. It will be housed at the national university (KRSU) in Bishkek. A 2005 Statute established the Centre as a non-governmental entity, but partly funded by the Ministry of Nature Protection and Emergency.
FYR Macedonia	–	<i>In process.</i> <b>Ministry of Environment and Physical Planning</b>	–
Moldova	The State Hydrometeorological Service of the Ministry of Ecology and Natural Resources	<b>A National Commission (NC)</b> with 18 members representing parliament, the government, private sector, research, and academic institutions. It is chaired by the Minister of Ecology and Natural Resources and co-chaired by the Director of the State Hydrometeorological Service.	The State Hydrometeorological Service provided an office for the NC with two computers and an internet connection. The Climate Change Office Manager of the Ministry of Ecology and Natural Resources acts as Secretary of the NC.
Montenegro <sup>b</sup>	–	–	–
Serbia <sup>b</sup>	Ministry of Environment	–	–
Tajikistan <sup>b</sup>	–	<i>In process.</i> <b>Ministry of Environmental Protection</b>	Secretariat to be housed in the Ministry of Environmental Protection
Turkmenistan	–	<i>In process</i>	–
Uzbekistan	–	<i>In process</i>	Proposed: The Department for External Economic Relations and Foreign Investments of the Cabinet of Ministers makes the final decision, while administration and technical review will be handled by the State Hydrometeorological Committee.

<sup>a</sup> From the list of DNA's reported to the UNFCCC: "Designated National Authorities." <http://cdm.unfccc.int/DNA> accessed April 2006.

<sup>b</sup> Bosnia and Herzegovina, Kazakhstan, Montenegro, Serbia, and Tajikistan have not yet ratified the Kyoto Protocol.

Ultimately, the structure of the DNA will depend on the institutional preferences of each country. Four possible models could be used by the host Party government for establishing the DNA, including:

1. Single Ministry Model
2. Two-Tiered Inter-Ministerial Committee Model
3. Independent DNA Outside the Government
4. New Government Entity

The first three options are described further below. The fourth option of establishing a new government entity has not been used in Eastern Europe and the CIS for a number of reasons, including lack of financial resources and ongoing pressure to reduce the size and number of government institutions. As a result, this option is not considered further in this report.

### 3.1.1 Single Ministry Model

The DNA may be located within an existing department or ministry to take advantage of already existing infrastructure and expertise. This would most likely be the Ministry of Environment. In this case, the minister would sign the approval letter, while a specific department or subdivision would be identified as the contact point for external communication, internal/interagency project review, and day-to-day administration of the DNA. A simple version would involve the allocation of one extra staff member to the existing division to be responsible for the operation of the DNA.

CDM and JI projects may involve different sectors and validation requires specific technical expertise. To take advantage of relevant expertise in other ministries during project review, the model could include establishment of an interagency review committee composed of technical experts that review and provide feedback on the project proposals. If desired, NGOs, industry groups, and academia could be asked for expert advice as well. However, even though other agencies and entities would be asked for input, the final decision authority would rest with the Minister responsible for the DNA.

This model is low in cost and relatively easy to implement because it benefits from using an already existing infrastructure. Moreover, the simple reporting and decision-making structure of using just one ministry speeds up the approval process by avoiding lengthy interagency discussions. However, it is possible that by locating the DNA Secretariat within an existing division, the new CDM staff may be asked to perform other duties in addition to DNA administration, thus being distracted from the main duties of reviewing CDM projects. Moreover, this model may concentrate the decision-making powers within one agency which may not be optimal. Text Box 3-2 describes an example of how this model was implemented in Armenia.

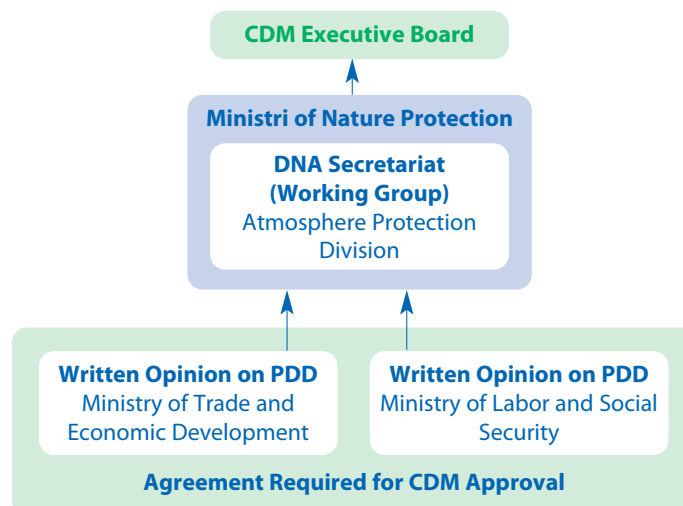
As a variation of the Single Ministry Model, some countries have split the decision-making and administrative functions between two different ministries or departments. Although these countries split some of the functions of the DNA between different ministries, final decision making is always delegated to one ministry to avoid confusion. For example, when the Polish government established its JI Unit it placed the JI Secretariat for technical review and administration within the National Fund for Environmental Protection and Water Management and gave final project approval authority to the Ministry of Environment.<sup>21</sup> Uzbekistan is

<sup>21</sup> Mirosław Sobolewski, Zbigniew Karaczyn and Andrzej Kassenberg. "Case Study: JI Secretariat in Poland." Warsaw, February 2005. <http://europeandcis.undp.org/files/uploads/Kyoto%20Protocol/JI%20Secretariat%20PL%20-%20FINAL.doc>

considering making the Department for External Economic Relations and Foreign Investments of the Cabinet of Ministers the final decision maker while the State Hydrometeorological Committee will handle administration and technical review.

*Text Box 3-2 Case Study – DNA in Armenia*

Armenia's proposed DNA offers an example of how an existing department was used as a basis for establishing the DNA. Armenia's Ministry of Nature Protection was designated as the DNA in 2003. However, the specific procedures for project review have not yet been finalized. According to a draft Governmental Decree on "the establishment of a CDM procedure", the UNFCCC Focal Point, who is also the Head of the Environmental Protection Department, will be tasked with operating the DNA Secretariat while the Minister of Nature Protection is the final decision maker who signs off on the approval letter.



There is no inter-ministerial commission which meets to decide on the projects. Instead, the head of the DNA Secretariat must forward the project documents (PDD) to the Ministry of Trade and Economic Development and the Ministry of Labor and Social Security for their review and "agreement". According to the Decree, these two ministries must submit their response within 10 days of receipt of the proposal. This deadline is based on established procedures for inter-ministerial review in Armenia, and must therefore be complied with (although this is not specified in the draft decision). To increase the transparency of the final host country decision, the Decree requires that the final project evaluation must be posted on the DNA's website.

### 3.1.2 Two-Tiered Inter-Ministerial Committee Model

The DNA can also be created as an inter-ministerial committee, representing different ministries and departments and perhaps also non-government enterprises, such as academia, NGOs and industry groups. The committee would have the final authority on project approval, negotiations with potential donors, and other issues related to the operation of the DNA, and its decisions would be made during regular committee meetings. One ministry would act as the coordinator of the committee, another could act as a co-chair, but all members undertake approval of

projects, and the committee as a whole must come to an agreement before an approval letter can be signed. In most cases, the minister of environment acts as the chair or coordinator.

