

CARICOM SUBMISSION

SBSTA Agenda – Articles 6.2 and 6.4 October 2016

Guidance referred to in Article 6.2 of the Paris Agreement Rules, modalities and procedures under Article 6.4

Saint Lucia is pleased to make the following submission on behalf of the Caribbean Community (CARICOM), comprised of Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, Saint Lucia, St Vincent and Grenadines, Suriname, and Trinidad and Tobago, responding to the invitation by SBSTA for the submission of views on **guidance referred to in Article 6.2** of the Paris Agreement (FCCC/SBSTA/2016/2, para 96) and views on **rules, modalities and procedures referred to in Article 6.4** of the Agreement (FCCC/SBSTA/2016/2, para. 100).

1. Article 6: centralized oversight; multilaterally-agreed rules

CARICOM is of the view, repeatedly expressed by AOSIS on behalf of all SIDS,¹ that it would undermine the credibility and environmental integrity of the climate change regime to endorse a fragmented and decentralized approach to the establishment of internationally-recognized offset units. This would raise unsolvable issues and concerns regarding environmental integrity, additionality, transparency, accountability, measurability and verifiability, among others.

An overarching system, with **centralized oversight and robust, multilaterally-agreed rules**, is needed to build trust and confidence among Parties, and build trust in the private and public sectors, in the quality of any internationally transferred mitigation outcomes (ITMOs) generated and transferred for use toward NDCs and in crediting systems administered under the Paris Agreement. To this end, a coherent set of rules is needed across Article 6, to ensure that all elements of Article 6 are complementary, consistent and mutually-reinforcing, rather than in competition.

These rules should provide **incentives** to move developing countries toward quantified economy-wide absolute emission reduction targets over time, enabling developing countries to join developed countries in this respect through successive NDCs that are progressively more ambitious in depth and scope. Equally, these rules must avoid the creation of perverse incentives for Parties to avoid necessary domestic emission reductions in reliance on the availability of ITMOs, or perverse incentives for Parties to shield categories of emissions or removals from inclusion in their future NDCs for use as a supply of international offsets.

Most importantly though, Article 6 presents an opportunity to go beyond what the Kyoto Protocol's flexible mechanisms sought to achieve. **Article 6 can and should be operationalized in a manner designed specifically to move beyond offsetting, delivering net global emission reductions beyond the level of mitigation ambition presented in Parties' NDCs.** In this way, Article 6 will add credibility and value at the international level to the emissions trading systems and crediting systems that are already in place and in

¹ See, e.g., Submission of Nauru on behalf of the Alliance of Small Island States, Various approaches, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries, FCCC/SBSTA/2013/MISC.11 at 32.

development at the domestic and regional levels.

2. Role of Article 6: delivering mitigation ambition beyond Parties' stated NDCs and beyond offsetting

All Parties to the Paris Agreement have agreed to pursue a 1.5°C limit in global average surface temperature increase above pre-industrial levels. However, ***Parties' aggregate NDCs are not yet consistent with 1.5°C pathways***. More mitigation ambition will be needed, beyond the ambition of the NDCs that have been expressed to date, in order to achieve the necessary phasing out of carbon emissions.

In this context, Article 6 needs to be operationalized in a manner that ***facilitates and rewards cooperation*** between Parties, ***and operates to incentivize and deliver mitigation ambition beyond Parties' stated NDCs***. The delivery of an overall mitigation in global emissions is an explicit aim of the mechanism established under Article 6.4, but it should also be an aim of approaches under Article 6.2. The credibility and utility of market mechanisms at the international level under the UNFCCC umbrella will be enhanced through Article 6 design choices that provide both the opportunity and incentive to investing Parties and host or transferor Parties to drive reductions beyond the ambition of stated NDCs.

