MOBILISING FINANCE FOR CLIMATE CHANGE MITIGATION: PRIVATE SECTOR INVOLVEMENT IN INTERNATIONAL CARBON FINANCE MECHANISMS

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This article examines the role of non-state actors in the climate change regime, particularly the role that the private sector plays in the implementation of the United Nations Framework Convention on Climate Change *and the* Kyoto Protocol*. The international carbon market serves as an example of how the direct regulation by international law of the activities of private entities poses certain challenges to the traditional state-centric conceptual paradigm of international law. This article discusses the following issues: first, while the text of the* Kyoto Protocol *clearly includes provisions to facilitate private sector participation in the* Kyoto Protocol *mechanisms, the lack of safeguards for private sector concerns is indicative of the prevailing state-centric mentality amongst international law-makers. Second, the failure to design rules and institutions to adequately protect private interests threatens the legitimacy and effectiveness of the* Kyoto Protocol *mechanisms. This proposition is already borne out by current developments concerning the Clean Development Mechanism Executive Board. We prescribe a number of reforms to address the situation, such as professionalising the Executive Board and introducing administrative rules. Finally, we build upon the discussion of non-state actors as subjects of international regulation to make certain proposals for the emerging international mechanism focused on reducing emissions from deforestation and forest degradation in developing countries.*

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I INTRODUCTION

The declining importance or centrality of the state in international law has been the subject of extensive discussion.[1] Scholars have debated whether globalisation, in the sense of increasing transnational movement of people, goods, information, pollution and capital, has had an erosive effect on the sovereignty of states, a cornerstone of the international legal order. In making their case, proponents of this viewpoint generally refer to two developments. First, states today voluntarily or otherwise find themselves subject to international regulation or governance beyond the state,[2] which impinges upon the areas where they were previously free from external influence. Second, the leading role of states as actors on the international plane is challenged by intergovernmental organisations ('IGOs'), non-governmental organisations, businesses, epistemic communities, and even private individuals that exercise significant influence over or are actively involved in the creation, implementation and enforcement of international norms today. Yet other scholars argue that the role of the state has in no way diminished but merely evolved,[3] or that the state continues to 'remain at the epicenter of international law'.[4]

This article takes these strands of scholarship as a starting point to examine the role of non-state actors in the climate change regime, particularly the role that the private sector plays in the implementation of the *United Nations Framework Convention on Climate Change*[5] and the *Kyoto Protocol to the United Nations Framework Convention on Climate Change*.[6] The role and influence of the non-governmental sector in the processes of international environmental law-making have been the subject of detailed academic analysis over the past decade.[7] The participation of non-state actors in the processes of generation, interpretation and application of international norms has generally been seen as

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1 See, eg, Martin van Creveld, *The Rise and Decline of the State* (1999); Oscar Schachter, 'The Decline of the Nation-State and Implications for International Law' (1998) 36 *Columbia Journal of Transnational Law* 7; Vincent Cable, *The Diminished Nation-State: A Study in the Loss of Economic Power* (1995).

2 See Markus Jachtenfuchs, 'Conceptualizing European Governance' in Knud Erik Jørgensen (ed), *Reflective Approaches to European Governance* (1997) 39.

3 Thilo Marauhn, 'Changing Role of the State' in Daniel Bodansky, Jutta Brunnée and Ellen Hey (eds), *The Oxford Handbook of International Environmental Law* (2007) 727.

4 Duncan B Hollis, 'Private Actors in Public International Law: Amicus Curiae and the Case for the Retention of State Sovereignty' (2005) 25 *Boston College International and Comparative Law Review* 235, 237.

5 Opened for signature 9 May 1992, 1771 UNTS 107 (entered into force 21 March 1994) ('*UNFCCC*').

6 Opened for signature 16 March 1998, 2303 UNTS 148 (entered into force 16 February 2005) ('*Kyoto Protocol*').

7 Asher Alkoby, 'Non-State Actors and the Legitimacy of International Environmental Law' (2003) 3 *Non-State Actors and International Law* 23; Chiara Giorgetti, 'The Role of Non-Governmental Organizations in the Climate Change Negotiations' (1998) 9 *Colorado Journal of International Environmental Law and Policy* 115; Chiara Giorgetti, 'From Rio to Kyoto: A Study of the Involvement of Non-Governmental Organizations in the Negotiations on Climate Change' (1999) 7 *New York University Environmental Law Journal* 201.

enhancing the legitimacy of international law.[8] This article will leave the discussion on the role of non-state actors in the shaping of rules to others, and focus on an emerging role of the private sector in the international system: the private sector as the subject of international regulation. Departing from the Westphalian notion of international law as an affair between sovereign states, we will examine the international market in greenhouse gas ('GHG') emissions rights (the so-called carbon market) as an example of how direct regulation by international law of the activities of private entities poses certain challenges to the traditional state-centric conceptual paradigm of international law.

This article advances the following claims. First, while the text of the *Kyoto Protocol* clearly includes provisions to facilitate private sector participation in the *Kyoto Protocol* mechanisms — Joint Implementation ('JI'), the Clean Development Mechanism ('CDM') and International Emissions Trading — the lack of safeguards or consideration for private sector concerns is indicative of the prevailing state-centric mentality amongst international law-makers. Further, the rules, institutions and the very property right that is the subject of private sector transactions in international carbon markets are created by the *Kyoto Protocol* with the consent of states. Following this logic, the *Kyoto Protocol* mechanisms only permit and facilitate the involvement of non-state actors in order to help states meet their legal obligations under the *Kyoto Protocol*. In short, the focus remains on states and their needs.[9] Second, the failure to design rules and institutions that provide sufficient protection for the rights and interests of private non-state participants in the *Kyoto Protocol* mechanisms threatens their legitimacy and effectiveness.

This proposition is already borne out by current developments concerning the Executive Board of the CDM ('Executive Board'). The Executive Board is the de facto regulator of the CDM, and in playing this role, it makes decisions that affect the rights and interests of private entities. However, it does so without fulfilling due process requirements, such as giving reasons for a decision and affording parties affected by its decisions the right of appeal. Discontent with this state of affairs has already surfaced, with some project developers threatening legal action against the Executive Board and the *UNFCCC* Secretariat.[10] We attempt to prescribe a number of reforms to address this

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[8] See David A Wirth, 'Reexamining Decision-Making Processes in International Environmental Law' (1994) 79 *Iowa Law Review* 769, 802; Daniel Bodansky, 'The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?' (1999) 93 *American Journal of International Law* 596; Farhana Yamin, 'NGOs and International Environmental Law: A Critical Evaluation of Their Roles and Responsibilities' (2001) 10 *Review of European Community and International Environmental Law* 149.

[9] Browen Morgan and Karen Yeung have argued that in the case of both the *Kyoto Protocol* emissions trading system and the European Union Emissions Trading Scheme, the structure and dynamics of the resulting 'market' are significantly influenced by inter-governmental politics in which states (rather than polluting firms) remain the primary actors. As a result, they describe the market as being, at best, partial and incomplete: Bronwen Morgan and Karen Yeung, *An Introduction to Law and Regulation: Text and Materials* (2007) 316.

[10] See Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol ('COP/MOP'), UNFCCC, *Privileges and Immunities for Individuals Serving on Constituted Bodies under the Kyoto Protocol: Implementation of Decision 9/CMP.2*, 3rd sess, UN Doc FCCC/KP/CMP/2007/2 (13 November 2007) (*Note by the Secretariat*).

situation, such as professionalising the Executive Board and introducing administrative rules.

Finally, we build upon the discussion of non-state actors as subjects of international regulation, and our analysis of the CDM, in order to make certain proposals for the emerging international mechanism focused on Reduced Emissions from Deforestation and Degradation ('REDD') in developing countries. An international REDD mechanism is discussed in the context of a post-2012 climate agreement. While referring to carbon markets as a source of finance, most of the proposals for a REDD mechanism are state-centric and neglect the conditions necessary for carbon markets to function and private capital to be mobilised. A lesson that can be drawn from current market conditions relating to the CDM is that investors perceive the risk of faulty action by an international body such as the Executive Board as being lower than the equivalent risk relating to national governments of countries that have poor governance indictors (which is the case for the majority of countries with high deforestation rates). Therefore, in order to create an effective REDD mechanism, we argue that a governance structure that relies on the delegation of power and control to an international review mechanism should be created to administer the REDD mechanism when it emerges. In this regard, parties to the *UNFCCC* should contemplate the delegation of certain elements of power to an internationally-established market regulator. Provided that such a regulator is properly equipped with powers and able personnel, it may be an appropriate means to encourage participation by the private sector in a future REDD mechanism.

Part II of this article provides a general introduction to the role that non-state actors play in international law. Part III is explanatory in nature and sets out the conceptual origins of private sector involvement in the *Kyoto Protocol* mechanisms. Part IV presents an analysis of the CDM as a regulatory arena in which the Executive Board is effectively *the* market regulator, which has coopted or delegated additional regulatory functions to other actors who consequently play quasi-regulatory roles. This analytical framework sets the stage for the more prescriptive analysis wherein we make specific recommendations to promote more effective regulation by the Executive Board, including more transparent decision-making processes to address project developers' need for due process and certainty. These recommendations include professionalising the Executive Board; more 'conversations' between regulated entities and the Executive Board; and the introduction of an appeals mechanism through which project developers can seek review of Executive Board decisions. In Part V, we examine the proposals for a REDD mechanism in the future and argue that to the extent that a REDD mechanism will rely on private carbon markets for mobilising finance, the establishment of an international regulatory body will be necessary.

II PRIVATE ACTORS IN INTERNATIONAL LAW

International law is, by definition, state-centric. States are the principal actors on the international stage and a salient feature of international law is that most of its rules aim at regulating the behaviour of states, not of individuals.[11] However,

[11] Antonio Cassese, *International Law* (2nd ed, 2005) 3.

sub-national (and supranational) entities increasingly play a role in the international law sphere, and do so in a variety of ways. Thus, while the conduct of states continues to determine the rules of international law, whether by treaty or practice, what has emerged is that states have opened the doors to allow others some limited level of international sovereignty. Modern states recognise the ability of other actors to have rights and duties on the international plane, a status that, while certainly not equal to that of states, is sufficient for those actors to participate in the formation, implementation, and even the enforcement of international law.[12]

The involvement of non-state actors on the international scene is not a recent phenomenon. Historic examples of non-state actors that have left their mark on the international legal system include medieval political structures, religious institutions, commercial entities such as the East India Company and other chartered bodies engaged in colonial enterprise.[13] Steve Charnovitz's work on the long history of NGO participation in international governance provides a fascinating and comprehensive account of the profound influence that NGOs have had on the scope and content of international law.[14] However, what is new is the variety of non-state actors, their geographical range and their degree of influence — partly due to the media and the information technology revolution.

A *Non-State Actors as Law-Makers*

Non-state actors contribute to and influence the creation of international legal norms. States can involve private entities in law-making by including them in national delegations to negotiate and adopt treaties. NGOs, trade associations (or business NGOs which are defined as 'interest groups that unite several companies to campaign for a specific point of view')[15] and other private actors frequently serve as observers in conferences to negotiate various multilateral treaties. Although they generally do not have a role in formal negotiations or a treaty's final adoption, as observers, accredited NGOs may speak before the conference, make proposals and substantially influence the outcome of the negotiations.[16]

Non-state actors also actively participate in law-making as signatories to non-binding memoranda of understanding or binding agreements that establish initiatives or lead to the adoption of rules that guide certain aspects of the behaviour of (initially) the parties to the relevant agreement. Such agreements can be concluded among private or between private and public entities. The *UN Global Compact*[17] is a good example of a public–private partnership that brings together companies, UN agencies and civil society in the quest for corporate social responsibility in the areas of human rights, labour, anti-corruption and the

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12 Hollis, above n 4, 237.