The benefit of using this type of structure is that it ensures participation by a wide range of entities thus spreading the word regarding the potential for using the CDM as a means of attracting investment to the country. It offers the opportunity to bring a larger set of specialist skills and experience with specific sectors and enables a much broader integration of the CDM into the national decision-making process. However, committee members are typically not paid for this work and their participation is not part of their primary job description. This creates a challenge in terms of ensuring full and timely participation by all appointed members, and if not managed properly, it could slow down the approval process considerably. One option is to give committee members a specific timeframe within which they have to provide comments on each project. If no comments are provided within that period, this may be interpreted as 'no objection' by the remaining committee members.

The inter-ministerial model typically consists of two tiers:

- 1) The joint committee which approves projects and oversees the review process, and
- 2) A Secretariat that undertakes routine administration and acts as the contact point to the external community.

*Text Box 3-3 DNA Activities in Georgia*

In January 2003, after the ratification of the Kyoto Protocol by the Georgian Parliament in 1999, the Climate Change National Agency at the Ministry of Environment of Georgia was designated as the national authority for CDM (DNA) under the order of the Minister of Environmental Protection and Natural Resources (MEPNR). Capacity building for the DNA and implementation of the elements of national CDM procedure started immediately after this decision.

In 2004, the government was reorganized and, as a result, the Climate Change National Agency was transformed into the Hydrometeorology and Climate Change Administration of the Department of International Relations and Conventions of the MEPNR. In accordance with the Government Decree N2 from 20 January 2005, the MEPNR became the CDM DNA in Georgia and the Hydrometeorology and Climate Change Administration was designated as the DNA secretariat. The DNA is responsible for establishing all necessary national procedures for CDM implementation, raising the awareness of private sector and government decision makers, drawing of CDM investments, and creation of a CDM infrastructure. The DNA must not make public any confidential information submitted by the project participants. DNA secretariat is tasked with archiving CDM projects and monitoring their implementation process.

A September 2005 governmental resolution (N172 of 29.09.2005) established the CDM National Board (hereafter "The Board") and identified its composition of nine high-level members, including representatives of the Ministry of Environment; Ministry of Finance; Ministry of Energy; Ministry of Economic Development and Energy Efficiency Centre. The Minister of MEPNR is the Chair of the Board. In accordance with the resolution, the CDM National Board has been established in order to coordinate and facilitate the CDM implementation process in Georgia. The Board is authorized by the Georgian government to establish the national CDM project approval procedure and to make recommendations on submitted projects. Final decision on a project will be made by the Cabinet of Ministers. On 9 February 2006, the Minister of MEPNR approved the Board's procedure under order N89 (See Annex X).

The first informal meeting of the Board was held in March 2006 as part of a side event at the regional workshop on CDM implementation organized in Georgia by the EuropeAid project "Technical assistance to Armenia, Azerbaijan, Georgia and Moldova with respect to their global climate change commitments." The meeting highlighted the benefits of the CDM to the country's economy and discussed key barriers envisaged while implementing CDM projects. Georgia's possible sustainable development criteria were also considered at this workshop.

The first formal meeting of the Board was held on 23 May 2006 where Georgia's proposed sustainable development criteria were considered, weighted, and recommended to the Government for further use for the assessment of a CDM projects' contribution to sustainable development. A proposed national procedure for CDM project approval was also considered and recommended to the government for approval. The proposed procedure consists of a list of documents to be submitted to the DNA secretariat for approval of a CDM project and a time schedule for the different steps involved in reviewing a CDM project. The Board agreed to ask the Ministry of Finance to consider the development of a CER taxation policy and the Ministry of Justice to consider how CER ownership should be treated within Georgia.

*Contributed by Marina Shvangiradze*

The DNA secretariat could be staffed by different ministries, or just one. In many instances, the Minister who chairs the committee also houses the Secretariat. In Georgia, as described in Text Box 3-3, the proposed DNA structure follows this model; that is, the CDM National Board will be chaired by the Minister of Environmental Protection and Natural Resources and the DNA Secretariat will be located in the Administration of Hydrometeorology and Climate Change within this ministry. The Department of Climate Change also acts as the UNFCCC Focal Point. This option is relatively low in cost because it takes advantage of already existing administrative structures and utilizes staff already experienced with the issue of climate change.

Another option for establishing a DNA Secretariat adopted by some CIS countries is to create an independent non-government CDM entity to act as the administrative office for the government-run inter-ministerial committee. Kazakhstan, for example, plans to establish an inter-ministerial commission – the Interagency Committee on Climate Change (IACCC) – with a secretariat placed within a non-governmental organization, the Climate Change Coordination Centre. This Centre was previously established with financial support from the United States Agency for International Development (USAID) and others. As described in Text Box 3-4, Kyrgyzstan followed the same model for its establishment of a DNA in 2005.

*Text Box 3-4 Kyrgyzstan's Non-Government Climate Change Centre to Support the DNA*

The DNA model selected for Kyrgyzstan consists of an inter-ministerial National Climate Change Committee (NCCC) supported by the Climate Change information office established earlier by the Ministry of Ecology and Emergencies (MEE) with funding from a UNDP/GEF project that ended in 2004.

During the process of establishing the Kyrgyz DNA, stakeholders determined that it would be beyond the financial capacity of the MEE to continue to finance the Climate Change office and retain the staff needed for administering CDM projects. Instead, stakeholders decided to establish the Climate Change office as a non-governmental organization because then it would be able to seek financing from both the MEE and other potential donors to implement CDM and other climate change activities in the country. The expectation was that such a set-up would improve the sustainability of the office in the long run. The designers also determined that during the start-up phase of the Climate Change Centre, seed money would be provided by MEE to give the Centre some time to solicit funds from other entities.

*Source: Zuhra Abaihanova. Summary Report of Assistance Activities to Support Climate Change Centre. Kyrgyz Republic. Prepared under TACIS Project "Technical Assistance to Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan with respect to their commitments on global climate change." Bishkek, 2005.*

### **3.1.3 Independent DNA, Outside the Government**

The last option involves the establishment of an independent CDM or JI office outside the regular government structures. The office would operate independently of the government. However, it would need to receive full authority via government legislation verifying that it is authorized to sign approval letters on behalf of the host Party. Although such an arrangement may be preferable in terms of avoiding the usual government bureaucracy, it may not be sustainable in the long run. Some parts of the government may change over time and become reluctant to

delegate full authority and independence to such an entity. Moreover, the entity may not be able to stay financially independent if outside funding from various donors or CDM fees dry out.

The selection of an institutional setting will ultimately depend on a range of factors, including:

- 1 Existing capacity in the area of climate change and GHG inventories?** Building on existing climate change institutions would strengthen the capacities of the DNA. To ensure its smooth operations, the new DNA Secretariat could be placed within an institution that is already familiar with climate change and GHG emissions accounting. For example, housing the DNA in the same place as the UNFCCC Focal Point would provide access to staff that is already familiar with potential project developers and has a network within the international community. Many DNAs in the region have also benefited from local climate change expertise developed as part of GEF-funded projects to prepare national communications for climate change.
- 2 Desired involvement of all ministries in project review?** Deciding on what setup to use may be influenced by the desire to incorporate all sectors into the CDM decision-making process. This decision may in part be influenced by past experience with inter-ministerial commissions, such as the one used for the preparation of the National Communication on Climate Change.
- 3 Desired involvement of public stakeholders?** Many countries have representatives of public stakeholder groups in the DNA supervisory or advisory committees in order to encourage participation and ensure a transparent screening process. These representatives typically come from industry, NGOs and academia. This inclusion of public stakeholders is beneficial in terms of opening up the review process to the outside. It is not a required step, since public comment periods are built into the validation and registration process.
- 4 Is there a CDM champion?** Most successful DNAs credit their success to specific individuals who have been instrumental in championing CDM projects through the government bureaucracy. When considering how to structure a DNA, national policy makers may want to frame the DNA structure to utilize existing proponents of climate change and CDM projects.
- 5 Intent to insulate DNA staff from frequent government turn-over?** If the government experiences frequent elections and turn-over of high-level staff, it may be useful to structure the DNA in a way that key staff and technical reviewers are shielded from such changes. CDM project review can be a complicated affair and delays are likely to occur if new reviewers must be brought up to speed. One possibility is to minimize reliance on high-level committee members by using mid-level government experts in the inter-agency committees.
- 6 Sectors with many potential projects?** When considering where to locate the DNA, it may be useful to examine which sector of the economy is likely to offer the most CDM opportunities. If most of the projects are expected within the energy sector it would be beneficial to offer the Ministry of Energy a significant role in the DNA.

