



## Submission to the Articles 6.2 and 6.4 of the Paris Agreement by the Republic of the Maldives on behalf of the *Alliance of Small Island States*

27 April 2017

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On behalf of the Alliance of Small Island States (AOSIS), the Republic of the Maldives welcomes this opportunity to provide its views on, inter alia,

- the elements to be addressed, including their operationalization, in the guidance referred to in **Article 6.2** of the Paris Agreement, overarching issues, and relationships between Article 6.2, and other provisions of the Paris Agreement, the Convention and its related legal instruments, as relevant (FCCC/SBSTA/2016/4, para. 85).
- the elements to be addressed, including their operationalization, in the rules, modalities and procedures for the mechanism established by **Article 6.4** of the Paris Agreement, overarching issues, and relationships between Article 6, paragraphs 4–6, and other provisions of the Paris Agreement, the Convention and its related legal instruments, as relevant. (FCCC/SBSTA/2016/4, para. 93).

### **I. Overarching issues**

In Paris, all Parties agreed to pursue efforts to limit the temperature increase to 1.5°C. To achieve this goal will require the full delivery of Parties' current NDCs, as well as significantly greater mitigation effort from Parties over time, which may start with the NDCs to be communicated under decision 1/CP.21, paras. 23 and 24, by 2020.

Article 6.1 recognizes that some Parties choose to pursue cooperation in the implementation of their NDCs *to allow for higher ambition in their mitigation and adaptation actions* and to promote sustainable development and environmental integrity. In this context, the relationship between Article 6 and Article 4's aims should be carefully considered, to ensure that the operation of Article 6 does not undermine progress toward the global mitigation goals of the Paris Agreement.

Priority issues for AOSIS under Article 6 include:

- ensuring that use of market-based mechanisms *does not erode the environmental integrity* of Parties' NDCs, individually or in aggregate
- ensuring that Article 6 *delivers a substantial overall mitigation in global emissions*
- ensuring that use of Article 6 tools is only *supplementary to domestic mitigation efforts* and does not replace them, keeping Article 4.2 in mind;
- providing *centralized oversight* over all units generated under the UNFCCC and transferred for recognition at the international level toward achievement of NDCs;
- establishing a *common international accounting framework* to ensure no double counting or claiming of reductions takes place, as well as to ensure transparency.
- directing a substantial *share of proceeds* to support the adaptation needs of particularly vulnerable developing country Parties;

- creating opportunities and *positive incentives* to support mitigation ambition, while avoiding incentives that run contrary to the principles and goals of the Paris Agreement.

The achievement of an *overall mitigation in global emissions* and the delivery of a *share of proceeds* for adaptation are features of the 6.4 mechanism, but they could also be features of cooperative approaches under Article 6.2, so that Article 6 as a whole contributes to the goals of the Paris Agreement, going beyond offsetting. The application of these Article 6.4 elements under Article 6.2 would avoid disadvantaging the role of Article 6.4 and leverage the utility of these provisions.

## **II. Role of Article 6.2**

### **A. Scope of Guidance under Article 6.2**

Article 6.2 contains a series of binding requirements for Parties engaging in cooperative approaches that involve the use of internationally transferred mitigation outcomes (ITMOs) towards NDCs. Guidance under Article 6.2 must address each of these requirements:

- (1) promoting sustainable development
- (2) ensuring environmental integrity, and transparency, including in governance; and
- (3) robust accounting to ensure, inter alia, the avoidance of double counting.

Decision 1/CP.21 para. 36 further provides that this guidance should include "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 nationally determined contributions."

### **B. Scope of ITMOs under Article 6.2**

ITMOs transferred under Article 6.2 should represent emission reductions that are additional, not double counted, and surplus to the reductions host Parties need to achieve their own NDCs. These could build on lessons learned from mechanisms and tools under the Kyoto Protocol, recognizing the challenges that the Protocol's accounting system faced with respect to oversight and environmental integrity, and fashioning an appropriate system for accounting for Article 6 transfers that avoids these shortcomings.

*Article 6.2 could address transfers of ITMOs between Parties with quantified economy wide emission reduction and limitation targets, as well as transfers with other Parties that have quantified emission reduction and limitation targets in identified sectors. ITMOs could be defined to include emission reductions from Article 6.4 mechanism, which could be used by any Party toward achievement of its NDC, provided sufficient measures for ensuring environmental integrity and the avoidance of double counting are in place, including through corresponding adjustments. See discussions below on corresponding adjustments.*

Reaching greater clarity on the definition and scope of the ITMOs to be addressed under Article 6.2 will facilitate the development of the necessary guidance. This guidance should address the tools, institutions and processes needed to deliver against the three requirements in Section A, above.