13 Alan Boyle and Christine Chinkin, *The Making of International Law* (2007) 42.

14 Steve Charnovitz, 'Two Centuries of Participation: NGOs and International Governance' (1997) 18 *Michigan Journal of International Law* 183.

15 Giorgetti, 'From Rio to Kyoto', above n 7, 220.

16 See generally ibid.

17 UN Global Compact, *United Nations Global Compact* (2008) <http://www.unglobal compact.org> ('*UN Global Compact*').

environment.[18] Governments have also aimed to institutionalise environmental protection not only through classic instruments (such as administrative law and criminal law) but also by concluding agreements (sometimes dubbed 'regulatory agreements') with companies or industries to reduce their pollution.[19] When resorting to regulatory agreements, governments are prioritising the use of persuasive power above that of coercive authority.

Non-state actors are also actively involved in the development of standards and codes of conduct that are increasingly incorporated into law, the most prominent example being the standards developed by the International Organization for Standardization.[20] In the context of the CDM, private entities develop and elaborate upon the methodologies that guide the calculation of GHG emissions reduction. Such methodologies are validated by private accredited auditors (Designated Operational Entities ('DOEs') in CDM terminology) and adopted by the Executive Board. They then become standards that are freely available for use by any entity that is developing a comparable project activity.

In terms of enforcement, NGOs and think tanks often carry out investigations and publish reports on how states are complying with their international legal obligations. This occurs most often in the human rights context and to a lesser degree in the environmental context.[21] Supranational regimes rarely confer direct enforcement powers upon private actors. Within the World Trade Organization, for example, only states have standing and only member countries may formally raise complaints. The World Bank Inspection Panel allows qualifying non-state actors to hold the World Bank accountable for actions that cause or threaten to cause serious harm to the complainants and that are inconsistent with the World Bank's own operational policies and procedures.[22]

It is now recognised that much of international governance is no longer primarily between states. Instead, it is occurring among specialised government agencies, which are increasingly networking with their counterparts abroad and

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18 Johanna Brinkmann-Braun and Ingo Pies, 'The Global Compact's Contribution to Global Governance Revisited' (Discussion Paper No 10, Martin-Luther Universität Halle, 2007). See also UN Global Compact, *Advancing Corporate Citizenship in the World Economy* (2008) <http://www.unglobalcompact.org/docs/about_the_gc/gc_overview.pdf>.

19 Jan Klabbers, 'Reflections on Soft International Law in a Privatized World' (2005) 16 *Finnish Yearbook of International Law* 313. Japan was one of the first countries in the world to pioneer the use of voluntary environmental agreements: see, eg, Environment Directorate, Organisation for Economic Co-operation and Development, *Voluntary Approaches: Two Japanese Cases* (2003), available from <http://www.oecd.org>.

20 Naomi Roht-Arriaza, '"Soft Law" in a "Hybrid" Organization: The International Organization for Standardization' in Dinah Shelton (ed), *Commitment and Compliance: The Role of Non-Binding Norms in the International Legal System* (2000) 263.

21 Human Rights Watch and Amnesty International are just two of the more well-known human rights NGOs that publish such reports on the compliance of states with international human rights law. TRAFFIC, the global wildlife trade monitoring network, conducts highly valuable research and information gathering on the illegal wildlife trade and the compliance of states with their obligations under the *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, opened for signature 3 March 1973, 993 UNTS 243 (entered into force 1 July 1975) ('*CITES*'). The UNTS contains the unamended text of the treaty. See also the *CITES* website for the amended text of treaty: CITES Secretariat, *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, <http://www.cites.org>.

22 *Resolution Establishing the World Bank Inspection Panel*, 22 September 1993, IBRD Res No 93-10, IDA Res No 93-6, 34 ILM 520 (1995). See also Inspection Panel, World Bank Group, *About Us* (2008) <http://www.worldbank.org/inspectionpanel>.

in the process, are sharing information, ideas and policies.[23] Thus, the shift in power and attention does not only include private actors but also includes shifts within the public sector from formal interstate forums of cooperation towards cooperation between agencies, departments and civil servants of different governments.[24]

Traditionally, non-state actors have not had rights and obligations bestowed directly upon them by the international system. Any international legal rights or obligations that non-state actors may have would usually be acquired through the state. For example, a private business may undertake to fulfil the regulatory requirements established by the *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal*,[25] but it does so because it is complying with the domestic laws of its home state, which have been promulgated by the state to fulfil its international legal obligations under the *Basel Convention*.[26] As such, the international legal obligations upon states may entail domestic regulation of the actions of non-state actors within their jurisdictions, but that is conceptually different from positioning non-state actors directly under international legal obligations. In this manner, non-state actors have not traditionally been direct 'addressees' of international law. This is changing however, and corporations are increasingly recognised as actors at the international level, with the capacity to bear some rights and duties under international law. They have rights under bilateral investment treaties, and are subject to duties under civil liability conventions dealing with marine pollution.[27] International climate law is another example of an international law regime that directly regulates private actors (making them 'addressees' of international law), thereby posing certain challenges to the traditional state-centric paradigm of international law.

B *Delegation of Authority to the International Level*

In a world that is increasingly interdependent, a growing set of international bodies coordinate, and also regulate, responses in fields such as security,

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23 Kal Raustiala, 'The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law' (2002) 43 *Virginia Journal of International Law* 1; Charlotte Streck, 'Governments and Policy Networks: Chances, Risks and a Missing Strategy' in Frank Wijnen, Kees Zoeteman and Jan Pieters (eds), *A Handbook of Globalization and Environmental Policy* (2005) 653.

24 Anne-Marie Slaughter, 'Governing the Global Economy through Government Networks' in Michael Byers (ed), *The Role of Law in International Politics: Essays in International Relations and International Law* (2000) 177; Anne-Marie Slaughter, 'Globalization, Accountability, and the Future of Administrative Law: The Accountability of Government Networks' (2001) 8 *Indiana Journal of Global Legal Studies* 347.

25 Opened for signature 23 March 1989, 1673 UNTS 57 (entered into force 5 May 1992) ('*Basel Convention*').

26 It is not within the scope of this article to discuss the monist and dualist theories on the relationship between national law and international law. For a general discussion, see Ian Brownlie, *Principles of Public International Law* (6th ed, 2003).

27 See, eg, *International Convention on Civil Liability for Oil Pollution Damage*, opened for signature 29 November 1969, 973 UNTS 3 (entered into force 19 June 1975), which places the liability for oil pollution damage resulting from maritime casualties on the owner of the ship from which the polluting oil escaped or was discharged. The *International Convention on Civil Liability for Bunker Oil Pollution Damage, 2001*, opened for signature 1 October 2001, [2002] ATNIF 25 (not yet in force) places a legal obligation on all registered vessel owners to maintain compulsory insurance cover.

development, banking, immigration and refugees, and environmental protection. By delegating authority to the international level, national authorities shift the locus of decision-making and regulatory responses to the international level. Non-state actors therefore find themselves increasingly exposed to direct contact with international bodies administrating certain tasks or public programmes.

Such delegation is not unproblematic as the increased distance between the legitimised law-makers (the national governments) and the executive bodies to which significant powers have been delegated poses the risk of deficits in control and accountability.[28] Discomfort about the delegation of authority to distant officials adds to concerns about inadequate checks and balances on the international level to the extent that the lack of democratic foundations for international bodies creates serious legitimacy issues.[29] While delegated decision-making in the domestic context exists within a broader rule-based system, the accountability regime in the international realm is much thinner. As Daniel Esty points out, there are various forms of legitimacy that support authority and bolster the political acceptance of decisions taken by those bodies. He argues that legitimacy flows from democratic selection, but also from decisions that result in welfare gains, and from due process, order and the deliberative processes that lead to a certain decision.[30] Some of these sources support each other, others may be conflicting. Where democratic legitimacy is missing, it is important that legitimacy is enhanced by procedural safeguards that promote a widely accepted method of policymaking. Such procedures often form part of the toolbox of administrative law and premise decision-making on notions of predictability, fairness, transparency, rationality, stability, neutrality and efficiency.[31]

The transfer of responsibilities from the national to the international level is most problematic when non-state actors become subjects of international law. In an increasing number of instances, international bodies make decisions that have direct legal consequences for individuals or firms without any intervening role

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28 The delegation of 'legislative' or rule-making power from the COP/MOP to the Executive Board poses the thorny question of abdication of responsibility on the part of the COP/MOP, which has been given such powers by the *UNFCCC* and the *Kyoto Protocol*. The delegation of decision-making power to constituted bodies and subordinated panels would raise questions with respect to general principles of good governance such as accountability. While the Executive Board has not delegated any decision-making powers further, it is the role and authority of the Executive Board itself and its accountability towards the COP/MOP or any legitimised law-makers (such as national governments) that is questionable. For the role of the COP/MOP and the constituted bodies established under its authority, see Jutta Brunnée 'COPing with Consent: Law-Making under Multilateral Environmental Agreements' (2002) 15 *Leiden Journal of International Law* 1.

29 See, eg, Daniel C Esty, 'Good Governance at the Supranational Scale: Globalizing Administrative Law' (2006) 115 *Yale Law Journal* 1490; Benedict Kingsbury, Nico Krisch and Richard B Stewart, 'The Emergence of Global Administrative Law' (2005) 68 *Law and Contemporary Problems* 15, 16; Robert O Keohane, 'Global Governance and Democratic Accountability' in David Held and Mathias Koenig-Archibugi (eds), *Taming Globalization: Frontiers of Governance* (2003) 130; Robert O Keohane, 'The Contingent Legitimacy of Multilateralism' in Edward Newman, Ramesh Thakur and John Tirman (eds), *Multilateralism under Challenge? Power, International Structure, and World Order* (2006) 56.

30 Esty, above n 29, 1490–520.

31 Ibid 1524–36.

for national government action.[32] Examples of mechanisms and areas wherein decisions by international bodies directly affect non-state entities include the system of UN targeted sanctions; United Nations High Commissioner for Refugees ('UNHCR') determinations of refugee status of individuals; and accreditation of NGOs by UN agencies to participate in their procedures; and, of course, the CDM.