### 3.2 Design the Project Review Process

Designing an efficient project review process is essential for creating a transparent and effective DNA or DFP. This includes development of:

- *A project evaluation cycle* for coordinating project review, including evaluation steps, a time line, and a list of agencies, departments and/or experts involved.
- *A process for public participation.*
- *Application and evaluation documents:* Application templates for use by project developers, consultants, investors, and validators.
- *Host country approval* templates for preliminary endorsement and final approval.
- *A strategy for providing technical assistance* to project developers throughout the review process.

#### 3.2.1 The Project Evaluation Cycle

The selection of a project review cycle depends on the institutional preferences of each host country. Most governments in the region have proposed a two-step approval procedure, whereby project developers have the option of submitting a short PIN for initial feedback via a letter of endorsement, before the complete PDD is submitted for final approval (Table 3-3). This two-tiered process reduces the risk to the project developer because he or she will receive early feedback on the eligibility of the project before expending resources on preparing the full PDD. Most carbon funds also require submission of an initial PIN so this step would not lead to additional effort on the part of the project proponent.

The design of a review cycle also includes deciding who in the government should review the proposals, when they should do this, and in what order. Typically, when a proposal is submitted, the DNA or DFP first undertakes an initial screening to determine if all the required documents have been submitted. If any documents are missing, the DNA may request these from the project developer before a complete internal evaluation is initiated.

Table 3-3 Sample Project Review Cycles in Eastern Europe and the CIS

Country	Initial Project Endorsement			Final Project Approval		
	Project Idea Note (PIN)	PIN Template	Time Line	Project Design Document (PDD)	PDD Template	Time Line
<b>Georgia</b>	Optional	Provided by DNA	10 working days	Required	CDM EB design	Final decision in 25 working days (10 days for the Secretariat, 15 days for the Board) if no additional info is requested by the Board
<b>Moldova</b>	N/A	N/A	N/A	Required	Stage 1: Request authorization from government to negotiate project & sign PDD. Stage 2: <sup>22</sup> Official approval by DNA (National Commission - NC): Baseline and monitoring methods must be approved by CDM EB before PDD in CDM format can be submitted to the NC.	A stage 2 decision must be made within two weeks. Rejected and revised proposals will also be examined within two weeks.
<b>Bulgaria</b>	Required	Investor or JI unit design		Required	Not specified, but list of required information must be addressed.	
<b>Armenia</b>	Optional	Provided by DNA	10-15 working days	Required	CDM EB design	20 working days
<b>Romania</b>	Required			Required		

If the application is complete, the DNA/DFP typically sends the proposal for review by a pre-designated expert group. This group normally consists of government representatives from sectors where CDM projects could be developed, including energy, transportation, agriculture, land use and forestry, and waste. Depending on the scope of each proposal, the relevant experts would then be asked for comments. Representatives from the ministries of finance, economy, and/or trade may also be included, and some DNAs may decide to hire outside experts to assist in the evaluation. However, because of the additional resources required for outside reviews, this rarely happens. The expert reviewers are given a certain time frame for their reviews (such as 5 - 10 days). These time frames are typically aligned with existing inter-ministerial rules for commenting on official documents to ensure that a response is provided.

Based on the comments received by the expert reviewers, the DNA/DFP would write up a final opinion to be submitted to the body governing the DNA for its final approval. Depending on the

22) Even though the official approval of CDM projects in Moldova is supposed to come from the National Commission (NC) there has been some problems with doing so because communication within the NC does not function very well. As a result, the first approval letter was issued by the Commission without the knowledge of the Ministry of Ecology and Natural Resources and the NC Secretariat.

institutional setup, this could either be the Minister who hosts the DNA/DFP or an inter-ministerial commission. Once a final decision has been made, an approval or rejection letter is drafted and sent to the project developer.

Several variations can be made to this process according to individual country settings. For example, in Moldova, the Secretariat skips the expert group and sends the proposal directly to the National Commission for a final decision. In Armenia, both the PDD and the draft approval/rejection letter are sent to the appointed experts in the Ministry of Trade and Economic Development and the Ministry of Labour and Social Security to obtain their consent. In general, the fewer evaluation steps that are used the more likely it is that the review will stay on schedule.

Some countries have set a timeline for when the project developer must be notified of a final decision (Table 3-3). This helps provide certainty to project proponents and investors. In the case of Moldova, the PDD review must take no more than two weeks after official receipt of the proposal. A proposal that is rejected with revisions will also be reviewed within two weeks after resubmission. Armenia proposes to review PINs within 15 working days and PDDs within 20 working days. If additional information is requested on the PDD, the counting of days will be halted until the required information has been received. Text Box 3-5 describes Georgia's project approval cycle.

*Text Box 3-5 CDM Project Approval Cycle in Georgia*

Georgia's proposed national approval procedure is based on a two-step approach. The first step, which is optional, involves the assessment of a Project Idea Note (PIN) in order to confirm or reject the project idea as a potential CDM project. Within 10 working days after a PIN has been registered with the DNA secretariat, project participants must receive a letter of confirmation or rejection with clear argumentations for why the specific decision was made. The second evaluation step is obligatory, and involves evaluation of the PDD and other financial/legal information requested from the project participants. A project proposal will be registered by the DNA secretariat when all required documents are formally in place. No more than 10 working days after the registration of an application, the DNA secretariat must submit a recommendation to the CDM National Board. The recommendation letter should consider the sustainable development criteria and other requirements.

The Board members must receive the DNA secretariat recommendation file along with all required documents no later than 15 working days after a project has been registered with the DNA. If the Board requests additional information from the project participants, 15 days will be added after the information was received by the secretariat. In short, the Board must make the final recommendation to the Cabinet of Ministers within 15 working days after receiving the completed file.

### 3.2.2 Public Participation

During the Kyoto Protocol negotiations, the CDM project review cycle was carefully designed to allow public stakeholders to comment on proposed CDM projects. The Marrakesh Accords specify that project participants must invite comments by local stakeholders, summarize any comments received, and provide a report to the DOE on how due account was taken of these comments. Moreover, as part of the validation process, the DOE is required to solicit comments from the general public during a 30-day review period. All of these comments must be listed and addressed in the final validation opinion that is submitted to the CDM Executive Board. If any member of the Executive Board finds that these comments have not been addressed properly, he or she may request a review of the proposed CDM project. A review will be triggered if three Executive Board members or a Party request the review.

DNAs are not required to involve the public in their deliberations regarding host country approval. Many host countries avoid public review in order to keep the approval process as short as possible. However, other countries try to include public stakeholders in the review process thinking that this will ensure more effective support in the long run.