### C. Promotion of sustainable development

Article 6.2 requires Parties engaging in cooperative approaches that involve the use of ITMOs toward NDCs to promote sustainable development. The guidance developed under Article 6.2 must therefore address the promotion of sustainable development. This element could be operationalized through publication of the criteria Parties apply to investment in Article 6.2 activities, or to the hosting of Article 6.2 activities, recognizing that Host Parties should have the flexibility to decide on standards for sustainable development which are dependent upon national circumstances.

### D. Ensuring environmental integrity, and transparency including in governance

The use of Article 6 approaches and mechanisms cannot be permitted to erode the environmental integrity of Parties' NDCs. Accordingly, guidance under Article 6.2 will have to address both the *quality of any ITMOs* considered for use, and the *quality of the cooperative approaches* through which these ITMOs are generated, transferred and tracked, to ensure environmental integrity.

*Transparency, including in governance*, is closely related; Parties and the public need to have information sufficient to provide *confidence* that any emission reductions used toward achievement of Parties' NDCs in fact do not undermine the environmental integrity of what NDCs individually or in aggregate are intended to deliver-. This requires *transparent, comprehensible and publicly accessible information* on the underlying quality of the mitigation outcomes for transfer as ITMOs, and on the quality of the approaches used to identify, manage, deliver and account for these outcomes.

With respect to the *quality of ITMOs*:

- If Article 6.2 participating Parties are permitted to *transfer ITMOs* from within the scope of economy-wide NDCs, or from within the scope of quantified sectors, to ensure environmental integrity the creation and transfer of "hot air" will have to be avoided. Transparent information will have to be provided sufficient to demonstrate this, including, inter alia, through presentation of an adequate time series of economy-wide or sectoral emissions so that the context of any transferred ITMOs is clear. Regular GHG inventories will be needed so that the context of any transferred ITMOs is clear.
- If Article 6.2 participating Parties are permitted to *transfer activity-based ITMOs*, to ensure environmental integrity, these outcomes will have to meet standards that are at least as stringent as those applied under Article 6.4, such that ITMOs represent **real, measurable, additional, verified and long-term emission reductions** that are not double counted or double claimed, and measures are in place to address situations of **non-permanence or leakage**. This requires transparent information to demonstrate that ITMOs satisfy each of these elements, and that the minimum standards applied are no less stringent than those applied under Article 6.4.

*Centralized oversight at the international level* will be needed to ensure:

- Any agreed **criteria** on environmental integrity are met before ITMOs are allowed for use

- **incentives are maintained** for domestic mitigation effort, to avoid undermining progress toward global goals
- **third party technical review** to ensure agreed Article 6 criteria are met before ITMOs are allowed for use
- the necessary **reporting and accounting structures are in place** in participating Parties
- **reporting** is transparent, accurate, complete, comparable and consistent, uses internationally-approved methodologies and metrics and avoids double counting
- **robust accounting** avoids double counting, and tools are in place to correct any issues found
- **corresponding adjustments** are undertaken in a transparent manner and verified to ensure ITMOs are not double counted or double claimed
- **registries** in which outcomes are held satisfy technical standards and have the functionality agreed by the CMA
- a **centralized registry** is available to enable the transparent transfer and acquisitions of ITMOs that are intended for use toward achievement of NDCs and to report summaries of transfers and holdings
- **transfers are undertaken in a transparent manner**, through an international transactions log, that checks for conformity with technical standards and agreed rules
- **rules and documentation are clear**, readily accessible to all Parties, and publicly available in English
- **unique serial numbers** that indicate the Party source, vintage and project type, to facilitate tracking, and avoid double counting and double claiming
- participating Parties' **initial accounting starting point is clear**, a final accounting of its NDC achievement is done, and ongoing reporting is sufficient to track progress toward achievement of NDCs, in recognition of the requirements of Articles 4 and 13 and the need to ensure double counting is avoided on the basis of corresponding adjustments.

National level information, depending on the level at which oversight takes place and depending on the nature of ITMOs agreed, may be needed on:

- how relevant internationally-agreed guidance, standards, or rules, modalities and procedures are applied at the national level;
- what agreements are in place between participating parties;
- how ITMOs represent real, measurable, additional, verified and long-term emission reductions;
- how double-counting is avoided;
- stakeholder consultation and grievance procedures countries have put in place
- what sustainable development criteria are applied;
- other relevant issues.

#### **E. Robust Accounting of ITMOs**

Robust accounting of ITMOs will be needed to ensure environmental integrity, transparency, support tracking, and to allow for an accurate assessment of the ITMOs that are issued, transferred, cancelled and retired.