III PRIVATE SECTOR INVOLVEMENT IN THE *KYOTO PROTOCOL* MECHANISMS

A *Non-State Actors in the Climate Change Regime*

The *UNFCCC* recognises the role of non-state actors and takes a relatively open approach to their participation in the international climate regime. The *UNFCCC* addresses the role of non governmental entities in arts 4(1)(i), 7(2)(l) and 7(6). The *Kyoto Protocol* reiterates the right for NGOs to participate[33] in meetings of the states parties and mandates the states parties to seek non governmental support to promote the protocol's effective implementation.[34] In addition, the Protocol assigns an explicit role to the private sector when it authorises its participation in the CDM[35] and JI[36] and emphasises its role in the transfer of environmentally sound technologies.[37]

Joyeeta Gupta has identified four ways in which the climate change regime makes room for the participation of the non-state actor.[38] First, non-state actors are permitted to participate in the negotiations, subject to the accreditation procedures. Second, the text of the *UNFCCC* calls on states to actively involve non-state actors in domestic policymaking processes. Third, the Subsidiary Body for Scientific and Technological Advice has been established under art 9 of the *UNFCCC*. This body constitutes, amongst others, a communication mechanism with the scientific community, the Intergovernmental Panel on Climate Change ('IPCC'). Other epistemic communities such as industry, local governments and environmental organisations lack such an explicit communication channel with treaty negotiations. Finally, the *UNFCCC* and the *Kyoto Protocol* actively solicit the participation of private organisations in the *Kyoto Protocol* mechanisms.

Amongst the four ways identified by Gupta, the role of NGOs in influencing the climate negotiations has received the most attention.[39] This is not surprising,

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32 Kingsbury, Krisch and Stewart, above n 29, 16, 24.

33 *Kyoto Protocol*, above n 6, art 13(8).

34 Ibid art 13(4)(i).

35 Ibid art 12(9).

36 Ibid art 6(3).

37 Ibid art 10(c).

38 Joyeeta Gupta, 'Non-State Actors: Undermining or Increasing the Legitimacy and Transparency of International Environmental Law' in Ige F Dekker and Wouter G Werner (eds), *Governance and International Legal Theory* (2004) 297, 302–6.

39 See, eg, Alkoby, above n 7; Peter Bombay, 'The Role of NGOs in Shaping Community Positions in International Environmental Fora' (2001) 10 *Review of European Community and International Environmental Law* 163; Elisabeth Corell and Michele M Betsill, 'A Comparative Look at NGO Influence in International Environmental Negotiations: Desertification and Climate Change' (2001) 1 *Global Environmental Politics* 86; Chad Carpenter, 'Business, Green Groups and the Media: The Changing Role of Non Governmental Organizations in the Climate Debate' (2001) 77 *International Affairs* 313;

as NGOs have not hesitated to use the international legal status bestowed upon them by the *Charter of the United Nations* to gain access to the law-making activities of international institutions, and they have certainly not stopped at the doors of the climate negotiations.[40] Until today, relatively little attention has been paid to the innovative way the *Kyoto Protocol* involves non-state entities in the compliance system of the treaty. The *Kyoto Protocol* differs from the traditional state-centric model of international law when it makes public and private entities subjects of the CDM and JI. It goes even further when it establishes, with the CDM Executive Board and the JI Supervisory Committee, international bodies that administer the *Kyoto Protocol* mechanisms directly and enter into relationships with private entities participating in these mechanisms. This article focuses on this aspect of the involvement of non-state actors in the climate change regime.

B *The* Kyoto Protocol *Mechanisms*

The *Kyoto Protocol* establishes three market mechanisms to help industrialised countries (so-called Annex I countries)[41] meet their emissions reduction commitments in a cost-effective manner. States parties with 'quantified emission limitation and reduction commitments'[42] can participate in emissions trading,[43] JI[44] and the CDM.[45] In the case of international emissions trading, a state party listed in Annex I to the *Kyoto Protocol* that is able to meet its target may sell its surplus emissions allowances to another party that finds it more difficult or costly to reduce its own emissions.[46] Under JI, an Annex I state party may fund carbon emissions abatement projects in another Annex I state party, and use the resulting credits to meet its own commitment under the *Kyoto Protocol*. The CDM works in a similar way to the JI mechanism, but the projects are hosted in developing countries instead. The aim of the CDM is not only to help Annex I states parties meet their emissions targets in a cost-effective way,

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Giorgetti, 'The Role of Non-Governmental Organizations', above n 7; Giorgetti, 'From Rio to Kyoto', above n 7; Pamela S Chasek, David L Downie and Janet Welsh Brown, *Global Environmental Politics* (4th ed, 2006).

40 Amongst civil society actors, only NGOs have been given international legal status by the *UN Charter*. Article 71 of the *UN Charter* provides that the Economic and Social Council 'may make suitable arrangements for consultation with non-governmental organizations which are concerned with matters within its competence'. Alan Boyle and Christine Chinkin have suggested that a symbiotic relationship has developed between NGOs and IGOs such as the UN. IGOs acquire additional legitimacy from the participation of NGOs in their processes, while NGOs can point to this participation as evidence of their status and the importance of their activities — a matter of considerable interest to donors. This mutually reinforcing relationship is recognised by the fact that ongoing proposals for UN reform include strengthening NGO participation: Boyle and Chinkin, above n 13, 45.

41 *UNFCCC*, above n 5, annex 1. This annex lists the countries that agreed to assume binding emissions limitation and reduction targets. Such targets are set out in the *Kyoto Protocol*, above n 6, annex B.

42 *Kyoto Protocol*, above n 6, art 3(1).

43 Ibid art 17.

44 Ibid art 6.

45 Ibid art 12.

46 Emissions trading schemes were developed in the United States during the 1970s. One of the most successful emissions trading scheme to date is the Acid Rain Program, and its success was one of the reasons why the US negotiators of the *Kyoto Protocol* argued for the inclusion of emissions trading as one of the 'flexible mechanisms'.

but also to promote sustainable development in the developing countries.[47] The CDM thus establishes a scheme of joint implementation between industrialised and developing countries and provides an important tool for involving developing countries in the *Kyoto Protocol* processes.[48] Emissions reduction generated by JI or CDM need to be 'additional' to any that would occur in the absence of the project activity.[49] Both mechanisms generate credits that can be used by Annex I states parties for the purposes of meeting their emissions reduction obligations. In both cases, approval by the host country is required[50] and private sector entities may be authorised to participate in project activities.

The direct involvement of private entities in the *Kyoto Protocol* mechanisms is one of the most innovative features of the *Kyoto Protocol*. As an instrument of public international law, the *Kyoto Protocol* applies to states parties. Both the *UNFCCC* and the *Kyoto Protocol* have reaffirmed the sovereignty of nations and the sovereign right of countries to control their own natural resources.[51] Nevertheless, the negotiators of the *Kyoto Protocol* foresaw private participation in the flexible trading mechanisms that they established under the Protocol. The articles in the *Kyoto Protocol* that establish the JI and the CDM both refer explicitly to the participation of the private sector in the mechanisms. Article 6(3) of the *Kyoto Protocol* states that a 'Party included in Annex I may authorize legal entities to participate, under its responsibility, in actions leading to the generation, transfer or acquisition under this Article of emission reduction units'. Article 12(9) of the *Kyoto Protocol* states:

> Participation under the clean development mechanism, including in activities mentioned in paragraph 3(a) above and in the acquisition of certified emission

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47 See *Kyoto Protocol*, above n 6, art 12(2).

48 The idea of the CDM originated from a Brazilian proposal called the Clean Development Fund ('CDF'), which was intended to be a compliance mechanism under which Annex I countries defaulting on their binding emission targets would contribute to a fund to facilitate technology transfer to developing countries. However, the CDF was rejected because, amongst other reasons, it was a punitive instrument entailing financial penalties and there were misgivings about the allocation of resources from the fund to developing countries. Therefore, during the negotiations in Kyoto, the CDM concept was put forward as a counterproposal to the CDF to satisfy developing countries' demands for financial transfers while giving Annex I countries additional efficiency gains and more flexibility to meet their emission targets: see Emilio L La Rovere, Laura Valente de Macedo, and Kevin A Baumert, 'The Brazilian Proposal on Relative Responsibility for Global Warming' in Kevin A Baumert et al (eds), *Building on the Kyoto Protocol: Options for Protecting the Climate* (2002) 157.

49 *Kyoto Protocol*, above n 6, arts 6(1)(b), 12(5)(c). The 'additionality' requirement may be explained as such: CDM project activities must result in reducing or absorbing (sequestering) GHGs that are real and measurable and would not have occurred in the absence of the proposed project activity. See Conference of the Parties ('COP'), UNFCCC, *Report of the Conference of the Parties on Its Seventh Session, Held at Marrakesh from 29 October to 10 November 2001, Addendum — Part Two: Action Taken by the Conference of the Parties*, UN Doc FCCC/CP/2001/13/Add.2 (21 January 2002) 36 (*Decision 17/CP.7 — Modalities and Procedures for a Clean Development Mechanism as Defined in Article 12 of the Kyoto Protocol*). In other words, to qualify for credits, a project activity must demonstrate that GHG emissions were reduced against the 'baseline scenario', a representation of GHG emissions under normal circumstances. The 'additionality' requirement of both JI and the CDM is a concept that is closely related to the incremental cost principle of the Multilateral Fund for the Implementation of the Montreal Protocol ('MLF') and the Global Environment Facility.

50 *Kyoto Protocol*, above n 6, arts 6(1)(a), 12(5)(a).

51 See *UNFCCC*, above n 5, preamble; ibid preamble.

> reductions, may involve private and/or public entities, and is to be subject to whatever guidance may be provided by the executive board of the clean development mechanism.

While art 17 of the *Kyoto Protocol* does not refer explicitly to private or public entities participating in international emissions trading, the implementation guidelines adopted with the *Marrakesh Accords*[52] clarify that parties can also authorise non-state actors to participate in emissions trading.[53] These provisions provide the states parties to the *Kyoto Protocol* the legal basis to authorise the participation of private entities in the generation and transfer of carbon rights. Parties have made and are making use of this right. Private entities are thus directly involved in the implementation of the *Kyoto Protocol* mechanisms and indirectly in treaty compliance. In the following discussion, we will focus on the CDM as the most popular of the three mechanisms, with 1524 projects registered by April 2009. The CDM market was valued at US$12.9 billion in 2007.[54]

C *The CDM Experience and the Conception of the Non-State Actor in International Law*

In introducing the concept of market-based mechanisms to the realm of international law and creating a framework for public–private partnerships, the CDM is unprecedented in international environmental law. Further, as Benedict Kingsbury has argued, the CDM 'is perhaps indicative of future patterns in that an interstate environmental agreement confers substantial powers on an

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52 The *Marrakesh Accords* are the decisions adopted by the seventh session of the COP held in Marrakesh, Morocco, in 2001: COP, UNFCCC, *Report of the Conference of the Parties on Its Seventh Session, Held at Marrakesh from 29 October to 10 November 2001*, UN Doc FCCC/CP/2001/13 (21 January 2002) ('*Marrakesh Accords*'). The *Marrakesh Accords* were confirmed by the first session of the COP/MOP in Montreal: see COP/MOP, UNFCCC, *Report of the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol on Its First Session, Held at Montreal from 28 November to 10 December 2005, Addendum — Part Two: Action Taken by the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol at Its First Session*, UN Doc FCCC/KP/CMP/2005/8/Add.1 (30 March 2006) 6 (*Decision 3/CMP.1 — Modalities and Procedures for a Clean Development Mechanism as Defined in Article 12 of the Kyoto Protocol*) ('*Decision 3/CMP.1*'); COP/MOP, UNFCCC, *Report of the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol on Its First Session, Held at Montreal from 28 November to 10 December 2005, Addendum — Decisions concerning Guidelines under Articles 5, 7 and 8 of the Kyoto Protocol*, UN Doc FCCC/KP/CMP/2005/8/Add.2 (30 March 2006) 2 (*Decision 9/CMP.1 — Guidelines for the Implementation of Article 6 of the Kyoto Protocol*).