There are four ways in which a DNA can involve the public in the decision making process and/or ensure that public stakeholder comments are addressed properly:

- **Include public stakeholders in the work of the DNA itself**, for example, by including representatives of the public in the DNA project review. Private sector participation usually involves national banks, business associations, chambers of commerce and export consortia. Moldova involves NGOs and the private sector by including these as observers in the National Commission for implementing the Kyoto Protocol. Their observer status means that they cannot vote on CDM projects, but they can participate in all meetings and contribute to the process informally. The Moroccan CDM Council consists of 20 representatives from a wide range of ministries, departments and government agencies as well as industry associations, NGOs and research centres. In countries such as Brazil, Morocco, and South Africa this type of arrangement now appears to be working quite effectively and has assisted in integrating social and community benefit considerations into decision making.<sup>23</sup> In some cases, it has also stimulated the engagement of national research institutes in R&D on sustainable technologies and climate change issues, and led to increased cooperative partnerships between the public and private sector, including foreign investors.<sup>24</sup>
- **The DNA can invite the public to submit comments on all final project proposals (PDDs) it evaluates.** South Africa's DNA directly solicits public comments on project proposals by posting submitted PDDs on its website for 30 days. This is the most direct method for soliciting input from the public. However, it also increases the administrative burden of the DNA as it has to respond to all comments received. It may also lengthen the project review period.
- **Notify the public and all stakeholders when a CDM project is undergoing public review as part of the validation process.** To facilitate public input during the CDM project development process, Armenia's DNA links its website to that of the DOE, while the DOE is requesting public comments on the CDM project being validated. In addition to such a website notification, DNAs could notify all stakeholders directly when a project is

<sup>23</sup>) United Nations Development Programme (UNDP). "An Assessment of Progress with Establishing the Clean Development Mechanism (CDM). 2006

<sup>24</sup>) These were important conclusions drawn from country-level CDM studies conducted by UNDP in Brazil, South Africa, and Morocco (2004).

undergoing validation and is available for public comments. Upon request from project participants, Georgia's DNA offers its media facilities (access to the internet and its web page) to the participants to help them solicit local stakeholder comments.

- **The host-country may require that project participants include, along with the PDD, a discussion of measures taken to involve public participation in the project review.** Following extensive discussions on how best to involve public participation in the project review process, the governments of Armenia, Azerbaijan, Georgia and Moldova decided to add such a requirement along with the PDD. The individual DNAs can then assess whether public participation has been adequately addressed.

### 3.2.3 CDM Project Application and Evaluation Documents

To streamline the project evaluation process the DNA should design application guidelines and templates that can be accessed by project developers when applying for host country approval. This may include a PIN template, an overview of the project evaluation cycle, sustainable development criteria, potential evaluation/scoring criteria, and a list of supporting documentation that must be submitted along with the proposal. Some DNA/DFPs, such as South Africa, also provide templates for application letters.<sup>25</sup> It is important to be as explicit and descriptive as possible in order to facilitate the submission of complete proposal packages. All of these documents should be made available in English and the national language and should be posted on an external website for ease of access by foreign investors. Annex I provides a template for a PIN, Annex II presents a sample application checklist and Text Box 3-6 illustrates the type of documentation required for submission of a JI proposal in Bulgaria and a CDM proposal in Georgia.

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<sup>25</sup> A copy of South Africa's CDM application form can be obtained at: [www.dme.gov.za/publications/pdf/cdm/Application%20Form.pdf](http://www.dme.gov.za/publications/pdf/cdm/Application%20Form.pdf).

*Text Box 3-6 Required Documentation for Requesting Letter of Approval in Bulgaria and Georgia***JI in Bulgaria**

In order to start the evaluation of a JI project in Bulgaria, the following documents must be submitted to the JI Unit in the Ministry of Environment and Water (MoEW):

- A formal letter to the MoEW requesting approval;
- A PDD in Bulgarian and English, including electronic versions;
- A validation (or pre-validation) report, including a version translated into Bulgarian;
- A letter from the MoEW or regional inspectorate stating whether an Environmental Impact Assessment (EIA) is required. This depends on the project type. If an EIA is needed, the letter of approval will be conditional on the outcome of the EIA;
- A signed declaration on the financial and legal status of the offering company(ies);
- If more parties are involved in the JI project, the company must show letters of evidence that it has the rights to the emission reductions;
- If needed, a letter of support from the municipality or other relevant institution;
- Letter of intent from the carbon investor(s); and
- Any documents requested in the letter of endorsement submitted in response to the PIN;

The project developer may also submit a paper (maximum 3 pages) describing the social, economic, and environmental benefits of the project.

**CDM in Georgia**

The following documents must be submitted to the DNA to obtain a CDM Letter of Approval in Georgia:

- A formal letter to the Ministry of Environmental Protection and Natural Resources (MEPNR) requesting approval;
- A PDD in the latest format approved by the CDM Board attached with a write-up by the project participants describing why the project contributes to sustainable development and how the comments from the local stakeholders have been taken into consideration;
- An EIA if the project falls in a category requesting such assessment in accordance with the national legislation;
- An Emission Reduction Purchase Agreement (ERPA) in Georgian and English;
- A letter signed by all project participants identifying the project contact person; and
- A signed declaration on the financial and legal status of the investor entity.

All documents should be submitted in Georgian, except for the PDD and ERPA which must also be submitted in English. The documents must be provided in electronic format along with at least one hard copy.

To streamline internal evaluation of CDM projects, the DNA or DFP may also wish to design template review forms that can be used for streamlining internal evaluations undertaken by expert reviewers. This may include a list of required information that must be addressed in the proposal documents, such as proof of additionality, confirmation of financial stability of project participants, and a list of national laws and policies that different types of CDM projects must comply with (See Text Box 3-8). Indicators for scoring conformity with sustainable development goals should also be developed. Proposal reviews can be quite subjective depending on the background and expertise of the evaluator. Standardized evaluation questionnaires will help ensure that all reviewers address the important issues that need to be assessed. Annex III includes a questionnaire for conducting a general CDM project review. If the DNA would like to evaluate also the technical aspects of a CDM project, Annex IV presents a more detailed questionnaire for examining additionality and financial issues related to CDM projects.

To facilitate transparency, the programme's internal evaluation criteria should be made available to the public and the evaluation final reports should be posted on the DNA's website. This would increase opportunities for public participation and minimize the potential for corruption.

*Text Box 3-7 Key national elements which could be evaluated by the host country***Compliance with relevant policy and regulatory regimes***National scope:*

- Compatibility with national sustainable development goals.
- Eligibility of the project proposal according to a list of eligible CDM activities, technologies and/or sectors.

*Sectoral scope:*

- Compliance with related political and legal frameworks.
- Environmental impact assessment in accordance with procedures as required by the relevant sector.

*Local scope:*

- Compatibility with local priorities, as stated in local development agendas.

**Financial Review**

- Excluding the use of official development aid for project funding.
- Overview of financing structure.

**Technical and institutional feasibility***Management capacity*

- Description of the institutional arrangements and each institution's participation in the implementation of the project.
- Legal and financial sustainability of project participants
- Previous experience and performance in the field.

*Infrastructure and technical capacity*

- Local availability of qualified human resources.
- Local availability of adequate institutional resources.

*Transfer of technology and know-how*

- Description of the implications for local institutional enhancement.
- Description of the implications for national capacity building.
- Description of technology transfer.

**Special consideration of other environmental and developmental impacts**

- Additional environmental, socio-economic, technical and institutional benefits (and costs) that are considered relevant.