Guidance for accounting for Parties' NDCs under Article 4.13 will be designed to ensure that Parties account for emissions and removals in accordance with methodologies and metrics assessed by the IPCC and adopted by the CMA, and that Parties strive to include all emissions and removals in their NDCs (1/CP.21, para. 31).

Additional accounting guidance will be needed in the context of Article 6 and to support corresponding adjustments. To support robust accounting, accounting guidelines may need to consider, among other things, accounting for transfers in the context of timing of underlying reductions, and timings of transfers.

Information consistent with this guidance should be reported under Article 13.7b which relates to the information necessary to track progress made in implementing and achieving their NDCs. Parties would need to demonstrate that transfers and acquisitions are properly reported, and any needed corresponding adjustments have been made.

#### **F. Corresponding Adjustments**

1/CP.21, para. 36 requests SBSTA to develop guidance referred to under Article 6.2, including "*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 nationally determined contributions under the Agreement.*"

The notion of corresponding adjustments implies additions and subtractions from transferring and acquiring Parties' accounts to reflect the transfer of ITMOs, to avoid the same reductions being claimed by both Parties toward achievement of their NDCs. It also raises the questions of *what* is transferred, and *where*, and *when*.

Additions and subtractions should be made in **tonnes of CO<sub>2</sub> equivalent emissions**. Corresponding adjustments could be applied as additions and subtractions from **emission levels, reflected in NDC accounts established for this purpose, distinct from** GHG inventories (which should always reflect the ongoing state of play), and NDCs (which should remain fixed until updated or until new NDCs are communicated, so that progress toward achieving these NDCs can be assessed).

#### **G. Overall mitigation in global emissions under Article 6.2**

Article 6.2 does not expressly refer to an aim to deliver an overall mitigation in global emissions. However, Article 6.1 recognizes that some Parties choose to pursue voluntary cooperation in the implementation of their NDCs *to allow for higher ambition in their mitigation actions*. Use of the accounting system for ITMOs can be used to operationalize such a higher ambition. This can be done by cancelling a percentage share of ITMOs upon transfer or use. See discussion below, in the context of Article 6.4.

#### **H. Lessons learned from existing mechanisms and approaches adopted under the Convention and its related legal instruments**

Many lessons have been learned through the operation of the Kyoto Protocol's flexible mechanisms in the first commitment period that can inform development of Article 6.2 guidelines. Because the scope of activities to be included under Article 6.2 is not yet defined, lessons from all three flexible mechanisms are relevant for consideration: Article 17, addressing international emissions trading, which enabled Parties to transfer units that were intended to reflect overachievement of their targets; Joint Implementation under Protocol Article 6, allowing countries with economy-wide targets to host emission reduction activities resulting in transferable units; and the CDM under Article 12, allowing for countries without capped emissions to host emission reduction activities resulting in transferable credits.

To protect the environmental integrity of Parties' targets, some initial protections included, among others, distinct rules for land sector accounting, distinct units for reductions resulting from the different mechanisms, quantitative restrictions on the use of certain units, quantitative limits on the carryover of different units, and commitment period reserves to prevent overselling and an international transactions log to check and record transfers. Nevertheless, some large challenges emerged:

- an accounting system that enabled the creation of transferable units that did not represent real emission reductions (so called "hot air")
- carryover rules that enabled a build-up of surplus units
- transferable units that did not always represent additional emission reductions, undermining the environmental integrity of aggregated efforts
- low market prices for units, reducing the incentive for domestic mitigation efforts in countries with economy-wide targets
- unit prices that sometimes substantially exceeded the cost of underlying reductions
- uneven distribution of project-based activities
- land sector accounting loopholes, estimation uncertainties, and difficulty in addressing non-permanence
- insufficient transparency and predictability in connection with certain Joint Implementation activities
- insufficient transparency in connection with holdings by Party in the CDM Registry
- the fungibility among units usable for compliance, undermining the impact of quantitative restrictions set for purposes of ensuring environmental integrity
- governance challenges
- a lack of flexibility in CDM and JI rules, once established.

A number of these issues were addressed in developing the rule set for the second commitment period, and in draft revisions to the Joint Implementation Guidelines. Some issues remain to be addressed. Further approaches to address environmental integrity that have been developed under the Protocol have included: quantitative restrictions on the establishment of emissions budgets for the second commitment, to ensure that they do not exceed a period of recent average historical emissions levels (Article 3.7ter); additional restrictions on the use of carried over surplus units through establish; cancellation of unused units; establishment of previous period surplus reserves.