53 See, eg, COP/MOP, UNFCCC, *Report of the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol on Its First Session, Held at Montreal from 28 November to 10 December 2005, Addendum — Decisions concerning Guidelines under Articles 5, 7 and 8 of the Kyoto Protocol*, UN Doc FCCC/KP/CMP/2005/8/Add.2 (30 March 2006) 19 (*Decision 11/CMP.1 — Modalities, Rules and Guidelines for Emissions Trading under Article 17 of the Kyoto Protocol*):

> A Party that authorizes legal entities to transfer and/or acquire under Article 17 shall remain responsible for the fulfilment of its obligations under the Kyoto Protocol and shall ensure that such participation is consistent with the present annex. The Party shall maintain an up-to-date list of such entities and make it available to the secretariat and the public through its national registry. Legal entities may not transfer and/or acquire under Article 17 during any period of time in which the authorizing Party does not meet the eligibility requirements or has been suspended.

54 Karan Cappor and Philippe Ambrosi, *State and Trends of the Carbon Market 2008* (World Bank Report, May 2008) 1.

international institution to directly administer a regime affecting private market actors as well as state agencies'.[55] While this may be so, the regulatory design of the CDM reveals deep-seated notions of the non-state actor as one of limited international legal personality as well as ambivalence about the involvement of private entities in treaty regimes. The design of the CDM, which has not incorporated rules and institutions to adequately protect the rights and interests of private participants, demonstrates the difficulties that international law encounters when seeking to involve non-state actors in treaty implementation. The difficulties, it may be argued, stem from the state-centric nature of international legal doctrine as well as the prevailing practices in international law, wherein non-state actors have played an increasing role on the global stage but nonetheless remain on the periphery. Returning to the design of the *Kyoto Protocol*, while its text clearly includes provisions to facilitate private sector participation in the *Kyoto Protocol* mechanisms, there is a lack of safeguards or consideration for private sector concerns. The *Kyoto Protocol* mechanisms may be viewed as permitting and facilitating the involvement of non-state actors simply in order to help states meet their legal obligations under the *Kyoto Protocol*. In other words, the involvement of private entities can be viewed as one way of spreading the burden of climate change mitigation across a wider pool of actors but the focus remains on states and their needs. Further, the fact that the rules, institutions and the very property right that is the subject of transactions in the carbon markets are created by the *Kyoto Protocol* regime *with* the consent of states and *without* the input of private actors (who are affected by these rules and institutions) further proves the centrality of states in the *Kyoto Protocol* regime.[56]

D *Private Sector Participation in the CDM*

There is a high degree of private sector participation in the CDM. DOEs perform auditing and verification functions and thereby act as guardians of the integrity (both procedural and environmental) of the CDM, while private project developers, project partners and consultants act as investors or purchasers of carbon credits (Certified Emission Reductions, or 'CERs'). The involvement of states parties in the CDM is limited to: first, verification by the government of the country in which the intended CDM project is to be carried out that it participates voluntarily in the CDM and that the project contributes to its sustainable development; second, approval by the state party who imports the resulting CERs of the project activity and, if applicable, the authorisation of private sector participation.

1 *Designated Operational Entities*

DOEs are accredited by the Executive Board and designated by the *UNFCCC* COP/MOP on the basis of a set of requirements which include relevant expertise,

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[55] Benedict Kingsbury, 'Global Environmental Governance as Administration: Implications for International Law' in Daniel Bodansky, Jutta Brunnée and Ellen Hey (eds), *The Oxford Handbook of International Environmental Law* (2007) 63.

[56] Of course, private entities may lobby their governments or form associations that directly lobby the treaty negotiations process but these actions do not constitute formal participation processes and their efficacy is not guaranteed.

financial stability, insurance coverage and resources.[57] The responsibility of a DOE is to validate a CDM project by independently evaluating the project design against the CDM requirements, including a substantive review of the baseline and monitoring methodology, and assuring that an adequate monitoring plan is in place to safeguard against the overstatement of emissions reductions.[58] During the implementation of a CDM project activity, the project participants prepare a monitoring report and forward it to another DOE for verification or certification.[59] After the second DOE verifies and certifies the amount of emissions reductions, it submits a report together with a request for issuance of CERs to the Executive Board.[60] The second (and final) certification by the DOE results in the issuance of the specified number of CERs by the CDM registry administrator unless the Executive Board, the project participants, or one of the parties involved exercise their power of review, which is limited to fraud, malfeasance or incompetence of the DOE.[61] Thus, much of the power to create CERs rests with the DOEs, which are themselves market actors that are not created by intergovernmental action (albeit each DOE needs to be approved by the Executive Board and the COP/MOP) and are contracted by the project participants.[62]

There are two main ways in which the DOEs are held accountable by the CDM rules. First, the DOEs have to comply with applicable CDM modalities and procedures as well as other relevant decisions of the COP/MOP and the Executive Board. The failure to do so will result in suspension or withdrawal of their accreditation. If the Executive Board concludes, after reviewing a CDM project activity, that a DOE no longer meets the accreditation criteria, it may recommend to the COP/MOP that the DOE in question be withdrawn or suspended. Such withdrawal or suspension directly takes effect upon the Executive Board's recommendation.[63] Second, DOE accountability is also achieved through financial penalties. In the event that an Executive Board review shows that excess CERs have been erroneously issued, the responsible DOE bears the costs of the review and has to transfer an amount of CERs equivalent to the number of excess CERs issued to the Executive Board's cancellation account.[64] Finally, DOEs are likely to be subject to market disciplines and to

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57 COP/MOP, *Decision 3/CMP.1*, above n 52, 23–4.

58 Ibid 12: Section E sets out the scope of the DOE's work. The criteria that a project design document must meet are also specified in Appendix B: ibid 23.

59 Information on the issuance of CERs can be found in Section J ('Work Programme on Mechanisms') of the *Draft Marrakesh Accords*: COP, UNFCCC 'The Marrakesh Accords' in *The Marrakesh Accords and the Marrakesh Declaration* (2001) pt 1, s J <http://unfccc.int/cop7/documents/accords_draft.pdf> ('*Draft Marrakesh Accords*'). Section J of the *Draft Marrakesh Accords* was adopted by the COP as *Decisions 15/CP.7–19/CP.7* in its seventh session: COP, UNFCCC, *Report of the Conference of the Parties on Its Seventh Session, Held at Marrakesh from 29 October to 10 November 2001, Addendum — Part Two: Action Taken by the Conference of the Parties*, UN Doc FCCC/CP/2001/13/Add.2 (21 January 2002) ('*Decisions 15/CP.7–19/CP.7*'). A list of all accredited DOEs can be found on the CDM website: UNFCCC, *Designated Operational Entities (DOE)*, <http://cdm.unfccc.int/DOE/index.html>.

60 See COP, *Decisions 15/CP.7–19/CP.7*, above n 59.

61 See ibid.

62 Kingsbury, above n 55, 75.

63 COP/MOP, *Decision 3/CMP.1*, above n 52, 11.

64 Ibid.

reputational accountability constraints, provided they are repeat players and are unable to establish monopolies or to engage in regulatory capture.[65]

2 *Project Participants*

Public and private entities can engage in CDM project activities. Governments and IGOs have been active participants in the CDM since its inception. They act as project proponents, consultants, investors or purchasers of CERs. Today, an overwhelming majority of the entities trading in the CDM market are private entities.[66] They participate in the market either through investments in funds (for speculative purposes or compliance); through intermediaries; or through direct purchases. There are two basic reasons why private entities are motivated to participate in activities related to the CDM.

First, in order to achieve their emissions reduction commitments under the *Kyoto Protocol*, some national governments have allocated GHG emissions quotas among the current and future sources of emissions in their own countries, most of which are owned by the private sector. As a consequence, the private sector is required to achieve reductions and if allowed to do so, may choose to meet some of its obligations by carrying out clean development projects. The European Union Emissions Trading Scheme[67] is one of such policy measures through which Annex I states parties translate their *Kyoto Protocol* commitments into emissions reduction targets of a group of private sector actors. Private sector entities also participate in project activities in order to gain profit, if they are engaged in businesses which are related to these emissions reduction activities, such as trading, financing, brokering, technology development, power generation or contract negotiations.[68]

Second, private sector entities and NGOs from non-Annex I states parties see the possibility of generating and selling GHG emissions reduction under the CDM as a means of making a difference in the internal rate of return of their projects and of pushing marginal projects into the realm of economic viability. The CERs arising from a CDM project have cash value that will make a project viable from the sponsor's point of view.

A private entity requires the authorisation of a state party to participate in a CDM project and to receive CERs. An Annex I state party that authorises a private or public entity to act as a participant in a CDM project remains responsible for fulfilling its *Kyoto Protocol* obligations. The *Kyoto Protocol* empowers non-state actors to participate in the *Kyoto Protocol* mechanisms, but

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65 Kingsbury, above n 55, 75.

66 According to the 2007 *Point Carbon Report*, the market segmentation in 2006 was eight per cent governments; 34 per cent funds; and 58 per cent private buyers. According to this same report, private buyers are dominating the market as more companies see the value of project credits, and most of the governmental buyers are European countries: Kjetil Røine and Henrik Hasselknippe (eds), *Carbon 2007 — A New Climate for Carbon Trading* (Point Carbon Report, 13 March 2007) 17–19 ('*Point Carbon Report*').

67 See discussion above n 9.

68 Laura B Campbell, 'Emission Trading, Joint Implementation and the Clean Development Mechanism: The Role of Private Sector and Other Non-State Actors in Implementation' in William Bradnee Chambers (ed), *Global Climate Governance: A Report on the Inter-Linkages between the Kyoto Protocol and Other Multilateral Regimes* (UN University, Global Environment Information Centre and UNU Institute of Advanced Studies Joint Report, 1998) 7–12.

ensures — and thus reflects on the ambivalence of the Protocol's attitude towards private sector involvement[69] — that states ultimately bear the legal liabilities and any private participation takes place under their auspices.

IV THE CDM AND MARKET REGULATION

The success of the CDM depends on the active participation of private entities. Yet, there are growing concerns about the efficiency and effectiveness of the CDM. Some authors have expressed concerns about the mechanism's promise to generate measurable and real emissions reduction.[70] Michael Wara and David Victor, for example, argue that it is impossible to resolve the inherent tension between the demands of the market and environmental integrity and are therefore sceptical about the ability of the CDM to lead to real climate change mitigation.[71] Not only has the CDM's environmental integrity been questioned, but its institutional performance has also been subject to debate and criticism.[72] Continued delays as well as the lack of transparency and predictability in the Executive Board's decision-making have frustrated those participating in the CDM.[73] Project participants are likely to be deterred from participating in the CDM if they perceive that they may not be treated with fairness or enjoy certain minimal due process rights, or that the decision-making processes carry risks of uncertainty. DOEs are unlikely to build sufficient staff capacity if they feel exposed to flawed Executive Board decisions and are not provided with a long term perspective for the CDM. If market-based global regulatory systems are to succeed, they must provide market participants with regulatory and legal

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69 For a similar view, see Ernestine Meijer and Jacob Werksman, 'CDM — Concepts, Requirements and Project Cycle' (2007) 15 *Environmental Liability* 81, 87.