*Source: Adapted from Christiana Figueres (2002)*

**3.2.4 Prepare Template Letter of Approval**

The host country approval letter represents government consent of the proposed project and serves as a guarantee that the project meets the country's sustainable development objectives and other regulatory requirements. The letter does not represent a guarantee of future emission reductions. It is typically sent to the project participant(s) who then use it for requesting registration from the CDM Executive Board. Without this letter, a project proponent cannot request registration of the CDM project. Examples of host country endorsements and approval letters are included in Annexes V, VI, and VII and additional samples can be obtained from the UNFCCC website at <http://cdm.unfccc.int/Projects/registered.html>.

At a minimum, a host country letter approving a CDM activity must include the following:

- Confirmation that the Party has ratified the Kyoto Protocol;
- Approval of voluntary participation in the proposed CDM project activity; and
- A statement that the proposed CDM project activity contributes to the sustainable development of the host Party and meets all other national regulatory requirements.

A letter approving a JI project does not have to include a statement concerning sustainable development. Other statements that host countries may choose to include in the JI or CDM approval letter include:

- *Authorization of project participants.* The CDM guidelines require that at least one of the Parties involved in the project must authorize all private and public entity participants in the projects. This is typically done by explicitly mentioning the project participant(s) in the letter of approval, or to address the letter to the project participant(s).
- *No objection to current and/or future allocation of CERs.* Many DNAs include a statement approving the proposed transfer and/or allocation of CERs. Some DNAs have also started including a statement that the Party will not object to future allocations of credits generated, thereby honouring any commercial arrangement between the project developer and its investors after project registration by the CDM Executive Board. This is particularly useful for unilateral CDM projects that have not obtained an investor at the time of host country approval, as it reduces the risk that the government may object to the sale of the CERs once an investor has been identified.

### **3.2.5 Determine the Level of DNA's Support for Project Development**

Provision of technical and advisory services for the development of PINs and PDDs will be requested of the DNA and relevant line ministries throughout the project design and approval process. In some cases, international investors, such as the European Bank for Reconstruction and Development (EBRD) or the World Bank, will circulate potential project concepts within the government before they are submitted for official approval. This is particularly the case when large infrastructure projects are under consideration and these projects will need a host of other approvals in order to take place. In other cases, individual project developers may wish to obtain data for baseline preparation and technology evaluation, or may seek to obtain preliminary feedback on project concepts. Others may wish to get assistance with attracting finance, understanding the carbon market, such as realistic CER/ERU prices, or negotiating contracts with foreign investors.

The provision of such assistance and advice will occur on a continued basis and could be time consuming depending on the amount of projects in the pipeline. During the establishment of the DNA, the host Party may wish to develop general procedures for providing support and consider designating contact points within each relevant department and ministry, focusing on issues such as environmental impact assessments (EIAs), financial and contractual issues, or data collection for various sectors, including energy, waste, transportation and agriculture. Typically, investors prefer to deal with DNAs that are more open and responsive because this speeds up the project design and approval process and reduces transaction costs.

### 3.3 Develop Sustainable Development Criteria

The Kyoto Protocol stipulates that CDM projects must assist non-Annex I countries in achieving sustainable development. This should be seen not only as a prerequisite, but also as a real opportunity to channel resources towards projects that are most likely to further national interests. The selection of the sustainable development criteria is a sovereign matter of the host country.

Apart from GHG emission reductions, CDM projects will have a number of impacts in the host country including effects on economic and social development, and on the local environment. National authorities can use the sustainable development focus to select and design CDM projects in a way that creates synergies with local development goals.

The following outlines a three-step procedure for developing and assessing sustainable development criteria:

**Step 1:** *Based on a review of general policy priorities in the country, select sustainable development issues that are to be addressed in the CDM project evaluation. This would typically include economic, social, human and environmental policy dimensions.*

For the CDM to make a meaningful contribution to sustainable development, it needs to be integrated into other policies and programmes and used as a vehicle to achieve national development objectives. If CDM projects are reviewed and assessed in isolation, it is unlikely that the benefit of the CDM in terms of contributing to sustainable development will be realized.

Example objectives that a DNA may choose to link with its sustainable development criteria include broad based goals, such as the contribution to national development, enhanced technology transfer, development of sustainable development energy sectors, or stimulating foreign investment flows. In some countries, sustainable development programmes or national environmental plans may already be in place in areas relevant to the CDM, such as forest policies, renewable energy and clean technologies. The CDM could be used to promote priority projects in these and other areas. For example, countries with inadequate energy supply may want to encourage investment in energy projects, while nations with deforestation problems may prefer to invest in projects that lead to reforestation and/or afforestation. As part of the development of sustainable development criteria, host countries may want to examine such areas where CDM investment could be particularly beneficial, or where opportunities are especially plentiful, in order to determine whether the criteria should be geared towards those areas. For example, many countries in Eastern Europe and the CIS have very inefficient energy sectors and/or infrastructure and may want to target CDM investment in that direction.

In Morocco, the government has stressed projects that draw and develop national expertise, meet national technology development priorities and are compatible with ongoing policies and programmes. Malaysia's target area is renewable energy (particularly biomass) which links to their 5 per cent national renewable energy goal, as well as energy efficiency projects. Brazil is very much driven by market requirements but has indicated a strong preference for cogeneration projects involving sugar mill residues and small-scale CDM projects to increase the role CDM can play in rural development and poverty alleviation.<sup>26</sup>

<sup>26</sup> United Nations Development Programme (UNDP). "An Assessment of Progress with Establishing the Clean Development Mechanism (CDM). 2006.

Table 3-4 Overview of Different Approaches to Ensure the Sustainability of CDM Projects

Approach	Brief description	Examples
Guidelines	Guidelines define descriptively the aspects of sustainable development that should be considered in a project.	Indian CDM guidelines (issued by the Government of India)
Checklists	Checklists consist of clearly defined questions to be answered for a CDM project with a closed set of pre-defined answers.	CERUPT
Negotiated targets	Concrete targets are negotiated among stakeholders and the project owner. Indicators are defined to monitor the sustainability component of the projects.	Jepirachi Wind power project, PCF
Multi-Criteria Methodologies	Multi-Criteria Methodologies define various criteria for several aspects of sustainability and assess the project with regard to each criterion. Some methodologies suggest aggregating the indicators by weighting the respective criteria according to their importance.	SouthSouthNorth, Factor AG, PCF plus, WWF

Source: Christoph Sutter, "Sustainability Check-Up for CDM Projects: How to Assess the Sustainability of International Projects under the Kyoto Protocol," the Swiss Federal Institute of Technology (ETH), Zurich. October 2003.

There is no universally accepted definition of and approach to the assessment of sustainable development, especially at the project level. As a result there is considerable variation in sustainable development criteria and how they are applied across countries. Many use checklists and multi-criteria analysis, some attach weighting and point scoring systems and others take a more qualitative view. Table 3-4 provides an overview of different approaches used to evaluate the sustainability of CDM projects. South Africa, for example, defines sustainable development in terms of environmental, economic and social criteria subdivided into 25 indicators. The DNA does not assign numerical values to the qualitative goals but instead evaluates projects on balance in terms of their net benefits. This 'on-balance - net benefit' approach seems to be the most common interpretation adopted by countries.<sup>27</sup> Some other countries, such as India, have based their sustainable development project screening process on a 'no objections' basis. In other words, the DNA approves the project provided that it does not actually harm the environment or jeopardize development objectives. India's interpretation and application of project approval criteria is somewhat broader than those of other countries.