These tools and lessons are directly relevant for the consideration of appropriate guidelines for Article 6.2. Some are also relevant to the development of the Article 6.4 mechanism.

### **III. Role of Article 6.4**

Article 6.4 establishes a mechanism to contribute to mitigation and support sustainable development. To contribute to mitigation, Article 6.4 *needs to add value*, by helping countries achieve their NDCs at least cost, facilitating the engagement of private entities in emission reduction activities, and providing Parties with both the *opportunity* and the *incentive* to support emission reduction activities that will not only generate transferable emission reductions that can be used by Parties toward achievement of their NDCs, *but also at the same time generate a substantial overall mitigation in global emissions* that the atmosphere sees. This will create an inherent value in Article 6.4 units, beyond offsetting, and inspire **greater confidence** in the mechanism.

## A. Overall mitigation in global emissions

The aim to deliver an *overall mitigation in global emissions* is a central and critical new element of the mechanism under Article 6.4, that takes it beyond the offsetting approaches of the CDM and Joint Implementation.

AOSIS has long called for market-based mechanisms under the Convention and its related instruments to be redesigned to generate net global emission reductions that the atmosphere sees, beyond mere offsetting, and also beyond the notion of the Host Party benefit that can be achieved from conservative baselines. AOSIS has made this call in negotiations on the revision of the JI Guidelines, in the ongoing review of the CDM modalities and procedures,<sup>1</sup> in the context of the New Market Based Mechanism under the Convention,<sup>2</sup> and in the lead up to the Paris Agreement.<sup>3</sup>

Academics have explained how such a net atmospheric benefit can be produced from the operation of the international carbon markets. Some papers that have addressed this issue are cited below,<sup>4</sup> though these citations are not meant to be an endorsement of the authors' opinions by AOSIS. Now is the time to adapt these ideas for the new Paris Agreement context.

### 1. Operationalizing "an overall mitigation in global emissions"

In AOSIS's view, the context of the Paris Agreement, an overall mitigation in global emissions (OMGE) takes place when emission reductions are delivered at a level that goes beyond what would be achieved through the delivery of the Host Party's NDC and the Acquiring Party's NDC in aggregate. This can be achieved by designing the Article 6.4 mechanism to ensure that some verified reductions are not used by either the Host or Acquiring Party toward its NDC.

For example, if an Acquiring Party invests in a project in a Host Party, the requirement of an overall mitigation in global emissions can be operationalized by requiring *cancellation of a fixed share* of the emission reductions verified and recorded to a Host Party's account at the time of issuance to the Acquiring Party.

In this way, fewer emission reductions will be issued and transferred than have been recognized as having been achieved in the Host Party. Assuming that both Parties go on to achieve their NDCs,

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<sup>1</sup> See, e.g., Submission by AOSIS, *Views on revision of the CDM Modalities and Procedures* (June 2013) at 2 (moving beyond offsets to substantial net emission reductions)

<sup>2</sup> Submission by AOSIS, *Views on matters referred to in paragraphs 83 and 84 of decision -/CP.17: Work programme to elaborate modalities and procedures for a new market-based mechanism, operating under the guidance of the COP* (21 March 2012) (new market-based mechanism must deliver substantial, measurable, net global emission reductions, moving beyond offsetting in order to help reach global goals); Submission by AOSIS, *New market-based mechanism: views on role and technical design* (12 November 2013) (deliver both net domestic and substantial net global emission reductions, through a design that moves beyond mere offsetting of developed country Party emissions).

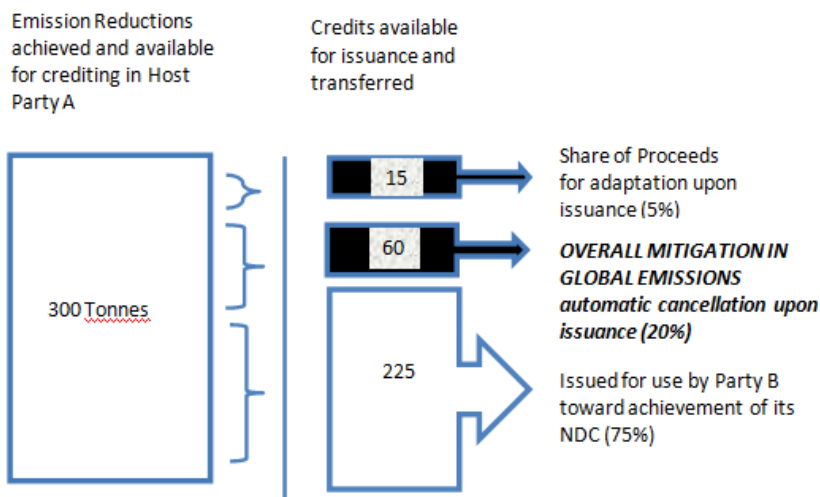
<sup>3</sup> *AOSIS Textual Proposal on Markets* (Section D) ("modalities and procedures shall ensure that the design and operation of the mechanism delivers net global emission reductions through the cancellation of a share of units generated, transferred, used or acquired from offsetting activities").

