SUBMISSION BY SWEDEN AND THE EUROPEAN COMMISSION ON BEHALF OF THE EUROPEAN UNION AND ITS MEMBER STATES

Stockholm, 6 March 2023

Subject: Submission of views on matters referred to in paragraph 9 of the CMA4 decision on Guidance on the mechanism established by Article 6, paragraph 4, of the Paris Agreement

The EU welcomes the opportunity to submit our views on the three matters referred to in paragraph 9 of the CMA4 decision on Guidance on the mechanism established by Article 6, paragraph 4, of the Paris Agreement.

Consideration of whether Article 6, paragraph 4, activities could include emission avoidance and conservation enhancement activities

Emissions avoidance is a term that has not been used in the Convention, the Kyoto Protocol or the Paris Agreement. It is an ambiguous term that can have many different meanings in varying contexts. The EU believes that it is not helpful to introduce and define the term *emission avoidance* under Article 6, in addition to anthropogenic *emissions reductions* and *enhancement of removals*. We think that the term *emission reductions* is broad enough to cover different types of mitigation activities. This is because under crediting mechanisms emission reductions are defined as a reduction compared to a baseline (taking into account leakage), and not necessarily a comparison to historical emissions. This implies that the term could also cover mitigation activities where no historical emissions occurred. Examples include the construction of efficient greenfield plants, thereby preventing the construction of a more carbon intensive alternative, or the composting of waste which prevents methane formation in landfills.

Regarding *conservation enhancement activities*, as mentioned in our previous submissions, we consider that they can represent an emission reduction or an enhancement of removals, as highlighted in the Warsaw REDD+ framework, which includes enhancement of forest carbon stocks delivered by conservation, forest landscape restoration or sustainable management of forests. The EU believes that it is therefore also not necessary to introduce and define the term *conservation enhancement activities* in a CMA decision, in addition to emission reductions and enhancements of removals.

Under the Article 6.4 mechanism, mitigation activities are only eligible if they fulfill all requirements of the Paris Agreement, relevant decisions by the CMA and the Supervisory Body. Not all mitigation activities will fulfill these requirements.

A general principle of the Paris Agreement is that only *anthropogenic* emission reductions or enhancements of removals are accounted for. Moreover, only *additional* mitigation outcomes can be traded as Article 6.4 emission reductions. This implies that concrete mitigation actions must be pursued under Article 6.4 and that the calculated emission reductions or removals must be attributable to these mitigation actions. Not implementing any mitigation actions, but just continuing the status quo, does therefore not qualify under Article 6. In this sense, the mere presence of carbon stocks, without implementing specific mitigation measures, does not qualify under Article 6. This holds both for biogenic carbon stocks, such as forests, and for fossil carbon stocks, such as gas, oil or coal reservoirs.

The protection of fossil fuel reservoirs as an Article 6 mitigation activity is also not compatible with other principles set out under Article 6. It would lead to double counting, as both the countries not using the fossil fuels and the country keeping the fossil fuels in the ground could claim the same emission reductions. It also raises broader

accounting issues, as GHG emissions accounting under the UNFCCC is based on fossil fuel consumption, and not on fossil fuel supply.

Ensuring environmental integrity is another important overall principle. Achieving this principle requires that emission reductions or removals are additional, robustly quantified, permanent, not double-counted and reduce leakage risks. For activities that involve emissions avoidance or conservation enhancements, additionality and robust quantification can pose serious challenges. Emissions and removals in the land-use sector are driven by both mitigation actions and various exogenous factors, such as changes in prices for agricultural commodities. Moreover, existing forests may be a sink without any anthropogenic intervention. Distinguishing between the impacts from mitigation actions and from exogenous factors can be challenging and associated with very high uncertainties, an issue sometimes referred to as "signal-to-noise" problem (the signal being the mitigation actions and the noise exogenous factors affecting emissions or removals).

Mitigation activities under the Article 6.4 mechanism should respect human rights and also have overall positive environmental and social impacts beyond mitigating climate change. Activities that pose environmental or social risks, in particular for biodiversity and food security, should not be eligible. In this sense, activities should be compatible with the biodiversity goals of the Kunming-Montreal Global Biodiversity Framework and align with the 2030 agenda for sustainable development.