Many host countries have focused on immediate and general macro-level development objectives such as poverty reduction, local environmental health benefits, employment generation, and economic growth. Using this approach, criteria for sustainable development may be as broadly categorized as:

- **Social criteria:** The project improves the quality of life, alleviates poverty, and improves equity.
- **Economic criteria:** The project provides financial returns to local entities, results in positive impact on balance of payments, and transfers new technology.
- **Environmental criteria:** The project reduces greenhouse gas emissions and the use of fossil fuels, conserves local resources, reduces pressure on the local environment, provides health and other environmental benefits, and is in accordance with energy and environmental policies.

However, adopting such broad sustainability criteria may raise problems for CDM project review because the criteria are designed to be used at the national level and therefore cannot estimate the relative contribution of one project to sustainable development.

<sup>27</sup> United Nations Development Programme (UNDP). "An Assessment of Progress with Establishing the Clean Development Mechanism (CDM). 2006.

To make the sustainable development assessment more meaningful at the project level, some countries in Eastern Europe and the CIS have proposed a more targeted approach that allows for a clearly defined, transparent, practical, and measurable review of projects relative to a comparable reference case.<sup>28</sup> One approach which has received significant attention in this regard is the use of multi-criteria analysis (MCA), in particular Multi-Attribute Utility Theory (MAUT). As described further in Step 2, the MAUT method enables the DNA to aggregate qualitative and quantitative results of different dimensions in a systematic manner. Moreover, criteria weighting can be used to introduce different preferences of host countries and individual policymakers.

Annex VIII lists examples of sustainable development criteria used by DNAs in Armenia, Georgia, and South Africa. These examples include ways to evaluate performance against each sustainable development criteria.

**Step 2:** *Design of a procedure for evaluating sustainable development impacts of CDM projects relative to the sustainable development criteria selected in Step 1.*

Once the sustainable development criteria have been selected (in Step 1) indicators for measuring adherence with each criterion should also be identified. This will facilitate internal evaluation of the CDM project proposals. The development of a procedure for evaluating sustainable development impacts of CDM projects typically include:

- Selection of sustainable development indicators;
- Design of an approach for assessing the indicators;
- Definition of a reporting format for the sustainable development impacts of the CDM project with standards for representing economic, social, human, and environmental information in quantitative and/or qualitative terms.

A mix of quantitative and qualitative indicators can be used for evaluating progress towards each sustainable development goal. DNAs should strive to use simple and measurable indicators that reviewers can easily apply. The following provides two different methods for selecting, assessing, and reporting on sustainable development indicators.

### **The SouthSouthNorth Matrix Tool**

SouthSouthNorth has produced a screening tool “SouthSouthNorth Matrix Tool” that uses checklists and other screening methods to derive an overall project score, based on both qualitative and quantitative factors.<sup>29</sup> The tool helps identify key variables countries may need to consider during project screening. Table 3-5 illustrates how this approach could be implemented.

28) Albert Zweering, *Proposed Method for Sustainability Assessment of CDM Projects*. Prepared for EuropeAid project “Technical assistance to Armenia, Azerbaijan, Georgia and Moldova with respect to their global climate change commitments.” 2005; and Christoph Sutter, *Sustainability Check-Up for CDM Projects: How to assess the Sustainability of International Projects under the Kyoto Protocol*, The Swiss Federal Institute of Technology (ETH), Zurich. October 2003.

29) SouthSouthNorth. “SouthSouthNorth CDM Toolkit. Module 1,” 2004.

Table 3-5 The SouthSouthNorth Matrix Tool

Component	Score
Indicator (example)	-2 to +2
<b>Local / regional / global environment</b> – Water quality and quantity – Air quality (emissions other than GHGs) – Other pollutants (toxicity, radioactivity, POPs, stratospheric ozone layer depleting gases) – Soil condition (quality and quantity) – Biodiversity (species and habitat conservation) <i>Sub total</i>	
<b>Social sustainability and development</b> – Employment (including job quality, fulfilment of labour standards) – Livelihood of the poor (poverty alleviation, distributional equity, access to services) – Access to energy services – Human and institutional capacity (empowerment, education, involvement, gender) <i>Sub total</i>	
<b>Economic and technological development</b> – Employment (numbers) – Balance of payments (sustainability) – Technological self reliance (project replicability, hard currency liability, skills development, institutional capacity, technology transfer) <i>Sub total</i>	
<b>TOTAL</b>	

Source: <http://www.southsouthnorth.org/>

The matrix provides sample indicators against which project performance can be tracked and includes a numerical scoring system for evaluating projects. Project performance would then be assessed against the list of indicators provided in the table, using the following scoring system:

-2	=	MAJOR NEGATIVE IMPACTS Significant damage to ecological, social and/or economic systems that cannot be mitigated through preventive (nor remedial) measures.
-1	=	VERY MINOR NEGATIVE IMPACTS Measurable impact but not one that is considered by stakeholders to militate against the implementation of the project/cause significant damage to ecological, social and/or economic systems.
0	=	NO (OR NEGLIGIBLE) IMPACTS No impact or the impact is considered insignificant by stakeholders
+1	=	MINOR POSITIVE IMPACTS
+2	=	MAJOR POSITIVE IMPACTS

To complete the assessment, performance of the project should be considered in terms of each indicator relative to the baseline scenario (i.e., in the absence of the proposed project) as defined in the project design document. As a threshold for assessing total project performance, SouthSouthNorth recommends that each sub-total must score better than -1 and each indicator must score better than -2.

#### **Multi-Attribute Utility Theory (MAUT)**

While adopting a scoring approach is a potentially useful quantitative indicator of project benefits, it still requires subjective value judgments about the importance of different criteria. The proposed MAUT method offers a way to adapt the assessment to the project level while

minimizing the subjectivity of the sustainability assessment. This is done by systematically weighting different criteria according to the preferences of individual policy makers and/or host countries.

The method consists of the following steps:

1. Define the (sub-) criteria for sustainable development;
2. Define the indicators for each (sub-) criteria and their scales;
3. Define the preference ("weight") for each (sub-) criteria; and
4. Determine the scores for each (sub-) criteria (the utility score) and the overall utility score.

The proposed sustainability criteria for Armenia and Georgia use this approach and are included in Annex IX for illustrative purposes. Figure 3-1 provides a sample weighting of possible sustainable development criteria and Figure 3-2 describes how the MAUT method would be implemented and scored using the weightings proposed in Figure 3-1. Since the scales of the indicators are normalized, all sub-scores lie between -1 and +1 and can be added to an overall score for the project. If the overall score is positive, the project contributes to sustainable development.

The use of equal weightings in Figure 3-2 is supposed to prevent the misuse of the weighting process by decision makers. As the weightings of all criteria are fixed at the average value, no decisions can be made with regard to the importance of the individual criteria. Consequently, it is impossible to bias the weightings.<sup>30</sup> Where certain criteria should be accounted for more than others, the criteria can be weighted by the involved decision makers. The weightings would then reflect the preferences of the deciding group. This process allows the set of criteria to be adapted to local circumstances and needs.

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<sup>30</sup> Albert Zweering, *Proposed Method for Sustainability Assessment of CDM Projects*. Prepared for EuropeAid project "Technical assistance to Armenia, Azerbaijan, Georgia and Moldova with respect to their global climate change commitments." 2005.