<sup>4</sup> See for example, Warnecke, C., Wartmann, S., Hohne, N., Blok, K., *Beyond pure offsetting: Assessing options to generate Net-Mitigation-Effects in carbon market mechanisms*, Energy Policy 68 (2014) 413-422 ; Lazarus, M., Erickson, P., Schneider, L., Kollmuss, A., *Potential for International Offsets to Provide a Net Decrease of GHG Emissions* (SEI, 2013); Bakker, S., Haug, C., van Asselt, H., Gupta, J., Saidi, R. (2011) *The future of the CDM: same, but differentiated?*, Climate Policy, 11:1, 752-767 at 763 (CER discounting could create a mechanism that results in net global GHG emission reductions); Schneider, L., *A Clean Development Mechanism with global atmospheric benefits for a post-2012 climate regime*, Int Environ Agreements (2009) 9:95-1.11.

and a corresponding adjustment is applied, the cancellation will deliver an overall mitigation in global emissions, beyond what Parties' NDCs taken together would deliver in aggregate, in the amount of the difference between the amount of emission reductions in tonnes verified in the Host Party, and the amount of emission reductions in tonnes transferred to the Acquiring Party. The Acquiring Party will have to acquire further emission reductions to make up this difference.<sup>5</sup>

**Overall mitigation in global emissions through fixed percentage cancellation of units**

*Example if 20% cancellation for overall mitigation, 5% for share of proceeds for adaptation, 300 tonnes of verified reductions achieved in the Host Party were assumed*



Through cancellation, an overall mitigation in global emissions will be achieved whether the Article 6.4 activity takes place inside the host Party's NDC or outside the scope of its NDC.

How this overall mitigation in global emissions is *accounted* in the Host Party will depend on whether a *corresponding adjustment* is required for both Host and Acquiring Parties for all activities under Article 6.4, or only required where reductions take place inside the scope of a Host Party's NDC.

**Example 1: Project inside scope of Host Party NDC / corresponding adjustment by both Parties**

Using the above example, assume 300 tonnes of additional, real, measurable, permanent emission reductions are verified from a project in the Host Party. Assume a fixed 20% cancellation<sup>6</sup> is in place to achieve an overall mitigation in global emissions, and assume a 5% share of proceeds of Article 6.4 activities is directed toward adaptation.

60 tonnes of emission reductions are cancelled, representing an OMGE. 15 tonnes are directed to an account established to receive a share of proceeds. The remaining 225 tonnes of credited emission reductions (75%) are issued to the Acquiring Party. A **corresponding adjustment**

<sup>5</sup> Consistent with Article 6.4, the project contributes to the reduction of emission levels in the host Party (6.4(c)(seen in its emissions inventories)); the host Party benefits from mitigation activities (6.4(c)); emission reductions result that can be used by another Party to fulfil its NDC (6.4(c)); but these reductions are not used by more than one Party to demonstrate achievement of its NDC (6.5). Double counting is avoided on the basis of a corresponding adjustment under Article 6.2 and decision 1/CP.21, para. 36).

<sup>6</sup> A 20% figure is used in this example for illustration only; technical work is needed to identify an appropriate cancellation percentage. See discussion below at section 2.



subtracts 225 tonnes from the Acquiring Party account, where they can be used toward achievement of the Acquiring Party's NDC. A **corresponding adjustment** also adds 300 tonnes to the Host Party's account, reflecting the fact that these 300 tonnes of reductions have become unavailable for use by the Host Party toward achievement of its own NDC to avoid double counting.<sup>7</sup>

It is important to point out that even if the Acquiring Party received all 300 tonnes of emission reductions credited, and there were no cancellations for an OMGE or share of proceeds, the Host Party would still have to add 300 tonnes to its account due to the need to avoid double counting under Article 6.5. So the cancellation **creates no disadvantage to the Host Party** from the perspective of the corresponding adjustment it must make, but an overall benefit to the atmosphere is achieved.

### **Example 2: Projects outside scope of Host Party NDC**

If activities are outside the scope of the Host Party's NDC, an overall mitigation in global emissions can again be achieved by identifying the reductions available for crediting, recording this credited volume, and **cancelling a fixed percentage prior to issuance** so that a percentage of the reductions achieved cannot be used by the Acquiring Party. The percentage cancellation is necessary to deliver an overall mitigation in global emissions, because otherwise 300 tonnes of transferred reductions would only be used to offset emissions in the Acquiring Party -- achieving no global mitigation benefit.