Where it is not possible to determine with a high level of confidence that the requirements of the Article 6.4 mechanism are met, other approaches may be better suited to incentivize the necessary mitigation in the sector. Emissions avoidance and conservation enhancement activities with their diverse set of co-benefits but considerable additionality, quantification, permanence and accounting challenges may therefore better be subject to other types of payments or incentives, including non-market approaches (NMAs). This is also the case for land-use activities implemented in countries with particular national circumstances, such as countries with high forest cover and low deforestation (HFLD). In this regard, it should be explored more deeply how activities in countries with such national circumstances could be addressed as an area of particular relevance under the spectrum of NMAs under Article 6.8.

Connection of the mechanism registry to the international registry as per paragraph 63 of the rules, modalities and procedures for the mechanism, as well as to other registries referred to in decision 2/CMA.3, annex, paragraph 29, if applicable, including the nature and extent of interoperable features

The details of the connection of the mechanism registry to the international registry under Article 6.2 as well as to other national registries will depend on further decisions on authorization and tracking to be taken under Article 6.2.

During the last year, it became clear that there are differences in approach to registries that may have significant impacts on the functions and structure of registries, and their implementation, as well as the burden placed on countries in managing their reporting obligations. Our expectation in the period to COP27 was that tracking would be implemented through a series of operations to be reflected in the relevant Article 6 registry systems, including authorisation and/or issuance of ITMOs in one registry, their subsequent transfer to, and acquisition by, another registry, and their use/retirement in registries, including use towards NDCs and OIMP. We also expected that there would be communication protocols between registries to reflect the status of transactions within and between registries.

Following the decisions adopted at Sharm El-Sheikh, we still believe that a centralized approach provides considerable advantages and leads to greater transparency and accountability. Nevertheless, we understand that some Parties are open to an approach that means that all transactions are effected within underlying carbon crediting programme registries, and the role of national registries or the international registry is reduced to the function of recording the underlying transactions for the Parties concerned.

The decisions on tracking taken in Sharm El-Sheikh on the requirements for registries, including national registries, the international registry and the Article 6.4 mechanism registry, set the basis for tracking and recording of ITMOs. However, in our view further work is necessary before Parties and the secretariat can implement their registries. For a decentralized approach – the use of underlying carbon crediting program registries as the main tracking tool – more work is in particular needed to ensure that records of ITMOs are consistent with data from underlying registries and that corresponding adjustments are appropriately reconciled. For example, it is not clear to us how host countries would be informed by underlying program registries about transactions (such as cancellation) that may constitute a trigger for the application of corresponding adjustments.

With regard to the specific question of the connection of the mechanism registry with the international registry, we consider that the mechanism registry and the international registry should be designed in a consistent manner and that hence authorized Article 6.4 emission reductions can be transferred from the mechanism to the international registry.

Provision of a statement by the host Party to the Supervisory Body specifying whether it authorizes Article 6, paragraph 4, emission reductions issued for an Article 6, paragraph 4, activity for use towards achievement of nationally determined contributions and/or for other international mitigation purposes, as defined in decision 2/CMA.3, in accordance with paragraph 42 of the rules, modalities and procedures, including its timing, relevant information on the authorization and any revisions

Timing of the statement

The EU believes that early clarity on the eligible uses of Article 6.4 emission reductions is important for host countries, mitigation activity proponents and buyers. In pursuing Article 6 cooperation, it is important for host countries to consider how such cooperation fits within their overall strategy to achieve their NDCs and long-term low emissions development strategies, including how emission reductions are shared between buyers and the host country, in order to enable the host country to use part of the achieved emission reductions to achieve its own NDC. For authorized Article 6.4 emission reductions, this can be achieved through ambitious baselines or crediting periods shorter than the operation of the mitigation activity. In the case of mitigation contribution Article 6.4 emission reductions, all reductions can be used by the host country to achieve its own NDC. We think that the initial report is an important instrument for host countries to develop a broader strategy on its use of Article 6, including in which areas Article 6.4 activities are pursued and whether the emission reductions are authorized or mitigation contributions. Early clarity on the status of Article 6.4 emission reductions is also beneficial for buyers and mitigation activity proponents, as they need clarity for how the emission reductions can be used. We recognize, however, that some Parties were requesting for flexibility on the timing when the statement on authorization should be provided by the host Party.

