

CDM DNA Legal Issues – International Rules and Practice

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The Objective of CDM – Article 12 of the Kyoto Protocol

The three-fold objectives of CDM:

- to assist developing countries in achieving sustainable development
- to assist developing countries in contributing to climate change mitigation
- to assist developed countries meeting their emission reduction obligations under the Kyoto Protocol

International rules on host country for CDM projects

- Being a Party to the UNFCCC and the Kyoto Protocol
- Established a Designated National Authority (DNA) capable of approval proposed CDM projects
- Developed CDM project approval criteria
- DNA issues Letter of Approval (LoA) for projects as evidence of host country approval

DNA institutional arrangement

- No international rules on the establishment and functions of DNAs. Subject to decision by individual host countries
- The information communicated to the UNFCCC is a person name and contact information
- DNAs have been structured by countries in different ways:
 - Ø Units within existing government departments or ministries;
 - Ø inter-ministerial committees
 - Ø new and independent offices

Important Functions of DNA

- Elaborate its decisions and administrative procedures based on a sound legal foundation and institutional mandate
- Act as a clear point of contact for entities wishing to invest in CDM projects in the country
- Approve proposed CDM projects fairly, effectively and efficiently
- Facilitate intergovernmental coordination and decision-making for appropriate CDM policies realise a country's CDM potential

Contents of host country Letter of Approval (LoA)

The LoA must confirm:

- Participation in the proposed CDM project is voluntary
- Implementation of the proposed CDM project will contribute to the host country's sustainable development

CDM approval criteria and LoA

- Each country decides its own sustainable development criteria for CDM project approval
- Typically the sustainable development criteria cover following aspects:
 - ü contribution to economic growth, environment protection, social equity
 - ü contribution to technology transfer
 - ü contribution to skills transfer, learning and employment
- Once a DNA determines a proposed CDM project satisfies the national sustainable development criteria for CDM project approval, it issues the Letter of Approval (LoA), which is a precondition that the project's international registration as a CDM project,

Additional Functions for DNAs – CDM Promotion

DNAs can actively promote CDM project implementation by:

- Assist in the identification of investment opportunities or in prioritisation of investment sectors
- Coordinate the development of a portfolio of priority projects, network information for marketing CDM activities, and promote CDM opportunities with trading partners
- Link local CER sellers with foreign buyers
- Facilitate and coordinate CDM capacity building to enhance local knowledge and interest in CDM

Additional Functions for DNAs – Monitoring, Facilitating, and Negotiation

- Monitor sustainable development impacts of CDM projects and report on national CDM programs to national policy makers
- Work with other government agencies to remove domestic legal and regulatory barriers to CDM projects, to ensure the transparency and quick CDM project approval (publishing emission factors of grids)
- Coordinate internal climate change policy and develop positions for international climate change negotiations

Supplementary domestic CDM laws

- Laws on CDM project proponent eligibility, land eligibility, project's normal approval procedures
- Laws governing foreign investment in CDM projects
- Laws providing particularly benefits or concession for particular CDM project types

Domestic laws affecting the CDM

The laws about:

- Normal regulatory assessment and approvals for projects implemented for CDM
- Title to land
- Investment in CDM projects
- Resource use (renewable energy, fossil fuel, vegetation)
- Securities and financial products
- Public sector transparency and efficiency
- Employment and labour
- Use and trade of project outputs

Domestic laws and CDM additionality

- Project activities/types subject to mandatory implementation requirements in domestic laws are not additional and can not be developed as CDM projects (unless widespread non-compliance)
- To avoid perverse incentives, CDM EB has decided the following policies should not be considered when determining the additionality of a proposed CDM project: To avoid perverse incentives,
 - ü Type E+ policies or regulations (which gives positive comparative advantages to **more** emission intensive technologies or fuels) after 11 Dec 1997
 - ü Type E- policies or regulations (which gives positive comparative advantages to **less** emission intensive technologies or fuels) after 11 Nov 2001

Remove domestic legal barriers to CDM projects

- Clear and robust domestic laws can facilitate CDM project implementation
- Existing domestic laws may inadvertently create barriers to CDM project implementation
- Identification of barriers by host country DNAs
 - ∅ identify relevant existing domestic laws with the potential to significantly impact CDM processes and/or underlying investment projects
 - ∅ assess the likelihood and magnitude of the impacts
 - ∅ formulating solutions and recommendations for remove the barriers
- Target domestic law reform to remove the barriers

Domestic Law and the CDM: Financial Regulations

- Classification: CERs shall be treated locally as a security or a commodity? This affect the transaction costs and which regulations/laws to be followed
- Foreign exchange controls. The CER sales revenue subject to foreign exchange control or not?
- Restrictions on Foreign Direct Investment (FDI): any restriction on foreign ownership and/or control on capital investment projects and related assets which may apply to CDM activity?
- CER pricing controls: any restriction on CER prices?