Because emission reductions take place outside the scope of the Host Party's NDC, an overall mitigation benefit will be achieved through cancellation -- with emission reductions achieved beyond the sum total of the Host Party and Acquiring Party's NDCs -- once a corresponding adjustment is made in the Acquiring Party's accounts, whether or not there is a corresponding adjustment in the Host Party accounts. Nevertheless, the CMA will need to decide whether: (1) to only require a corresponding adjustment in the Acquiring Party's account; or (2) to require corresponding adjustments in both Acquiring Party and Host Party accounts.

**(option 1) Only the Acquiring Party makes a corresponding adjustment** (Acquiring Party subtracts 225 tonnes from its account).

- It could be argued that because only one Party will be using these Article 6.4 reductions towards achievement of its NDC, there is no risk of double counting the same reductions toward more than one NDC, and therefore no corresponding adjustment is needed in the Host Party.
- However, it could also be argued that this approach may create a perverse incentive for Host Parties to maintain sectors outside the scope of their NDCs, where they can be used to generate offsets that do not require corresponding adjustments. This might deter Parties from moving to economy-wide emission reduction or limitation targets, or from putting mitigation measures in place in certain sectors, to protect these sectors for external investment.

**(option 2) Both Parties make corresponding adjustments** (Acquiring Party subtracts 225 tonnes; Host Party adds 300 tonnes).

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<sup>7</sup> Whether one Party adds or subtracts will depend on how the corresponding adjustment system for ITMO accounting develops -- as an addition to the reductions achieved, or as a subtraction from reductions that must be achieved.

- It could be argued that this might encourage Parties to bring relevant sectors and activities within the scope of their future NDCs, where they can use conservative baselines to achieve benefits from these activities that they can use toward their own NDCs.
- Corresponding adjustments on both sides may make it easier for Host Parties without economy-wide targets to move to economy-wide NDCs over time, with a clearer record of any Article 6.4 transfers previously made.

## 2. What level of cancellation percentage?

A cancellation percentage should be established at the outset, set at a level that would generate a substantial overall mitigation in global emissions, while not disincentivizing Parties from engaging in Article 6.4 initiatives. Although the example above uses a 20% cancellation percentage, **this figure is used for illustration purposes only**; technical work is needed to identify an appropriate cancellation percentage that would address these two aims. AOSIS is not now endorsing a specific percentage cancellation figure.

The **cancellation percentage** applied could be uniform for activities across all projects / programmes/sectors. Alternatively, it could be tailored to project type.

A cancellation rate, applied across Article 6.4 activities, would be likely to decrease the volume of reductions in the market, and increase the price these reductions can achieve. These price and volume effects may be useful in supporting a carbon market at the international level.

## 3. Cancellation on supply or demand side?

The examples above use cancellation on the supply side and corresponding adjustments at the time of issuance. This enables all issued units/reductions to be usable toward achievement of NDCs, without a subsequent discount and may support fungibility with Article 6.2 ITMOs. It is also possible to apply cancellations upon use (demand-side), but the delay in reflecting corresponding adjustments may make it difficult to track ownership of transferred reductions until corresponding adjustments are made, making it more difficult to track progress toward individual and aggregate goals.

## 4. Role of conservative baselines

Some have suggested that **conservative baselines** alone would be sufficient to deliver an overall mitigation in global emissions, but this is not the case where activities take place *inside* the scope of Parties' NDCs.

**If a Host Party and Acquiring Party have capped emissions** as a result of their NDCs, and activities take place inside the scope of the Host Party's NDC, applying a more conservative baseline will only shift the distribution of reductions achieved between the two Parties, with the Host Party capturing a greater share of the resulting reductions in its own national GHG inventory, where they will help it in achieving its own NDC. ***Conservative baselines will benefit the Host Party, but will make no difference to the emission reductions the atmosphere sees as a result of the Parties' NDCs in aggregate, assuming both Parties go on to achieve their NDCs.*** A Host Party will always have an incentive to set conservative baselines, to access a greater share of the actual reductions achieved that it can use toward its own NDC. In fact, the opportunity to set more conservative baselines provides an incentive to the Host Party to host Article 6.4 projects; but conservative baselines, by themselves, will not deliver an overall

mitigation in global emissions.