The rule set for Article 6 approaches can be designed to deliver emission reductions that go beyond offsetting and stated NDCs **through cancellation and discounting** in the context of transfers in capped environments (e.g., between Parties with economy-wide absolute NDC targets),² and emission reductions beyond offsetting can also be achieved **through conservative baselines and/or shortened crediting periods** in the context of activities hosted by developing countries outside the scope of their NDCs. **In this way, Article 6 will contribute to the multiple goals of the Agreement.**

Article 6 units that are presented as "offsets" toward achievement of Parties' NDCs will then in fact represent greater value, and draw investment, having driven reductions beyond the face value of Parties' NDCs.

For example, where ITMOs are transferred between two countries with economy-wide NDCs that effectively cap emissions, cancellation of a share of these ITMOs or units representing verified emission reductions upon transfer (e.g., 20%), results in an overall mitigation in global emissions by driving Parties to engage in or acquire additional emission reductions beyond the sum of their aggregated NDCs to meet their NDCs. Similarly, a fixed discount rate for ITMOs when used toward NDCs (e.g., requiring 5 tonnes of transferred reductions to be tendered to cover 4 tonnes of domestic emissions) can also result in overall global mitigation, by driving additional emission reductions beyond the sum of Parties' NDCs. In this way, the accounting system for ITMOs can drive additional reductions, beyond offsetting, achieving reductions that go deeper than Parties' combined NDCs.

In the context of activity-based reductions, host countries can benefit from the opportunity to set **conservative baselines** and **short crediting periods** for activities, to ensure that they **themselves benefit** from the additional domestic reductions that result from conservative baselines or occur beyond the term of crediting periods. Where these activities fall within the scope of a developing country's NDC, this **"own benefit / own contribution"** can help the

² See e.g., Lazarus, M, Erickson, P. and Schneider, L., 'Potential for International Offsets to Provide for a Net Decrease of GHG Emissions' (SEI, 2013) (explaining options to generate net global mitigation that the atmosphere sees, in a pre-Paris Agreement context).

host Party share the emission reduction benefit of the project, programme or crediting activity, by securing domestic reductions that are not lost through a “corresponding adjustment” when ITMOs or reductions are transferred.

Developing countries also may have an incentive to participate in Article 6 activities that fall outside the scope of their NDCs because, depending on the technologies involved, conservative baselines and shortened crediting periods **can result in near term and long-term domestic reductions**, despite the transfer of outcomes, which can support host countries in taking progressively more ambitious NDCs over time. Whether, where and how hosted reductions outside the scope of NDCs are balanced by corresponding adjustments requires discussion.

Just as the requirement of an overall mitigation in global emissions should be applied both the Article 6.2 and 6.4 approaches, the delivery of a **share of proceeds** is an explicit aim of Article 6.4, but should also be an aim under Article 6.2. ***In this way also, international units presented as offsets toward achievement of Parties’ NDCs will represent greater value, having also contributed to funding support for adaptation.***

The Article 6 rule set can go beyond offsetting, delivering an overall mitigation in global emissions, creating incentives and opportunities to host countries to participate, and generating a share of proceeds for adaptation.

As a result, private and public sector investors, and domestic and regional trading programmes, will benefit from access to credible, internationally-approved units or reductions that reflect a contribution to net global emission reductions and a contribution to the adaptation needs of vulnerable countries, which should earn a premium in the market.

3. Article 6 approaches

Between two or more Parties with economy-wide absolute emission reduction targets, the reference to “internationally transferred mitigation outcomes” in Articles 6.2 and 6.3 can be understood to set the parameters for a successor to **international emissions trading** under Article 17 of the Kyoto Protocol and activity-based Joint Implementation (JI) under Article 6 of the Protocol. Such an understanding would extend the opportunity to engage in international emissions trading beyond developed countries, as under the Protocol, to a broader grouping of Parties, now that many developing countries have presented economy-wide, absolute emission reductions as NDCs. Existing rules can be built upon to suit the Paris Agreement context, recognizing the improvements to environmental integrity and transparency that have been agreed already under these mechanisms for the post-2012 period, including the progress made in developing revisions to the JI Guidelines.³