70 Axel Michaelowa and Pallav Purohit, University of Zurich, Switzerland, *Additionality Determination of Indian Projects, Can Indian CDM Project Developers Outwit the CDM Executive Board?* (2007) <http://www.noe21.org/docs/Michaelowa-teripress-2007>; Nick Davies, 'Abuse and Incompetence in Fight against Global Warming', *The Guardian* (London, United Kingdom) 2 June 2007, 1; Nick Davies, 'Truth about Kyoto: Huge Profits, Little Carbon Saved', *The Guardian* (London, UK) 2 June 2007, 6; Andrei Marcu, President, International Emissions Trading Association ('IETA'), *IETA Response to 'Truth about Kyoto: Huge Profits, Little Carbon Saved' Guardian — Saturday June 2, 2007* (2007), available from <http://www.ieta.org>.

71 Michael Wara and David G Victor, 'A Realistic Policy on International Carbon Offsets' (Working Paper No 74, Program on Energy and Sustainable Development, Stanford University, 2008).

72 Charlotte Streck and Jolene Lin, 'Making Markets Work: A Review of CDM Performance and the Need for Reform' (2008) 19 *European Journal of International Law* 409; Ernestine Meijer, 'The International Institutions of the Clean Development Mechanism Brought before National Courts: Limiting Jurisdictional Immunity to Achieve Access to Justice' (2007) 39 *New York University Journal of International Law and Politics* 873; Charlotte Streck, 'The Governance of the Clean Development Mechanism: The Case for Strength and Stability' (2007) 15 *Environmental Liability* 91; IETA, *2006 State of the CDM* (2006), available from <http://www.ieta.org>.

73 See Andrei Marcu and Robert Dornau, IETA, *Strengthening the CDM: IETA Position Paper for COP 11 and COP/MOP 1* (Position Paper, 2005), available from <http://www.ieta.org>: IETA, *Position Paper for COP12/CMP 2* (on file with authors); Letter from Andrei Marcu, President, IETA, to Jose Minguez, Chairman, Clean Development Mechanism Executive Board, 6 October 2006, available from <http://www.ieta.org>; World Bank Carbon Finance Business, *Reforming the Clean Development Mechanism* (Background Paper for the Host Country Committee Steering Committee Meeting, October 2005); Center for Clean Air Policy, Washington DC, US, *Summary of an Informal Workshop on Streamlining the CDM, COP/MOP1* (on file with authors).

certainty, including opportunities for independent review of decisions and timely resolution of disputes.[74] It is therefore crucial to address these concerns by reforming certain aspects of the CDM governance.

Today, project participants consider the decisions and interpretations of the Executive Board to be slow and unpredictable.[75] Faced with decisions that they consider incomplete or incorrect, private entities participating in the CDM do not enjoy basic procedural rights, such as the right to be heard and to appeal an Executive Board decision, which magnifies the difficulties caused by the unpredictability of the Board's decisions. These decisions or their omissions have significant impact on project developers and their investments. If actions similar to those of the Executive Board were performed by national agencies, there would be little doubt of their administrative and regulatory character. Such actions by domestic agencies would usually be subject to judicial and/or political accountability to protect the rights of the individual, but in the international realm such accountability mechanisms are lacking, and in the CDM regime, their absence is particularly notable. We argue that this is not acceptable for reasons of due process. Further, in accordance with the market logic that guides the investment decisions of project developers, inadequate protection of the rights of private parties is an investment risk that will deter project developers from actively pursuing CDM opportunities. This, in turn, will hinder achievement of the environmental objectives of the global climate change regime. Delays and other systemic flaws of the CDM are also punishing project developers in developing countries disproportionately since they are carrying the financial and project risks in most cases.

We therefore argue that the CDM must apply commonly accepted principles of administrative law and due process to guarantee fundamental fairness, justice, and respect for property rights. Based on a review of the performance of the Board as well as normative theory, it is clear that the CDM governance regime can bolster public confidence in their decision-making only if they adopt basic administrative law procedures.

A *The CDM Executive Board*

While international bodies normally do not have the authority to take administrative or legal decisions that directly affect non-state actors, the Executive Board is an exception in this regard. The COP/MOP nominates the members of the Executive Board, which comprises 10 members and 10 alternate members appointed by the various regional groups of parties to the *Kyoto Protocol*.[76] While the COP/MOP is the ultimate authority of the CDM, the

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74 Richard B Stewart, 'US Administrative Law: A Model for Global Administrative Law?' (2005) 68 *Law and Contemporary Problems* 63, 91 (fn 11).

75 IETA, *Strengthening the CDM*, above n 73, 5.

76 The COP/MOP is an assembly of all the states parties to the *Kyoto Protocol*, which convenes annually and is the governing body of the *Kyoto Protocol*. The mandate of the COP/MOP is broadly drafted. The *Kyoto Protocol*, above n 6, art 13(4), states that the COP/MOP 'shall keep under regular review the implementation of this Protocol and shall make, within its mandate, the decisions necessary to promote its effective implementation'.

Executive Board carries out the day-to-day supervisory work.[77] The Executive Board 'shall … be fully accountable to the COP/MOP'.[78] Such language suggests that the Board is a regulatory authority to which rule-making, adjudicatory and decision-making powers have been delegated by the COP/MOP. The Board performs a mix of legislative and administrative functions and therefore its characterisation as akin to a regulatory agency is not far-fetched.[79] In its daily operations, the Executive Board clarifies and interprets the decisions of the COP/MOP. The Board takes decisions on methodologies and projects, mandates reviews and revisions to project applications. It is assisted in this task by various expert panels. However, the recommendations of these panels are not binding and increasingly, the Board's decisions do diverge from the recommendations of these panels.[80] The Executive Board is mandated to approve baseline and monitoring methodologies, review provisions with regard to simplified procedures for small scale projects, and accredit DOEs.[81] The Board also interprets the decisions of the COP/MOP and prepares technical and decision papers for review and adoption by the COP/MOP.[82] In the process of interpreting the *Kyoto Protocol* and the COP/MOP decisions, the Executive Board effectively engages in subsidiary law-making and adjudication. While the decisions of the Board are not legally binding in a formal sense, they have been accepted as de facto binding by entities that participate in the CDM, including both parties to the protocol as well as public and private sector legal entities. The COP/MOP responds to requests of the Executive Board and provides guidance on its operations.[83] The COP/MOP decides on the broader policy issues and on the strategic development of the CDM. It is the Executive Board, however, which implements these policy directives at the project level.

B *Good Governance and the Executive Board*

There has been growing unhappiness with a number of the Executive Board's rulings and its way of conducting business. Market actors generally appreciate the hard work by the individuals serving on the Executive Board, but there are mounting complaints about the continued lack of transparency and predictability

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77 Ibid art 12(4): 'The clean development mechanism shall be subject to the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to this Protocol and be supervised by an executive board of the clean development mechanism'. The role and the scope of the COP/MOP's powers are set out in COP/MOP, *Decision 3/CMP.1*, above n 52, 7–8.

78 COP/MOP, *Decision 3/CMP.1*, above n 52, 8.

79 IETA, *Strengthening the CDM*, above n 73, 11–14.

80 The divergence from recommendations in approving methodologies made by the Executive Board's Methodologies Panel ('Meth Panel') is an example of such divergence. An example is the pending issue of the double-counting of emission reductions generated by the use of biofuels. The Meth Panel has developed several proposals to address this issue, the last being rejected at the 30th session of the Executive Board from 21–3 March 2007. This renewed rejection of potential solutions to the double-counting problem is likely to lead to indefinite delay in approval of such methodologies. See UNFCCC, *Executive Board of the Clean Development Mechanism Thirtieth Meeting* (UNFCCC Report No CDM-EB-30, 23 March 2007) [20c].

81 See COP/MOP, *Decision 3/CMP.1*, above n 52, 8.

82 Ibid.

83 Pursuant to ibid 7–8.

in the Board's decision-making.[84] The CDM governance structure provides evidence of the increased delegation of authority under treaties to constituted bodies and subordinated panels.[85] This delegation is, however, not accompanied by a procedural framework that would support the implementation of the mechanism. The CDM does not provide entities affected by decisions of the Executive Board with procedural rights comparable to those of domestic administrative law regimes. Such entities have only recourse to the remedies provided by the modalities and procedures of the CDM.

The need to provide administrative due process requirements has been recognised by the *UNFCCC* negotiators and is reflected in the *Marrakesh Accords* and in other decisions of the COP/MOP. The CDM procedures provide for the independence of the Executive Board,[86] for open sessions and participation in CDM Executive Board meetings,[87] and the rules of procedure for the Executive Board including participation in requests for review of DOE decisions initiated by the Executive Board.[88] However, the procedures do not foresee any formal right of review of any decisions by the Board itself. Neither do they establish formal rights to hearings, timelines or the obligation of the Executive Board to substantiate its decisions.

While the importance of participation and transparency in the CDM project cycle is clearly recognised, it is questionable whether the same degree of transparency applies to the work of the Executive Board. To enable interested parties to follow the deliberations of the Board, its meetings 'shall be open to attendance, as observers, by all Parties and by all *UNFCCC* accredited observers and stakeholders, except where otherwise decided by the Executive Board'.[89] The objective of transparency is to be weighed against the need for efficiency and the need to keep certain information confidential. This is expressed in rule 14 of the *Rules and Procedures* adopted by the Executive Board,[90] which authorises the chair of the Board to make decisions regarding the opening and closing of Executive Board meetings without giving reasons. In addition, the

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84 IETA, *Position Paper on COP12 COP/MOP 2*, above n 73; IETA, *Strengthening the CDM*, above n 73; Letter from Andrei Marcu, above n 73; Center for Clean Air Policy, above n 73.

85 See also Benedict Kingsbury, 'The Administrative Law Frontier in Global Governance' (2005) *American Society of International Law: Proceedings of the 99th Annual Meeting* 143; Meijer, above n 72, 925.

86 COP/MOP, *Decision 3/CMP.1*, above n 52, 9–10.

87 Ibid 10.

88 Ibid 8–9.

89 Ibid 10.

90 The Board has further complied with its mandate and has proposed its *Initial Rules and Procedures*: UNFCCC, *First Report of the Executive Board of the Clean Development Mechanism (2001–2002)*, UN Doc FCCC/CP/2002/3 (24 October 2002) ('*Initial Rules and Procedures*'). These have been adopted by the eighth session of the COP: COP, UNFCCC, *Report of the Conference of the Parties on Its Eighth Session, Held at New Delhi from 23 October to 1 November 2002, Addendum — Part Two: Action Taken by the Conference of the Parties at Its Eighth Session*, UN Doc FCCC/CP/2002/7/Add.3 (28 March 2003) 6–18 (*Decision 21/CP.8 — Guidance to the Executive Board of the Clean Development Mechanism*). A more recent version of the rules was adopted by the first session of the COP/MOP, see COP/MOP, UNFCCC, *Report of the Conference of the Parties serving as the Meeting of the Parties to the* Kyoto Protocol *on Its First Session, Held at Montreal from 28 November to 10 December 2005*, UN Doc FCCC/KP/CMP/2005/8/Add.1 (30 March 2006) 31 (*Decision 4/CMP.1 — Guidance Relating to the Clean Development Mechanism*) ('*Rules and Procedures*').