**In contrast, where activities take place outside the scope of a host Party's NDC, conservative baselines will deliver an overall mitigation in global emissions that the atmosphere sees**, beyond the sum of aggregated NDCs. As long as actual reductions exceed transferred reductions, this difference will lead to reductions beyond Parties' aggregated NDCs. This is caused by the fact that some reductions driven by Article 6.4 activity will not be used toward NDCs.

#### **B. How do we operationalise the share of proceeds?**

The share of proceeds for adaptation under Article 6.6 can be operationalized through Article 6.4 by deducting a fixed percentage of the credited units/reductions upon issuance, and directing these units to an account for monetization. There is already experience in applying a share of proceeds under the CDM, and the rules for the second commitment period extend the share of proceeds to Joint Implementation and International Emissions Trading.

Consideration should be given to *increasing the scale* of the share of proceeds for adaptation beyond the 2% applied under the CDM. For example, AOSIS called for an increase in the share of proceeds to 5% in connection with the new market mechanism under the Convention.<sup>8</sup> Consideration should also be given to whether *exemptions* from this share of proceeds are appropriate or have any substantial effect on activity distribution, given the increasing need for adaptation funding.

Finally, consideration should also be given to the appropriate scale for the share of proceeds for *administrative expenses*, avoiding the accrual of surplus that could instead be directed to toward adaptation needs.

#### **C. Environmental integrity and governance**

If Paris goals are to be met, the use of market-based mechanisms cannot be permitted to erode the environmental integrity of Parties' existing NDCs, either individually or in aggregate. Accordingly, the rules, modalities and procedures developed for Article 6.4 should address both the *quality* of any emission reductions being generated for use or transfer, and the *systems* through which these units or reductions are held, issued, and tracked, recognizing that there could be overlap with the guidance under Article 6.2.

**With respect to the quality of emission reductions**, decision 1/CP.21, paragraph 37 sets out a number of elements required, for which rules, modalities and procedures will have to be developed:

- reductions that are **real and measurable, and provide long-term benefits related to mitigation** (para. 37 (b))
- reductions in emissions that are **additional** to any that would otherwise have occurred in the absence of the activity (para. 37(d))
- reductions that have been **verified and certified** by designated operational entities (para. 37(e)).

Also important for environmental integrity are:

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<sup>8</sup> See Submission by Nauru on behalf of AOSIS, *New market-based mechanism: views on role and technical design* (November 12, 2013) at 6.

- requirements to address situations of **non-permanence** or **leakage**
- **crediting periods** that do not undermine additionality

With respect to the *quality of systems*, a number of elements are needed, including

- a supervisory body, under the guidance of the CMA (Art. 6.4)
- a robust accounting system at the international level to transfer and track transfers and acquisitions of reduction units
- procedures for voluntary participation (para. 37(a) )
- national focal points
- information on stakeholder consultation
- third party technical reviews of inventories, proposed baselines, proposed crediting thresholds and/or caps
- standards for the accreditation of DOEs
- unique serial numbers that indicate the Party source, vintage and project type, to facilitate tracking, and avoid double counting and double claiming
- systems for correcting errors where reductions are improperly transferred or credited
- a centralized registry function - to facilitate transfers
- an international transactions log function - to track transfers, check transfers for conformity with technical standards and agreed quantitative and qualitative restrictions, enable verification of corresponding adjustments, facilitate periodic summary reports of transfers and holdings.
- regular reporting to the CMA of transfers, holdings and corresponding adjustments

Consideration should be given to ensuring that that Parties rely primarily on domestic mitigation measures for the achievement of their NDCs, that Host Parties remain on track to achieving their own NDCs, and that environmental integrity is ensured in sectors with a high degree of uncertainty in emission estimates.

#### **D. Voluntary participation authorized by each Party involved (37(a))**

It will be essential that Host Parties acknowledge and approve mitigation activities under Article 6.4, recognizing that Article 6.5 provides that reductions resulting from the Article 6.4 mechanism may not be used to demonstrate achievement of the host Party's NDC if used by another Party to demonstrate achievement of its own NDC. The ownership status of any reductions resulting from Article 6.4 activities should be clear at all times.

#### **E. Specific scopes of activities (37(c))**

It may be most prudent for Article 6.4 to begin with *project-based activities and programmatic activities*, learning from the CDM and Joint Implementation. In these contexts, it may also be worth considering whether it might be most efficient for the centralized body to supervise and administer a core set of methodologies, to minimize administrative expenses and transaction costs and to support project replication.

If it is agreed that activities under Article 6.4 may go beyond project-based and programmatic activities, for example to include sectoral approaches, stringent standards would have to be developed and applied to ensure that any resulting emission reductions are real, measurable, additional and permanent, do not reflect hot air, and also deliver the necessary overall mitigation in global emissions.