Domestic Law and the CDM: Taxation

- Different practices of tax treatment: (1) direct taxation on CERs) (2) taxation on CER sales revenue; (3) taxation on business activities and income; (4) Taxation of assets
- Tax concession and other fiscal incentives to promote CDM projects
 - ∅ import duty exceptions or reductions
 - ∅ income tax exemptions or reductions
 - ∅ accelerated depreciation
 - ∅ include CDM projects classified as encouraged investment projects or areas/sectors

Environmental Law

Domestic environmental law regime in CDM host countries governs three main areas:

- **The environmental impact assessment (EIA).** CDM projects are required to complete this under the international CDM rules
- **Any environmental permit and approval** required to carry out the CDM project activity, including licenses, operating permits, planning permits etc.
- **Liability of environmental harms:** Project participants may be held liable under domestic law for any environmental harms due to the project activity, e.g. methane capture pipe leaks, overflow of wastewater plants

Domestic property laws relevant to CDM projects

- Project land use
- Necessary equipment, technologies and materials for the project
- Resources and other inputs involved in the project (e.g. water, wind or landfill gas)
- Products, materials or other outputs generated by the project
- Proprietary security interests in the project assets (e.g. mortgage over land or equipment, benefiting banks)
- GHG reductions achieved by the project (CERs issued), CER sales revenue

Host country land rights

- Securing title to the land for the CDM project (tenure long enough to cover the project operation life and crediting period 10 -21 years)
- Property rights of other parties may affect CER title
- Restrictions on foreign ownership of property
- Restrictions on foreign ownership of CDM projects
- Proprietary rights to GHG reductions and removal from forestry projects
- Traditional or customary land title may create additional complications: low and regional variations in customary land titles; interaction with national property laws; lack of formal land title records and regulations

Other Domestic property laws Issues

- Rights and title to revenues from CER sales
- Rights, conditions or restrictions on land use by CDM project
- Extent to which individual project participants and other parties can use contracts to allocate title to CERs and other project assets (e.g. give CERs for equipment/PDD consultant fee)
- The CDM and State expropriation

Conclusions

- The establishment and operationalisation of CDM DNA is a precondition for CDM project implementation in a country
- Clear, transparent and effective CDM project approval is important
- CDM projects are also governed by various other national laws, policies and regulations, which can affect CDM project implementation
- CER sales revenue can only form a small part of the project revenue, supportive fiscal subsidies and taxation policies as higher feed-in-tariff for renewables are needed to make potential CDM projects economically viable

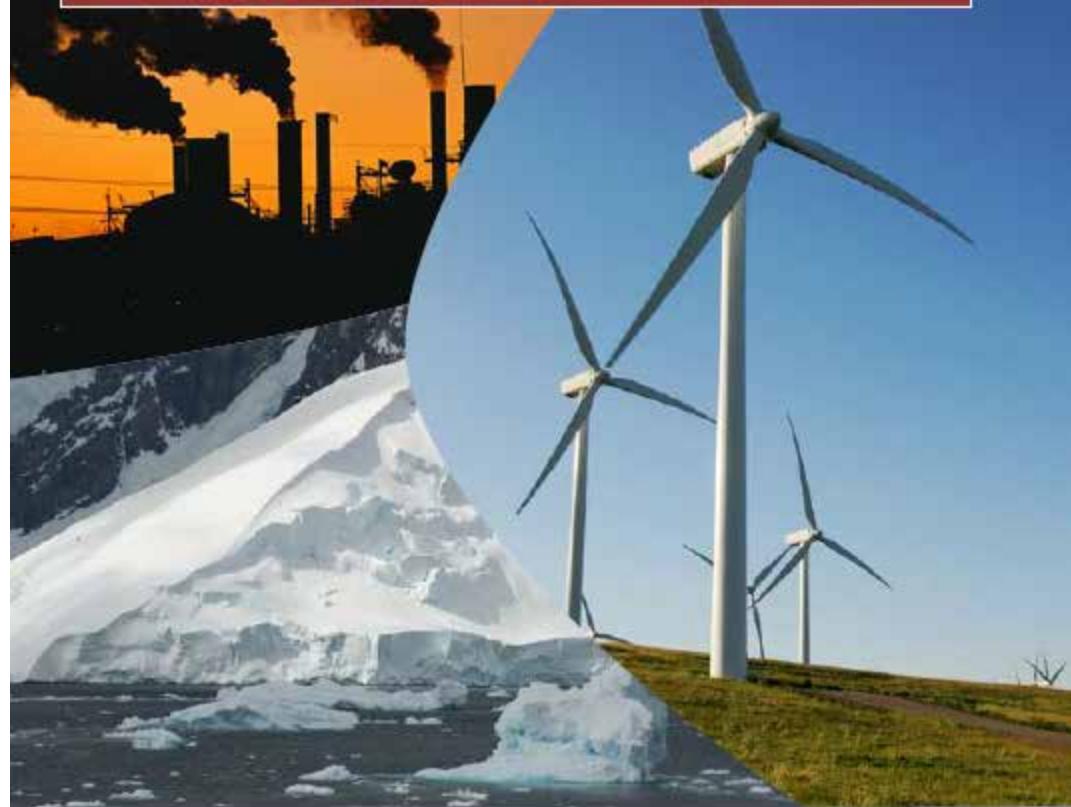
Guidebook available at:
www.cd4cdm.org

Project website: www.acp-cd4cdm.org

Contact: xzhu@dtu.dk

Implementing CDM projects

Guidebook to Host Country Legal Issues



BAKER & MCKENZIE