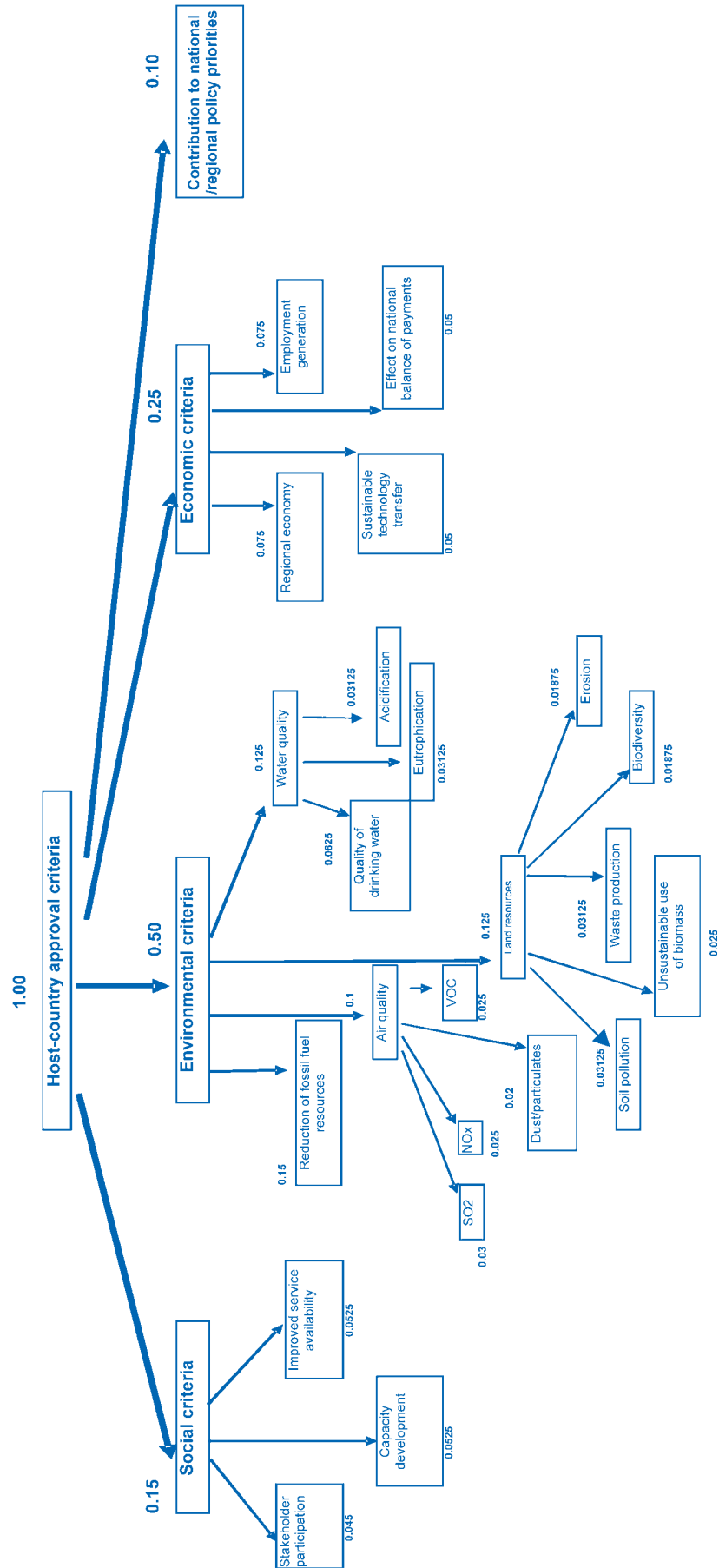


Figure 3-1 Sample Criteria and Weight Tree

Source: Albert Zweiring, Proposed Method for Sustainability Assessment of CDM Projects. Prepared for EuropeAid project "Technical assistance to Armenia, Azerbaijan, Georgia and Moldova with respect to their global climate change commitments." 2005

Figure 3-2 Sample Sustainability Criteria, Weighting, and Scores Using the MAUT Approach

Criteria:	Weight:		Normalised Utility score (between -1 and +1)	Final score	
<b>1. Social criteria:</b>	<b>0.15</b>				
a) stake holder participation	30%	<b>0.045</b>	0.5	0.0225	
b) capacity development	35%	<b>0.0525</b>	1	0.0525	
c) service availability	35%	<b>0.0525</b>	0	0	
<b>2. Environmental criteria:</b>	<b>0.50</b>				
a) fossil fuel reduction	30%	<b>0.15</b>	0.5	0.075	
b) water quality	25%	<b>0.125</b>			
– drinking water		50%	0.0625	-0.25	-0.125
– acidifikation		25%	0.03125	0	0
– eutrophication		25%	0.03125	0	0
c) air quality	20%	<b>0.10</b>			
– SO <sub>2</sub>		30%	0.03	0.25	0.075
– Nox		25%	0.025	0.25	0.0625
– VOC		25%	0.025	0	0
– dust/particulates		20%	0.02	1	0.2
d) land resources	25%	<b>0.125</b>			
– soil pollution		25%	0.03125	0	0
– waste production		25%	0.03125	-0.5	-0.125
– unsustainable biomass use		15%	0.01875	0	0
– erosion		15%	0.01875	0	0
– biodiversity		20%	0.025	0.25	0.05
<b>3. Economic criteria</b>	<b>0.25</b>				
a) regional development	30%	<b>0.075</b>	0.5	0.0375	
b) employment generation	50%	<b>0.125</b>	0.25	0.03125	
c) balance of payments effects	20%	<b>0.05</b>	0	0	
<b>4. Policy criteria</b>	<b>0.10</b>				
a) national/regional priorities	50%	<b>0.05</b>	0.25	0.0125	
b) sector priorities	50%	<b>0.05</b>	0.5	0.025	
			<b>total score:</b>	<b>0.39375</b>	

Source: Albert Zweering, *Proposed Method for Sustainability Assessment of CDM Projects. Prepared for EuropeAid project "Technical assistance to Armenia, Azerbaijan, Georgia and Moldova with respect to their global climate change commitments."* 2005.

The MAUT approach also allows for a non-weighted sustainability profile that shows the single utilities of all criteria. This non-weighted assessment provides a rapid overview (i.e., a Sustainability profile) of opportunities and problems of a project.

A few words of caution should be mentioned when applying this method in practice:

1. The number of criteria should be kept to a minimum, while still covering the key aspects of sustainable development.
2. Only those criteria for which a clearly determinable indicator can be found should be considered.
3. If an aggregation has to be done, it is strongly recommended that an additive aggregation model is used with thresholds for critical criteria in order to avoid misleading assessment results. Using this approach, a project that does not reach the minimal scores in all critical

criteria would disqualify for the CDM irrespective of its overall utility. For example, if no threshold is used, the overall score of a project could still be positive, even when a project scores negative on toxic emissions into the air or water. By setting a threshold on the relevant sub-criteria (“no increase in toxic emissions”) the project would be rejected even though its overall score is positive.

4. As the MAUT method measures the relative contribution of a CDM project to sustainable development, the use of standardized baselines for the reference scenario is recommended. If such a set of standards is defined, all projects can be measured against the same benchmark.

**Step 3:** *Assess CDM project impacts on sustainable development policies as part of project development. This may involve redesign of projects in order to incorporate sustainable development priorities.*

The third and final step involves the actual assessment of CDM projects against the evaluation criteria and indicators developed in Steps 1 and 2. Ultimately, this assessment will depend on the resources, technical expertise, and priorities of the individual DNAs.

### 3.4 Define an Outreach Strategy

The CDM and JI unit may also be responsible for marketing and promoting the country’s potential for CDM or JI. Outreach will be important to notify potential project developers of possible CDM opportunities and for attracting foreign investors to the country. Because of the different target groups, an outreach strategy should be developed to reach all of these. For example, informational materials must be prepared in both the national language and in English. Materials directed at potential project developers in the host country should focus on explaining the concept of CDM, including CDM benefits, eligibility criteria, and application procedures. Materials targeting foreign investors should highlight potential project opportunities, national project developers and consultants, investment climate, application procedures, and relevant contact points within the DNA.