If cooperative approaches are contemplated involving transfers of ITMOs between Parties with other forms or scopes of NDCs, much greater complexity would be involved and further information and rules needed to quantify, establish and verify baselines and targets, ensure environmental integrity (including additionality) and transparency, and avoid double counting. The nature and location of reductions becomes important (inside or outside NDC scope?), issues regarding the location of a corresponding adjustment arise (NDC? Inventory?), and the setting of ongoing incentives can become more complicated. It will be

³ See, e.g., FCCC/SBI/2015/L.30 (Modalities and procedures for implementation of Article 6 of the Kyoto Protocol (“joint implementation”).

important to carefully consider how the rule set for Article 6 as a whole, and its design features, can incentivize greater ambition, support Parties in moving toward economy-wide NDCs over time, and assist Parties in communicating progressively more ambitious NDCs over time.

At the same time, Article 6 should avoid unnecessary complexity by focusing at the outset on the NDC types and “specific scopes of activities” (1/CP.21, para. 37) most likely to be used in an Article 6 context, and most likely to deliver higher mitigation ambition, recognizing that this is an express goal of Article 6, and further recognizing that developing country Parties are encouraged under Article 4.4 “to move over time toward economy-wide emission reduction or limitation targets” and that Parties may adjust their NDCs at any time with a view toward enhancing its level of ambition (Art. 4.11).

Where similar cooperative approaches might be considered under Articles 6.2 and 6.4, **guidance under Article 6.2 should not be any less rigorous than the rules applied under Article 6.4.** It may be useful to consider rules, modalities and procedures for these contexts under Article 6.4 first, so that appropriate standards and requirements are set -- recognizing that many cooperative approaches will exist at the domestic and regional levels outside the UNFCCC context, but not all cooperative approaches will generate results with the rigour appropriate for transfer and use toward achievement of Parties’ NDCs at the international level under the Paris Agreement.

4. Avoidance of double counting

Accounting systems and institutions established under the Paris Agreement should address and avoid the double claiming of the same emission reduction outcomes by multiple Parties, the double issuance of units or outcomes from the same reductions, and the double selling of the same units or outcomes to multiple acquiring entities. Funding invested to acquire units or outcomes should also not be double counted as financial support to host Parties.

Measures to avoid double counting will become increasingly important with agreement on the possible use of UNFCCC and Article 6 units to address emissions from international aviation, under ICAO’s Carbon Offset and Reduction Scheme for International Aviation (CORSIA), and the addressing of HFCs under the Montreal Protocol.

5. Corresponding adjustments

Paragraph 36 of decision 1/CP.21 requests SBSTA to include in its recommended guidance under Article 6.2 guidance “to ensure that double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks covered by their [NDCs] under the Agreement.”

Where Parties intend to use ITMOs toward NDCs, both NDCs and ITMOs will have to be **quantified in tonnes of CO₂ or CO₂ equivalent** to enable corresponding adjustments, which require additions and subtractions, representing transferred mitigation outcomes.

A workable system will be needed to put single year targets and multi-year targets on a comparable footing, to avoid distortions where countries in different situations wish to use ITMOs toward their NDCs. It may not be appropriate, for example, for a country with a point year target to accumulate ITMOs generated over a sequence of years, and tender them

toward its single year target. Means will be needed to ensure comparability and consistency among Parties in different situations regarding use of ITMOs.

Similarly, where NDCs include the land sector, accounting systems will be needed to get clarity on emission levels at different points in time, over the course of a Party's NDC.

Consideration will have to be given to when and how frequently “corresponding adjustments” are to be made, as well as whether, where and how reductions are to be reflected that are outside the scope of NDCs.

6. Institutions and approaches to support Article 6

Ensuring environmental integrity under Article 6 will require the establishment of institutional oversight mechanisms at the international level to support Article 6.2, Article 6.4 and other Article 6 provisions. Many of the **institutions and systems** established under the Kyoto Protocol will be equally needed under the Paris Agreement to promote environmental integrity, ensure transparency, and avoid double counting in the context of ITMOs and emission reductions. These include:

- one set of internationally-agreed rules, applicable to all participating Parties
- international oversight under the CMA
- common accounting rules applicable to all participating Parties
- domestic and centralized registries, with unit tracking systems for holdings and transfers
- international transaction log, for conformity checks and for the suspension of transfers and use of outcomes at the international level where applicable guidance or rules are not followed
- national arrangements and systems to support robust reporting and review
- annual inventory reporting, and a consistent time series of emissions
- third party technical expert reviews
- adjustments to inventories, where needed for consistency with agreed rules
- transparent annual summary reports on registry holdings and transfers of units by Parties and the centralized registry
- information on the vintage and source of reductions
- quantified and verified baselines
- avenues for multilateral review
- a compliance system with authority to recognize and address issues relating to transparency and implementation, and apply consequences where rules and guidance have not been followed
- rules on "supplementarity", to ensure domestic emission reductions are central and use of ITMOs toward NDC achievement is only supplementary to domestic efforts
- specialized approaches to address emissions and removals in the land sector
- eligibility rules, to ensure the quality of ITMOs and their proper accounting.

7. Article 6.2 Guidance

The use of ITMOs under Article 6.2 toward NDCs is "voluntary", meaning that no country is required to engage in cooperative approaches that involve the use of ITMOs toward its NDC. However, those Parties that do wish to use ITMOs toward their NDCs will need to do so “consistent with guidance adopted by the [CMA]” (Art. 6.2), and with the authorized by participating Parties (Art. 6.3).

A condition precedent for Parties' use of internationally transferred mitigation outcomes under the Paris Agreement is therefore the adoption and application of appropriate guidance by the CMA. The scope of this guidance must address each of Article 6.2's **binding** requirements:

- Parties shall promote sustainable development, consistent with guidance adopted by the CMA (6.2)
- Parties shall ensure environmental integrity and transparency, including in governance, consistent with guidance adopted by the CMA (6.2)
- Parties shall apply robust accounting, to ensure, inter alia, the avoidance of double counting, consistent with guidance adopted by the CMA (6.2)
- The use of ITMOs to achieve NDCs under the PA shall be voluntary (6.3)
- The use of ITMOs to achieve NDCs shall be authorized by participating Parties (6.3)
- The guidance referred to in Article 6.2 shall, among other things, ensure that double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks covered by their NDCs under the Agreement (Decision 1/CP.21, para 36).

This guidance should ensure: (1) the environmental integrity of any reductions transferred (quality of outcomes); (2) the governance and transparency aspects of the systems between which outcomes are transferred (quality of contributing systems and quality of the transfer itself); and (3) robust accounting rules to ensure the avoidance of double counting. It will not be sufficient for Article 6 guidance to just address the mechanics of accounting; the fact that subtractions and additions are correct will not be sufficient to protect environmental integrity where the quality of the systems generating reductions, or the quality of the reductions themselves, are not transparently evident.

Technical work to inform this guidance should address the implications of different NDC types and scopes on each of the elements of environmental integrity, sustainable development, and transparency, including in governance, in the context of ITMO generation, acquisition and transfer.

In addition, different understandings of terminology will impact the development of guidance and the Article 6 rule set as a whole. For example, should it be clarified that "**internationally transferred mitigation outcomes**" are limited to emission reductions achieved and verified after the fact?

8. Eligibility Requirements

Depending on the nature of NDC and type of ITMO involved, certain foundational requirements should be in place both for Parties generating ITMOs and using ITMOs:

- quantified NDCs for the relevant period for which generation or use of units is intended
- establishment and review of baselines
- established registries or use of centralised registries and use of tracking systems
- presentation of annual emissions inventories, that are sufficiently transparent, accurate, consistent, comparable and complete, recognizing the special circumstances of those developing countries that require flexibility and the special circumstances of SIDS and LDCs in this regard

- third party review of inventories, with procedures for adjustments where necessary
- application of common accounting rules and common metrics
- common delivery cycles

9. Experience gained, lessons learned from the Kyoto Protocol

The Kyoto Protocol's budget-based system solves many problems, by creating certainty on the level of cumulative reductions to be achieved from baseline emission levels. However, it has also created challenges where targets are presented that either imply emission increases over recent historical levels, or where domestic emissions fall off dramatically over time due to economic conditions. Both of these situations resulted in some tradable surplus allowances (AAUs) in the first commitment period that did not represent emission reduction effort, and which thus became problematic when transferred to other Parties for use to offset increasing emissions. In addition, some developed country Parties' domestic GHG inventories have increased well beyond their base year levels, through a combination of access to tradable units and use of KP accounting rules, including land sector rules.