#### **F. Experience gained with and lessons learned from existing mechanisms and approaches adopted under the Convention and its related legal instruments (para 37(f)).**

Many lessons have been learned from the Kyoto Protocol's flexible mechanisms that are directly relevant to the rules, modalities and procedures that will be developed for Article 6.4. Joint Implementation and the Clean Development Mechanism (CDM) have particular relevance. Both are project-based baseline and credit schemes: Joint Implementation allows Kyoto Parties with absolute emission caps to host emission reduction projects that generate transferable emission reduction units; the CDM allows Kyoto Parties without absolute emission caps to host emission reduction activities that generate transferable certified emission reductions.

Many of the lessons learned from these mechanisms have been discussed in the negotiations around revisions to the rule sets for the operation of JI and the CDM, following the operation of these mechanisms in the first commitment period.

The draft revised JI Guidelines<sup>9</sup> address improved international oversight, transparency and governance, methodologies, standardization of common approaches, technical requirements to ensure additionality, simplified methodologies and net mitigation benefits, and many other issues detailed in the JISC's "*Analysis of the experiences and lessons learned from JI for the possible design of mitigation mechanisms and on links and interactions with other tools.*"<sup>10</sup>

Similarly, the review of the CDM modalities and procedures has raised a number of issues, including

- the avoidance of double counting between Host Party and acquiring Party
- securing net global emission reductions that the atmosphere sees
- crediting period length
- measures to improve environmental integrity
- sustainable development benefits and the role of the Host Party in this regard
- transparency in holdings by Party.

The *draft revised JI Guidelines* are also relevant to the Paris Agreement context, where both host and acquiring Parties have NDCs and all Parties are encouraged to move toward economy-wide targets.

#### **IV. Relationships within Article 6 and with other provisions of the Paris Agreement**

Articles 6.4 and 6.2 will have to operate under a **common accounting framework** to ensure no double counting or claiming of reductions takes place. If the scope of Article 6.2 approaches overlaps with 6.4 activities (e.g., if both include project-based activities), requirements applied under Article 6.2 should be at least as stringent as those under Article 6.4.

The goals of Article 6.4 should not be undermined through competition with Article 6.2 in the contexts of the *share of proceeds* and the requirement under Article 6.4 that the mechanism aim

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<sup>9</sup> See FCCC/SBI/2016/L.8 (Review of Joint Implementation Guidelines), Annex I (Work undertaken by the Subsidiary Body for Implementation on the review of the joint implementation guidelines), and FCCC/SBI/2016/L.8/Add.1.

<sup>10</sup> FCCC/KP/CMP/2016/5 (Annual report of the Joint Implementation Supervisory Committee to the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol), Annex 1 (Reflections on and analysis of experiences and lessons learned from joint implementation).

to deliver an *overall mitigation in global emissions*. Extension of a share of proceeds to Article 6.2, and extension of cancellation systems that deliver an overall mitigation in global emissions to Article 6.2 can leverage greater momentum from Article 6 tools as a whole.

**Incentives under Article 6 should be aligned with Paris Agreement principles and goals.**

Here, considerations include Article 4's direction of travel through successive NDC cycles, and **Article 4's** emphasis on the pursuit of domestic mitigation measures in achieving the objectives of Parties' NDCs (Art. 4.2), expectation that all Parties will move toward over time (Arts. 4.3, 4.4) and requirement that all Parties strive to include all categories emissions and removals in their NDCs (1/CP.21, para. 31).

**Additional accounting guidance and further reporting obligations will be needed for Parties participating in or authorizing the transfer and acquisition of ITMOs and emission reductions under Article 6.** TACCC principles become even more important when ITMOs and emission reductions are given a monetary value by those seeking mitigation outcomes that can be used toward achievement of their NDCs. Article 6's accounting guidance may have to provide guidance for corresponding adjustments to manage the complexities of different types of NDCs with different timeframes and target years or periods.

For Article 6.2 and 6.4 participating Parties, **reporting, technical expert reviews and multilateral consideration of progress** processes will require up to date information on ITMOs and emission reductions transferred between Parties, and corresponding adjustments, to ensure double counting is avoided, and track progress in the implementation and achievement of NDCs.

The **Article 15 mechanism** to facilitate implementation and promote compliance, and the **Capacity Building Initiative for Transparency** (1/CP.21, paras. 84-88), can assist Parties in establishing systems to support reporting, review and accounting, which will in turn assist in participation in Article 6 cooperative approaches and in the Article 6.4 mechanism. A number of **existing institutions and institutional arrangements** under the UNFCCC can be built upon to support Article 6, including centralized registry systems and the existing international transactions log.

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