Sample outreach activities that the DNA may undertake include:

- Development of a website in English and national language describing application procedures and providing relevant application templates, such as a PIN;
- Design CDM/JI promotion material and furnish it to the foreign direct investment (FDI) office and other relevant stakeholders;
- Awareness raising through workshops for industry representatives in CDM-relevant sectors to explain the CDM concept and discuss project potential;
- Capacity building to train potential project developers in baseline and monitoring methods;
- Coordination with potential donors and carbon funds to attract technical assistance for baseline studies and PDD design;
- Coordination with other CDM/JI units in the region to organize workshops showcasing projects in the pipeline;
- Work with local banks and financial institutions to enhance and facilitate financing options for CDM projects; and
- Educate relevant government decision makers who would be involved in CDM project review and approval.

If resources are limited, a staged approach can be adopted, whereby a few primary functions, such as website development, are implemented immediately while secondary outreach

functions are added in later years once the national CDM/JI authority is operational and additional financing has been attracted via government funds or international donors. Doing everything at the same time is likely to overburden available staff and may prevent effective establishment and implementation of the review process itself.

### 3.5 FREQUENTLY ASKED QUESTIONS AND ANSWERS

#### 1. Will there be any penalty for failure to meet sustainable development criteria?

It is not stipulated anywhere that CERs will be withheld for failure to meet sustainable development criteria. It will therefore be up to the host country to ensure that elements of sustainable development in the project documents are well documented and clear at the very beginning of the project. If there are serious concerns regarding the sustainability of a project, these could be raised with the designated operational entity, but project developers merely have to “address the concerns” by indicating how these could be removed or reduced. They are not required to make significant changes.

Instead, a clear commitment from the DNA to incorporate sustainability objectives in the project would reduce the risk to the project developer that the host country at a later stage may rescind the project if some criteria or requirement is not met.

#### 2. Should the DNA be housed within an existing climate change office or in the agency representing the sector with the biggest potential for projects?

The objective of the DNA is to determine whether the proposed project meets the sustainable development goals of the country. It is up to each individual country to determine which institutional setting is best able to undertake such a review – whether it would be the institution that is most familiar with environmental evaluations in general or the institution that may have the most expertise with the technical aspects of the proposal. Most countries have placed their DNAs within the Ministry of Environment due to the general focus of this ministry on climate change, environmental regulations and general sustainability goals. A few others have placed the DNA within a national energy office due to the importance of this sector on potential CDM projects. However, the risk of placing the DNA with an energy department is that projects from other sectors may receive less attention.

#### 3. Can projects that are rejected reapply for host country approval? If so, what are the requirements?

Within the rules of the Kyoto Protocol there is no limit on the amount of times a project proponent can apply for host country approval. It is up to the host Party to define the national application procedures, including procedures for resubmitting a proposal. Typically, if DNAs reject a proposal, the rejection letter will include suggestions for improvement. If the project proponent addresses these, he or she may reapply.

#### 4. How much technical advice should the DNA provide to project developers before and after a project is submitted?

Each individual country may decide its own procedures for providing technical assistance to project developers. In general, DNAs should be careful not to completely ignore requests for advice, since such unresponsiveness will turn away potential investors. However, in order to not get completely overburdened by questions, the DNA staff may decide to only provide help with interpreting the evaluation criteria and provide information on possible data sources and evaluation criteria instead of getting involved in the process of developing the GHG baseline study and preparing the monitoring plan.

**5. Is the DNA required to evaluate the technical and economic feasibility of the projects and assess their “additionality”?**

Because the DNA’s main task is to certify compliance with sustainable development goals and any other relevant national and local regulations, it does not necessarily have to assess the technical, economic, and additionality aspects of the project proposals. The GHG emissions aspects will be evaluated in much more detail by the DOEs and the CDM EB, while the economic aspects will be assessed by the financial institutions involved in the project. Still, some DNAs do choose to assess the financial arrangements of the project and confirm that the legal and financial status of the project participants is sound.

**6. Is the DNA required to approve the Emission Reduction Purchase Agreement (ERPA)?**

There are no rules that specify whether a DNA should review and approve the ERPA by which project participants spell out their rights to project CERs. However, some countries may decide that the DNA needs to approve the ERPA. Doing so may be counterproductive and hinder the development of CDM projects for several reasons. First, unilateral CDM projects, where the project participant generates the CERs, and keeps them for use after the project has been registered with the CDM Executive Board, will not have an ERPA at the time of application to the DNA. As a result, such projects would fail the DNA approval process, unless the DNA grants a specific exception to such projects. For example, Georgia’s DNA requires CDM projects to submit a copy of the ERPA along with the PDD, unless these projects are unilateral. However, as soon as the unilateral projects have negotiated an ERPA they must submit this for review by Georgia’s CDM National Board.

Another potential problem is that some ERPAs may only cover part of the expected CER emission reductions. This may create confusion about when to approve the remaining CERs. Finally, many government agencies lack the information to properly evaluate the terms of the ERPA and may thus hold up or complicate the approval process while getting the necessary understanding of this type of contractual agreement. Instead of getting involved in actually approving the ERPA, the DNA could offer project developers assistance and advice in negotiating this agreement. For example, Georgia’s DNA tracks information on recent price developments and informs local project developers of these in order to make sure that the developer receives a fair market price.

**7. Should the DNA develop its own PIN and PDD templates, or use CDM standard documents?**

The CDM EB has developed a detailed PDD template for project proposals, and may make revisions to this document on a regular basis. For that reason, it does not make sense for the DNA to develop its own PDD format, but should instead refer project developers to the most recent version of the CDM PDD. However, to assist national project developers, the DNA may want translate the CDM PDD into the local language and make it available on its website.

There is no standard PIN template, however. The DNA may choose to develop its own design, or it could elect to allow project developers to substitute the DNA PIN format with the PIN format of a particular carbon fund. This would reduce the transaction cost to the project developer. The DNA PIN should be made available in English and the local language.

**8. Can sustainable development criteria be used to target certain project types?**

Host countries may design sustainable development goals in such a way that they direct investment towards specific project types, including waste, renewable energy and energy efficiency. The DNA may also ban investment in certain project types, such as coal or HFC projects. The Kyoto Protocol left it up to each host country to design its own priorities.

### **9. Can the DNA accept bundled projects, or pre-approve certain project types to reduce transaction costs?**

To reduce transaction costs the DNA may pre-approve all projects of a certain type (such as all small-scale renewable energy projects), as long as a host country approval letter is issued to each individual CDM project submitted to the CDM Executive Board. The same would be the case of bundled projects.

### **3.6 Legalization**

According to the rules of the Kyoto Protocol, it is the government that commits to implementing the provisions of the Protocol and which has the authority to approve projects and the export of emission rights via participation in JI or CDM. It is therefore important that the national CDM or JI office has sound legal authority to grant the rights to transfer emission permits abroad. Without such official recognition, it is possible that future inter-ministerial competition or political changes could lead to a reversal of prior project approvals. Legal authorization of the DNA will provide guarantees to project investors and ensure long-term sustainability of the national office.

The major legal issues that must be addressed by the host country include:

1. Legal validation of the DNA set-up and the project review procedures;
2. Assessment of links to other legal documents that may relate to the DNA and the review of CDM projects;
3. Improve existing legal frameworks to promote and clarify treatment of CDM projects in the host country;
4. Define property rights to CERs; and
5. Establish a link to the CDM Executive Boards registry.

Each of these issues is discussed further in the following subsections.