Board may decide, 'in the interest of economy and efficiency, to limit attendance at its meetings to members, alternate members and secretariat support staff'.[91] The public is allowed to attend neither the meetings of the expert panels nor the meetings of the Working Groups.[92]

In practice, there is a clear tendency to limit attendance to Executive Board meetings and to conduct closed sessions. Little comfort is availed by the assurance that where the public remains excluded:

> the Executive Board shall take all practicable steps to accommodate in other ways the interests of Parties, non-Parties to the Kyoto Protocol that are Parties to the Convention and accredited UNFCCC observers and stakeholders to observe its proceedings, except when the Executive Board decides to close all or a portion of a meeting.[93]

As a result of this practice, even those very entities that are directly affected by the decisions of the Executive Board do not have access to the Board meetings. In addition, there is little opportunity for direct interaction between stakeholders and the Executive Board and its bodies — for example, between the Meth Panel and project participants — that could improve the transparency of the process for those directly affected.

C *Proposals for Reform*

Basic administrative procedures form part of good governance and foster the legitimacy of international rule-making. Private entities that are directly affected by decisions taken by an international body are much more likely to accept such decisions if they feel that the procedures were fair and due process was provided. We argue, therefore, that adopting administrative rules and procedures will add legitimacy and transparency to the Executive Board's decision-making process. The adoption of administrative rules should go along with the establishment of a review mechanism that provides aggrieved entities access to an independent tribunal. Finally, and as a consequence of the above, the Executive Board should be professionalised so that it can effectively carry out its de facto role as regulator of the CDM market.

1 *Adoption of Due Process Rules*

Currently, there are only a few formalised provisions governing the interaction between project proponents, the Executive Board and its panels. The uncertainty surrounding communications, hearings and time lines often makes the processes cumbersome and opaque. From the perspective of project participants, communication between them and the Executive Board is insufficient and circuitous. Communication becomes unsatisfying, redundant and ineffective, when new queries are brought up in each round of review of a project and it is not clear how many of such review cycles may take place. As a result, there is an undefined period of legal and planning uncertainty during

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91 COP/MOP, *Rules and Procedures*, above n 90, r 27(2).

92 The newly established 'Review and Issuance Team' has been created without any clear legal basis and, although it is highly influential, there is no international process of selecting and appraising its members, nor are the meetings of the team open to the public.

93 COP/MOP, *Rules and Procedures*, above n 90, r 27(2).

which project participants have to retain resources to answer an undefined and unlimited number of new questions, and have no indication on whether they can proceed to develop the corresponding CDM project activities.

We therefore recommend the adoption of administrative due process rules governing communication amongst the various CDM actors. The adoption of due process requirements would apply to any activities related to: first, the accreditation and withdrawal of accreditation of DOEs; second, the approval and review of baseline and monitoring methodologies; third, the registration, or refusal to do so, of CDM projects; and fourth, the issuance, or refusal of issuance, of CERs. The objective of such rules would be that any person (DOE or project participant) with a direct and material interest in any of the abovementioned processes would have a right to participate by expressing an opinion and its reasons, having that position considered, and having the right to appeal (see below). The administrative requirements have to go beyond the existing guidelines governing the internal proceedings of the Executive Board and establish rights for affected third parties, thereby promoting equity and fairness.

2 *Establishment of a Review Mechanism*

The establishment of a review mechanism is a crucial aspect of meeting due process requirements.[94] In order to be deemed fair, an administrative procedure must grant entities affected by the decisions of a regulatory body access to a full and fair review of the decision in question. Under the current CDM regime, affected project participants are afforded no opportunity for the review of the Board's decisions. While the facilitative branch of the Compliance Committee established under art 18 of the *Kyoto Protocol* affords 'advice and facilitation' to parties in noncompliance or dispute, there is no comparable body to hear grievances from DOEs or private sector CDM project participants. Affected private entities also lack direct access to the COP/MOP and can only make themselves heard through their governments. As a result, private entities that view themselves as directly affected by the decisions of an administrative body have no access to a court or independent tribunal that reviews these decisions.[95]

These shortcomings increase the likelihood of disputes between private (and public) entities and international bodies such as the COP/MOP or the Executive Board. Such disputes could be based on claims, for example, that the Board's determinations are ultra vires or that nonadherence to the Board's operational procedures has resulted in a violation of procedural rights under the CDM. Such rights include the right to open Executive Board meetings as well as access to information and hearings according to the CDM Procedures and Modalities.[96] The *Kyoto Protocol* does not extend immunities to the Executive Board or its members, exposing the Board to the risk of being held accountable in domestic

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94 See Moritz von Unger and Charlotte Streck, 'An Appellate Body for the Clean Development Mechanism: A Due Process Requirement' (2009) 1 *Carbon and Climate Law Review* 9.

95 Meijer, above n 72, 925.

96 See, eg, COP/MOP, *Decision 3/CMP.1*, above n 52, 10–11.

courts.[97] While the UN General Assembly could designate Executive Board members as 'Experts on Mission' under the *Convention on the Privileges and Immunities of the United Nations*,[98] such designation would have to be accompanied by a scheme that affords the affected party an effective remedy.[99]

Immunity from proceedings in national courts does not mean exemption from accountability and, in the absence of an international dispute settlement mechanism, national courts may hear claims filed by private entities. Generally, the conduct of organs, officials, or agents of an international body is deemed to be an act of that body under international law if the organ, official or agent was acting in its official capacity, even if that conduct exceeds the authority granted or contravenes instructions given.[100] Provided that an expert serving on a constituted body of the *Kyoto Protocol* was acting in the performance of its official capacity, the body will be liable for its acts. In the absence of a review mechanism and other basic procedural rights, however, claimants may seek compensation for damage suffered from actions of the body or its members. This increases the risk that an Executive Board member could be held personally liable for his/her activities on the Board.[101] Whether such suits would eventually be dismissed would depend on the substantive law of the state party concerned.

The protection of the UN, its officials, and Experts on Mission from claims before national courts is complemented by an obligation on the UN to provide an appropriate dispute settlement and appeal mechanism. In most cases, such mechanism is provided through arbitration. Arbitration is also a possible option to give private entities access to review and dispute settlement. With respect to disputes with a private law character, which are not based on commercial agreements and where no other dispute settlement mechanisms is provided for, it is common practice for the UN to enter into separate arbitration agreements.[102] DOEs and entities participating in CDM projects could therefore enter into arbitration agreements with the *UNFCCC* Secretariat which would establish an arbitration mechanism available for both parties in the event of a dispute. Whether such arrangements would be adequate and feasible is questionable. The CDM-related disputes are likely to be more akin to disputes brought before administrative courts than to contractual disputes frequently dealt with in arbitration proceedings. Arbitration proceedings also tend to be expensive and time consuming. Smaller entities and those from developing countries would be

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97 Subsidiary Body for Implementation, UNFCCC, *Privileges and Immunities for Individuals Serving on Constituted Bodies Established under the Kyoto Protocol*, 25th sess, UN Doc FCCC/SBI/2006/21 (4 October 2006) (*Note by the Secretariat*); COP/MOP, *Privileges and Immunities*, above n 10. The issue of privileges and immunities remains on the agenda of the climate negotiations and is expected to be addressed at the latest in the context of a post-2012 climate agreement.

98 Opened for signature 13 February 1946, 1 UNTS 15 (entered into force 17 September 1946).

99 See Anthony Miller, 'United Nations Experts on Missions and Their Privileges and Immunities' (2007) 4 *International Organizations Law Review* 11, 39.

100 International Law Association ('ILA'), *Accountability of International Organisations: Final Report* (ILA Report of the Berlin Conference, 2004) 28.

101 For a list of threatened action against the Executive Board and its members, see COP/MOP, *Privileges and Immunities*, above n 10.

102 See *Convention on the Privileges and Immunities of the United Nations*, above n 98, art VIII, s 29, for procedures in place for the settlement of disputes.

at a disadvantage since they are less likely to be able to engage in the costly process of taking the Executive Board to arbitration. This means that while one may consider using arbitration agreements as the last and final step in a review procedure, an initial process of review would establish a far more efficient process in affording recourse to entities affected by decisions of the Executive Board.

Meijer argues that national courts are a suitable forum for addressing the lack of accountability at the international level.[103] There is, however, the risk that the review of CDM procedures by national courts would jeopardise the coherence of the mechanism. The CDM is unlikely to survive as a global mechanism if it were subject to litigation in various jurisdictions and, consequently, differing judicial interpretations of the rights and obligations under the *Kyoto Protocol*. We therefore argue that the best way to enable affected non-state entities access to a review mechanism is the establishment of an appeals mechanism to deal with their frustrated expectations.

An appeal mechanism must be a satisfactory alternative to domestic litigation for aggrieved parties. We suggest the following basic design for the CDM appeal mechanism: first, investigations by the CDM appeal mechanism should only be triggered upon the receipt of a complaint and after an initial review of the facts show that there is, prima facie, a case to answer. The right to submit a complaint should be governed by the administrative requirements adopted by the COP/MOP. This is in line with the dispute settlement function of the CDM appeal mechanism. Second, the appeal mechanism should be empowered to issue binding decisions. Aggrieved parties, such as private sector project developers whose investments are at stake, want efficient, fair and effective settlement of any disputes. If the appeal mechanism is unable to render binding decisions, its ability to conclusively resolve disputes and make remedial orders will be significantly hampered. Third, the appeal mechanism should be given powers of investigation, including the ability to call for hearings, view all relevant files and other documentation, to interview staff members and to require them to give evidence, and the ability to conduct special inquiries if required. The investigation process should not be allowed to take too long, and therefore strict adherence to deadlines should be mandated. The Executive Board should be consulted and the aggrieved parties given the opportunity to be heard or to make written submissions. The aggrieved party should be informed of all steps taken during the investigation process so that the process is not perceived to be out of its hands and that, once again, it is the victim of opaque and exclusive decision-making. Fourth, persons who serve on the appeal mechanism should be experts in the appropriate fields, with qualifications elaborated by the COP/MOP, in order to preserve the independence of the appeal mechanism. As is the case with the members of the Executive Board, individuals who serve on the appeal mechanism should not be former or existing staff of the CDM regulatory regime and should not be allowed to take up employment therein for a period of time after the end of their term.

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[103] Meijer, above n 72. Meijer argues that the review of administrative CDM decisions by national courts should be possible. Assuming that the Executive Board would be protected by judicial immunity, she proposes a lifting of such immunity for any decisions of administrative nature.

3 *Professionalising the Executive Board*

A result of the CDM originating in international environmental treaty law is that the current Executive Board has been established as a UN committee, rather than as a professional regulatory authority overseeing the carbon market. It is revealing that the Board's role and powers as set out in Part C of the Appendix to the agreed 'Modalities and Procedures for a Clean Development Mechanism' does not include any regulatory objectives or principles.[104] Individuals serving on the Board are mostly officials from national environmental ministries or authorities. They often perform dual roles of being a member of the Executive Board as well as a *UNFCCC* focal point and climate negotiator. This leads to a complex set of interests and objectives which do not always favour the efficient and effective implementation of the CDM. These conflicting interests add to the fact that members of the Board are often insufficiently qualified to assess the technical details or methologies of CDM projects and are unfamiliar with the operation of markets and international trading.