These dynamics must be avoided under the rule set agreed under Article 6, in view of the urgent need to phase out emissions and adopt 1.5° C degree consistent mitigation pathways. Generous allowances cannot be locked in for extended periods of time when the current level of ambition is known to be inadequate.

Tools that have evolved to address environmental integrity, transparency, and governance concerns under the Protocol and elsewhere, in the context of allowance-based approaches, can nevertheless inform the development of Article 6 rules. These include:

- commitment period reserves, to prevent overselling of units needed to meet targets
- baselines derived from verified emissions inventories and set below
- use of recent historical emission levels as baselines to avoid the creation and trade of surplus (Art. 3.7 ter)
- quantitative limits on the use of tradable units toward targets
- quantitative limits on carryover of different unit types
- cancellation of units that are not permitted for carryover
- surplus reserves created and available for limited purposes
- limits on fungibility of unit types
- restrictions on units representing removals
- limitations on accounting options
- compliance system to ensure operation of rules-based system, with short common cycles

Activities under Article 6 should also benefit from lessons learned in connection with project-based approaches under the Kyoto Protocol, as well as inputs in connection with the development of the new market based mechanism under the Convention. With respect to Joint Implementation (JI), a lack of international oversight led to the exchange of some emission reduction units (ERUs) from JI projects that did not represent new and additional reductions. Work on the revision of the JI Guidelines resulted in agreement on many improvements for the enhancement of environmental integrity and transparency in governance, addressing stronger international oversight, crediting period length, additionality reviews, and options to achieve net mitigation through cancellation of units, among other issues.

The review of the CDM modalities and procedures has also raised key issues for environmental integrity and governance, including the need for the avoidance of double counting between host and acquiring Parties, the benefits of shorter crediting periods to support host Parties' own domestic mitigation efforts, the relationship of crediting period lengths to specific technologies, the importance of specific country contexts, the value of increased host country engagement, perverse incentives related to certain project types, and options to achieve net mitigation that the atmosphere sees, going beyond offsetting.

10. Share of proceeds

Article 6.6 provides that the CMA shall ensure that a share of the proceeds from activities under the mechanism referred to Article 6.4 is used to cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. The share of proceeds under the KP was 2%, with another 2% directed to administrative expenses. An insufficient amount was raised for adaptation needs, while 2% proved to be more than was needed for administrative expenses. AOSIS sought a 5% share of proceeds under the new market based mechanism established under the Convention by decision 1/CP.16.⁴

Consideration should be given to **increasing the share of proceeds beyond 2%** for Article 6.4, **decreasing** the share of proceeds for administrative expenses, as well as **extending** the share of proceeds across other Article 6 tools. Consideration should also be given to whether the **current exemption** to the share of proceeds requirement under the KP for projects in Least Developed Countries has been successful in increasing the number of projects in LDCs, sufficient to warrant the consequent loss in share of proceeds revenues for adaptation.

11. Inputs to future work

Future work on Article 6 should be supported by technical papers, workshops, and further submissions. It would be valuable if this technical work were to address:

- the implications of different NDC types for environmental integrity, transparency, governance and incentives in the context of generation, acquisition and transfers
- lessons learned from CDM and JI on environmental integrity and governance, recognizing the progress and discussions in recent years on the reform of the rules and guidelines for these mechanisms
- options for approaches to deliver new elements (e.g., overall mitigation in global emissions), drawing out these options to enable a technical discussion
- options for transition.

⁴ See Submission by Nauru on behalf of the Alliance of Small Island States on the New market-based mechanism: views on role and technical design (2013) at 6, available at http://unfccc.int/files/cooperation_support/market_and_non-market_mechanisms/application/pdf/nmm_aosis_12112013.pdf.