Nonetheless, whatever its role was originally intended to be, the CDM Executive Board today is in the position of a de facto market regulator. In order for the *Kyoto Protocol* to succeed, the CDM Executive Board must rise to the occasion and fulfil this role and a first step in this direction is to professionalise. Presently, most of the Board's members have a background in international environmental negotiations, not in market regulatory work (for example, work experience in financial regulatory authorities). As a result, the Board's considerations tend to be oriented towards issues raised during international negotiations rather than to the sort of issues related to the creation and maintenance of an efficient international market.

Professionalising the Executive Board would require recruiting full-time salaried individuals whose collective experience spans the entire range of sectors (including project finance, law, business management and science) and is grounded in practical, project level experience and knowledge of the CDM. Technical expertise should therefore be the governing criterion for selecting the Board's members.

D *CDM Governance: The Road Ahead*

In 2007, at the 13th session of the COP held in Bali, environmental ministers adopted the *Bali Action Plan*. This includes a roadmap, which charts the course of a negotiating process to be concluded by 2009 that will ultimately lead to a post-2012 international agreement on climate change.[105] The various decisions adopted by the conference and interventions made by state parties indicate that it is very likely that any future climate treaty will rely on the carbon market to mobilise a significant part of the financial resources needed to de-carbonise the world's economies. While recourse to economic instruments was still a contested notion in Kyoto, the reliance on market instruments has been an unquestioned

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104 COP/MOP, *Decision 3/CMP.1*, above n 52, 25–6.

105 COP, UNFCCC, *Report of the Conference of the Parties on Its Thirteenth Session, Held in Bali from 3 to 15 December 2007, Addendum — Part Two: Action Taken by the Conference of the Parties at Its Thirteenth Session*, UN Doc FCCC/CP/2007/6/Add.1 (14 March 2008) 3–7 (*Decision 1/CP.13 — Bali Action Plan*) ('*Bali Action Plan*').

assumption in the discussions on a post-2012 climate agreement. Negotiators may have been surprised by the success of the flexible mechanisms, the CDM in particular, and they may not understand the dynamics of the carbon market, but they have embraced the power of the market to mobilise finance and the possibility of harnessing this power for environmental goals.

Without explicitly referring to the need to improve protection of private sector rights, but with the objective of enhancing the effectiveness of the *Kyoto Protocol* mechanisms in mind, the 13th session of COP ('COP-13') and the third session of COP/MOP ('COP/MOP-3')[106] issued a call for submissions proposing ways to enhance the effectiveness of the mechanisms.[107] In its reaction to the annual report of the Executive Board, the Swiss delegation to COP/MOP-3 stated explicitly:

> Switzerland has some concerns about the governance of the CDM and in particular the way the Executive Board and the technical panels are working: there are not enough personnel and their work is therefore too slow for the quantity of projects that are in the pipeline and those coming; it is therefore imperative to professionalize them.[108]

Since this Swiss intervention in 2007, various submissions to the *UNFCCC* have stressed the need to improve the functioning and governing of the CDM.[109] Some parties have suggested greater delegation of decision-making from the Executive Board to the *UNFCCC* Secretariat and/or panels established under the Board. This would allow the Board to focus on strategic and policy issues and move away from case by case decision-making that is highly technical in nature.[110] The introduction of an appeals process for the CDM is also on the discussion agenda.[111] The design of the appeals mechanism depends on whether the option of the delegation of decision-making powers is taken up. It has been suggested that the Executive Board itself could hear appeals if decision-making were delegated to the Secretariat and panels.[112] However, as argued above, an appeals mechanism separate from the Executive Board would be preferable in terms of transparency, accountability, and the avoidance of conflicts of interest. Discussions on strengthening CDM performance and reforming its scope and structure stood high on the agenda at the COP/MOP-4 held in Poznan in

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106 Sessions of COP and COP/MOP will hereafter be referred to as COP-<session number> and COP/MOP-<session number> respectively.

107 COP/MOP, UNFCCC, *Report of the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol on Its Third Session, Held in Bali from 3 to 15 December 2007, Part Two, Addendum 1 — Decisions Adopted by the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol*, UN Doc FCCC/KP/CMP/2007/9/Add.1 (14 March 2008) 19 (*Decision 4/CMP.3 — Scope and Content of the Second Review of the Kyoto Protocol pursuant to Its Article 9*).

108 For the Swiss position, see UNFCCC, *Annual Report of the Executive Board of the Clean Development Mechanism to the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol*, UN Doc FCCC/KP/CMP/2007/3 (*Note by the Secretariat*) (on file with the authors).

109 COP/MOP, UNFCCC, *Compilation and Analysis of Available Information on the Scope, Effectiveness and Functioning of the Flexibility Mechanisms under the Kyoto Protocol*, 4th sess, Agenda Item 13, UN Doc FCCC/KP/CMP/2008/INF.3 (16 October 2008) (*Note by the Secretariat*).

110 Ibid 4–5: 'Section II(A): Delegation of Technical Decision Making'.

111 Ibid 6: 'Section II(D): Process for Appeals'.

112 Ibid.

December 2008, but expectations were frustrated as it became clear that little would be decided. However, despite the slow progress in reforming the CDM, it cannot be overlooked that the eight years of experience in implementing the CDM have created a robust body of experience and learning. Whether this learning will be translated into equally robust reforms remains to be seen. But the lessons learned from the CDM are relevant beyond the mechanism itself. Today, carbon trading is discussed as one of the preferred financial mechanisms to scale emissions reduction in developing countries beyond the project by project approach of the CDM. Carbon trading is also seen as an element of broader schemes that target whole sectors of developing country economies. It is the forestry sector, which was almost completely left out of the CDM, where negotiations on a post-2012 arrangement are comparatively advanced and where there has been much attention paid to creating positive incentives to reduce emissions from deforestation and forest degradation.

V REDUCING EMISSIONS FROM DEFORESTATION AND FOREST DEGRADATION

Until now, discussions conducted in the context of the post-*Kyoto* negotiation tracks have involved little talk of concrete action.[113] There is, however, a notable exception: the discussions on addressing GHG emissions from further deforestation and degradation of tropical forests. Most of the proposals for defining a REDD mechanism currently under consideration foresee, among others, the mobilisation of funding via international carbon markets. To the extent that these markets are to include private sector investments, we argue that lessons on the conditions for private sector involvement can be drawn from the CDM experience.

Governments and private entities have complementary roles when it comes to carbon markets. Governments have to establish policies and provide finance where markets do not reach. They have the capacity to support enhanced risks and transaction costs; that is, to play a critical role in building and pilot testing various policies and programs. Once suitable investment conditions are created, the participation of private sector entities can deepen and broaden financing capacity for REDD activities and catalyse the involvement and empowerment of people at local level. Strong governance and risk mitigation are critical to creating a sound investment environment. Host countries and international institutions have to work alongside each other to establish and manage a robust market infrastructure, ensure the environmental and socioeconomic integrity of market-based REDD activities and minimise undue transaction costs for developers and investors.[114]

A lesson that can be drawn from current market conditions relating to the CDM is that carbon markets depend on strong institutions. Where national

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113 Discussion on the future of the climate regime is divided into three tracks, two of which are under the auspices of the *Kyoto Protocol* and look at future Annex I emissions reduction and limitation commitments and the overall effectiveness of the Protocol: *Kyoto Protocol*, above n 6, arts 3(9), 9. These tracks exclude those countries that have not ratified the Protocol, most notably the US. The two *Kyoto* tracks are, however, complemented by another negotiation track organised under the *UNFCCC* and that considers long term cooperative action to address climate change.

114 ICF International, *Fostering Carbon Markets Investment in REDD: Final Report* (ICF International Report, February 2009).

governance is weak, international regulators may step in to remove some of the perceived or actual host country risk. Regulation by international bodies can be perceived as less risky and thus encourage participation by the private sector, as long as their due process and good governance measures are better than those of countries with poor governance indicators. Experience with the CDM should inform the development of better accountability and due process features for the REDD mechanism to address private sector concerns and interests so as to create a more favourable investment environment to attract private capital towards reducing deforestation and forest degradation.

A *Avoiding Further Emissions from Deforestation and Degradation*

Tropical deforestation is a major contributor to global climate change. On a worldwide scale, gross deforestation amounts to about 12.3 million hectares per year[115] and accounts for up to 25 per cent of total human-caused GHG emissions each year.[116] In many developing countries, such as Indonesia and Brazil, deforestation is the single largest source of GHG emissions. Effectively reducing deforestation is therefore a strategic issue on the climate change and development agendas of the post-2012 period.[117] At COP-11, Papua New Guinea and Costa Rica had put forward a proposal to consider whether and how incentives to reduce tropical deforestation could be included in the future climate regime under the *UNFCCC* or the *Kyoto Protocol*.[118] The proposal initiated a two year examination process, facilitated by the *UNFCCC*, and has attracted very active participation by the stakeholders concerned. It has also mobilised discussions amongst negotiators on how an international mechanism that would trigger reductions of emissions from deforestation and forest degradation could be shaped.

After two years of discussions and technical workshops, COP-13 adopted two very important decisions in relation to forests. First, REDD was included in the *Bali Action Plan* that sets out a two-year timeline for negotiating a post-*Kyoto* agreement.[119] Second, a separate decision on REDD was adopted that includes guidance on implementing REDD 'demonstration activities' that can be both national and sub-national in scale.[120] The REDD decision leaves open the

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115 Food and Agriculture Organization of the United Nations, *Global Forest Resources Assessment 2005: Progress towards Sustainable Forest Management* (FAO Forestry Paper No 147**,** 2005).

116 These figures use 1990 as the baseline and take into account emissions of carbon dioxide, methane, nitrous oxide, and other chemically reactive gases that result from deforestation and subsequent uses of the land. See Richard A Houghton, 'Tropical Deforestation as a Source of Greenhouse Gas Emissions' in Paulo Moutinho and Stephan Schwartzman (eds), *Tropical Deforestation and Climate Change* (2005) 13–23.

117 IPCC, *Fourth Assessment Report, Climate Change 2007*, available from <http://www.ipcc.ch>.

118 COP, UNFCCC, *Reducing Emissions from Deforestation in Developing Countries: Approaches to Stimulate Action*, 11th sess, Agenda Item 6, UN Doc FCCC/CP/2005/Misc.1 (11 November 2005) (*Submissions from Parties*).

119 COP, *Bali Action Plan*, above n 105, 3.

120 COP, UNFCCC, *Report of the Conference of the Parties on Its Thirteenth Session, Held in Bali from 3 to 15 December 2007, Addendum — Part Two: Action Taken by the Conference of the Parties at Its Thirteenth Session*, UN Doc FCCC/CP/2007/6/Add.1 (14 March 2008) 8–11 (*Decision 2/CP.13 — Reducing Emissions from Deforestation in Developing Countries: Approaches to Stimulate Action*).

possibility that the results of these demonstration activities may be recognised and rewarded in the future treaty. While the final incentive mechanism for REDD activities is still under negotiation, we will take a look at the proposals that are on the table and evaluate them in the context of their references to private sector involvement.

B *The Role of the Private Sector in REDD*

Despite the importance attached to addressing emissions from deforestation as underlined by the Bali decisions, differences remain as to when, if and how rewards for avoiding further deforestation should be integrated into a post-2012 climate regime. A number of options are being proposed, including both market and non market-based approaches. Market-based approaches would seek to create economic incentives for avoiding further deforestation. In most cases, such incentives would include the rewarding of tradable carbon credits once a country or project activity has generated a proven climate benefit by reducing GHG emissions.

Most REDD proposals are associated with baselines adopted at the national level.[121] In order to address project specific risks, such as leakage or permanence, some *UNFCCC* negotiators favour a REDD mechanism that is exclusively based on national accounting. Such a mechanism would reward emissions reduction below a pre-established national reference emissions level and would go hand-in-hand with the establishment of a national monitoring system in the REDD state. The establishment of such reference levels has profound implications for the climate effectiveness, cost efficiency and distribution of REDD finance (funds) among countries, and involves trade-offs between different interests and objectives.[122] A country would take on a national voluntary commitment to reduce its deforestation rates in the form of a reduction target vis-à-vis the national reference level. Carbon credits would be issued for any emissions reduction below the reference level. These credits could be fully or partly fungible with international carbon markets. Since the carbon accounting would happen on the national level, carbon credits would also be issued nationally. The advantage of national approaches is that they allow the recipient country to finance holistic forestry management programs that go beyond individual projects. National approaches would also account for the shifting of activities (leakage) that may reduce emissions at one site only to increase them at another. Such mechanisms, that rely on states to account for their emissions and to receive rewards for GHG reduction, reflect the traditional patterns of

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121 Marcio Santilli et al, 'Tropical Deforestation and the *Kyoto Protocol*' (2005) 71 *Climatic Change* 267; Paulo Moutinho and Márcio Santilli, Instituto de Pesquisa Ambiental da Amazônia [Amazon Institute for Environmental Research], *International Submission to the UNFCCC/SBSTA, UNFCCC/CP/2005/L/2, Reduction of GHG Emissions from Deforestation in Developing Countries* <http://unfccc.int/resource/docs/2006/smsn/ngo/007.pdf>; Environmental Defense, *Reducing Emissions from Deforestation in Developing Countries: Approaches to Stimulate Action, Submission to the XXIV Session of the SBSTA of the UNFCCC* (30 March 2006) <http://unfccc.int/resource/docs/2006/smsn/ngo/009.pdf>; Paulo Moutinho and Stephan Schwartzman (eds), *Tropical Deforestation and Climate Change* (2005).

122 See Arild Angelsen et al, *Reducing Emissions from Deforestation and Degradation: An Options Assessment Report Prepared for the Government of Norway* (Meridien Institute Report, March 2009) 13–19.

international cooperation. However, such traditional approaches alone are unlikely to create favourable conditions to attract private sector participation and therefore run counter to the objective of relying on market-based instruments and the mobilisation of private capital to address REDD.

In order to account for challenges that developing countries might face in establishing national scale systems, it has been proposed that national approaches be combined with a CDM type 'prompt start' of sub-national approaches and project activities.[123] While REDD is ultimately likely to be assessed on a national level, sub-national approaches and project level activities can be a step towards national approaches. Sub-national implementation will also occur within national approaches. For this reason, it is essential for national and sub-national approaches to be compatible. The interaction between national and sub-national approaches raises a number of issues, including risk allocation between governments and private actors and the accounting for emissions reduction on the various levels of implementation. Those who argue in favour of including project-based activities refer to the required level of resource mobilisation, which goes beyond what public funds can make available and thus the need to harness private capital. Private entities are unlikely to invest in government programs or purchase carbon credits direct from governments. Sub-national activities which allow direct investments therefore favour private sector engagement in REDD.

The majority of the proposed approaches rely in one way or another on private sector funding. Taking into account the lack of international enforcement and the weak domestic enforcement systems in most of the countries that are losing tropical forests rapidly, such capital can only be mobilised by creating incentive structures that trigger voluntary participation. Long-term protection of tropical forests will depend on the mobilisation of sufficient human and financial resources as well as the capacity of public institutions to promote efficient and sustainable forest protection and management. The Stern Review indicates that 'the opportunity cost of forest protection in eight countries responsible for 70 per cent of emissions from land use could be around USD 5 billion annually, initially, although over time marginal costs would rise'.[124] It is generally recognised that public financing has to be matched by private capital in order to achieve the required level of resource mobilisation. While increasing domestic taxes, duties and fees could raise additional funds, most of the countries involved are already presently unable to fully collect payment of timber concessions or taxes. A review of relevant data shows that donor governments and agencies show little signs of being able to contribute the required amount of funding.[125] Proponents of market-based approaches emphasise that it will be difficult to mobilise the required level of investment and induce GHG emissions reduction

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123 Lucio Pedroni et al, 'Creating Incentives for Avoiding Further Deforestation: The Nested Approach' (2009) 9 *Climate Policy* 207. The 'nested approach' was first presented by the Tropical Agricultural Research and Higher Education Center and the German Emissions Trading Association in a submission to the *UNFCCC* in February 2007 and was later proposed in a joint submission by Paraguay on behalf of Honduras, Mexico, Panama and Peru, and supported by Ecuador and Chile.

124 HM Treasury, *Stern Review: The Economics of Climate Change* (HM Treasury Report, UK, 30 October 2006) 640–73 <http://www.hm-treasury.gov.uk/sternreview_index.htm>.

125 Gonzalo Castro et al, Biodiversity Support Program, *Mapping Conservation Investments: An Assessment of Biodiversity Funding in Latin America and the Caribbean* (Biodiversity Support Program Report, October 2001).

activities at a scale that would be adequate for pursuing the ultimate objective of the *UNFCCC* without significant private sector investment. The richest and most promising source of funding comes from international carbon markets.

C *Investor Confidence: National Approaches or International Regulation?*

Private investors, communities, local governments, and other private and public entities necessarily aim to manage their investment risks and to be rewarded for their efforts. This is no less true in the case of REDD. Given the poor track record of state governance and forestry management in rainforest-rich countries,[126] potential investors will consider it too risky if they have to rely on national governments to implement forestry programs or to issue carbon credits. They are likely to then direct their capital towards less risky investment opportunities. Furthermore, while it is essential to integrate sub-national REDD activities into broader public programs, the rewarding of such sub-national activities (through the issuance of carbon credits) at the state level would burden the individual investment with the risks of broader policy failure.

An international REDD mechanism could mitigate the host country risk, by integrating a sub-national (or project) crediting scheme into a national REDD emissions accounting framework. A REDD mechanism could be modelled after JI, in the sense that a project mechanism could be embedded in a broader accounting framework. An international body to approve methodologies and projects could be made available to countries that do not yet meet the full GHG accounting requirements. Such body could be modelled after the CDM Executive Board or the JI Supervisory Committee and be tasked to ensure that the emissions reduction are real, measurable and additional.

If sub-national activities were implemented as freestanding project activities, participating REDD countries would have to appoint a national REDD authority that approves sub-national activities at the project or program level. The country would also have to adopt approval criteria that take into account national priorities and the specific legislative context.[127]

Since it is unlikely that participating REDD countries will establish and maintain GHG registries in the short-term, an international registry for the issuance of approved REDD credits would also be required. This could be structured similar to the CDM registry and managed by the *UNFCCC* Secretariat. Participating REDD countries could open national accounts in this registry and authorise non-government entities to hold sub-accounts. The REDD registry could be linked to national registries via the international transaction log. Where sub-national activities are integrated into a national framework, the country would, however, have to account for the credits that are issued for sub-national activities, and a registry system would need to be developed to track

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126 World Bank, *Strengthening Forest Law Enforcement and Governance: Addressing a Systemic Constraint to Sustainable Development* (2006), available from <http://go.worldbank.org/P5NVQ7Y0M0>; Craig Segall, 'The Forestry Crisis as a Crisis of the Rule of Law' (2006) 58 *Stanford Law Review* 1539.

127 Angelsen et al, above n 122.

these credits. These credits would then be deducted from the credits issued to the government at the end of a crediting period.[128]

Assuming that stimulating private investment in conservation projects is a desired objective, the lesson drawn from existing investment conditions of the carbon market should guide the development of a REDD mechanism. Generally, the greater the control that governments have over the raising or spending of funds and the weaker the governance indicators of the relevant countries, the lesser will be the flow of private investment. This means that any efforts to strengthen forestry policy and enforcement in a target country should be complemented by a bottom-up approach that rewards the efforts of local communities and local investment. In this regard, we would argue that a mechanism that relies on the delegation of power and control to an international review mechanism should be created to administer the REDD mechanism when it emerges.

In sum, carbon market participants, like any other investors, weigh risks against calculated returns when deciding on an investment. In a market that trades in intangible property rights that are created by an international accord, such as CERs or emerging REDD credits, investors will also assess the predictability and reliability of any action taken by governments or international bodies in their investment analysis. Investors are likely to perceive the risk of faulty action by an international body as being lower than the equivalent risk relating to national governments of countries that have poor governance indicators. In order to create an effective REDD mechanism under such conditions, parties would have to contemplate the delegation of power to an international administrator because regulation by international bodies, provided they perform better on the due process and good governance scorecards than the countries with poor governance indicators, is perceived as less risky and therefore more likely to encourage participation by the private sector in the future REDD mechanism. Further, as discussed earlier in relation to the reform of CDM governance, the delegation of power from the state to the international level to supervise the REDD mechanism should take into account the need to provide for due process in order to adequately address the expectations of project participants.

VI CONCLUSION

This article has sought to fill an existing gap in the literature on the role of private sector actors in the climate change regime, particularly as the subject of regulation by international law. Drawing on the implementation experience of the CDM, we argued that the state-centric nature of international law has proven an obstacle in designing rules and institutions that provide sufficient protection of the rights and interests of private non-state participants in the *Kyoto Protocol*

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128 Ibid. The risk that more credits are issued to sub-national activities than eventually to the government (in the case where sub-national activities were successfully implemented but the country as a whole did not reduce deforestation), could be addressed by: first, establishing a national reserve buffer, which receives a percentage of credits issued for sub-national activities and is managed by the government; second, compensation for the issuance of credits for sub-national activities from the national reserve buffer; and third, in the case where insufficient credits accumulated in the buffer, compensate for the remaining credits issued by over compliance in subsequent compliance periods.

mechanisms. At the same time, the delegation of supervision and governance of the CDM to a supranational authority without a supporting framework to guarantee due process and fairness has created a governance gap which threatens the legitimacy of international decision-making, which in turn threatens to deter project developers from participating in the CDM. Given such adverse implications, we have argued that the CDM governance structure requires reform and have proposed the adoption of administrative law like processes by the CDM Executive Board in its decision-making.

The examination of the emerging REDD mechanism also showed the predominance of state-centric thinking and assumptions, such as state control of REDD resources. Given the amount of private capital that could be generated by REDD activities and directed towards sustainable forestry management, negotiators should focus on creating incentives for private sector voluntary participation in the REDD mechanism. While the *Kyoto Protocol* and any post-2012 climate change international treaty will be one concluded amongst states and therefore governing the rights and obligations of states, the *Kyoto Protocol* has sought and promoted the involvement of private actors in its GHG mitigation regime. The post-2012 climate change regime is likely to do the same. Private actors have responded positively, resulting in the rather unexpected success of the CDM. However, in order to continue to attract private sector participation in the carbon market created by the *Kyoto Protocol*, private sector concerns and interests must be better addressed. This may require some creativity in our conceptualisation of the roles of different players in global environmental governance, and the role of states and non-state actors in international law generally.