In the view of the EU, the statement should be provided at registration of the mitigation activity. To provide further flexibility, we believe that it is also possible to provide the statement prior to each issuance of Article 6.4 emission reductions. Each Article 6.4 emission reduction should then be tagged in the mechanism registry with information on whether it is a mitigation contribution or an authorized Article 6.4 emission reduction.

Providing the statement at a later stage – i.e., after issuance – would create a number of issues which would undermine the effective functioning of Article 6, including the application and reconciliation of corresponding adjustments, implementing the provisions on share of proceeds (SOP), and implementing overall mitigation in global emissions (OMGE). This is because the Glasgow decisions on Article 6 provide considerable flexibility to Parties with regard to the definition "first transfer" in the context of other international mitigation purposes (OIMP) and the respective timing of applying corresponding adjustments.

To illustrate the implications of providing the statement after issuance, we provide here two examples.

Example A: Article 6.4 emission reductions are issued in 2024 for a project implemented in host country A. In the issuance process, in accordance with the RMPs, a share of 5% of the issued Article 6.4 emission reductions is forwarded to the Adaptation Fund, and a share of 2% is transferred to a cancellation account for OMGE. In 2025, the remainder of the Article 6.4 emission reductions are transferred within the mechanism registry to an account of an acquiring Party B. Subsequently, in 2028, the host Party issues a statement that the Article 6.4 emission reductions are authorized for use towards achievement of NDCs. Party B then decides to use the Article 6.4 emission reductions to achieve its NDC, and transfers them from a holding account to a retirement account in 2029.

In this example, paragraph 2(a) of the Annex to decision 2/CMA.3 applies, which defines the "first transfer" as the "first international transfer". In the example scenario, however, no international transfer is taking place *after* the authorization, since the Article 6.4 emission reductions are not transferred to another Party after their authorization. A transfer from the host Party A to the acquiring Party B took place in 2025. This transfer could, for example, have occurred within the mechanism registry, between accounts of the two Parties involved. By that time, however, the Article 6.4 emission reductions were not yet authorized, and hence no ITMOs. Therefore, this transfer between Party A and Party B does not qualify as a "first international transfers" in the sense of the Article 6.2 guidance. This situation might be interpreted such that the host Party A would not have to apply any corresponding adjustments, as

no “first international transfer” of ITMOs took place, effectively leading to double counting.

To address this, it is conceivable that the CMA establish further guidance that in such instances the “first international transfer” is deemed to have taken place when the transfer occurred within the mechanism registry, back in 2025. The guidance would thus clarify that in such instance the previous transfers should be considered, ex post, as a “first international transfer”. This potential solution would, however, raise several issues. Some Parties allow third-party entities to acquire emission reductions on their behalf. This may include entities located in the host country. In this case, there may not be any transfer to an account holder registered in another country but nevertheless another country uses the Article 6.4 emission reductions to achieve its NDC. In practice, it may thus be difficult to identify whether or not an international transfer took place. Moreover, in some instances, Article 6.4 emission reductions could change owners several times before they are used for a specific purpose. The Article 6.4 emission reductions from the mitigation activity could be spread across multiple account holders in the mechanism registry, including accounts hold by entities that act on behalf of different Parties. For the host Party A, it would thus be difficult to identify which of the issued Article 6.4 emission reductions were already “first internationally transferred” and which ones not. This raises concerns whether the host Party would actually apply corresponding adjustments for all Article 6.4 emission reductions, and hence whether double counting is effectively avoided.

A second concern relates to the retroactivity involved in the application of corresponding adjustments and the required information flows. In Example A, the host country A would only identify in 2028, or even later, that a “first international transfer” took place in 2025. This also means that the country would need to report on a first international transfer in the structured summary table several years after it has occurred. This would mean that previous reports of the structured summary, in particular on the row of “first transfer” would need to be corrected ex-post. This might also entail that this information, for past years, would need to undergo again a review under Article 6 and under Article 13.

Lastly, authorizing Article 6.4 emission reductions after their issuance could lead to lower incomes for the Adaptation Fund. Authorized Article 6.4 emission reductions are generally expected to have a higher market value than mitigation contribution Article 6.4 emission reductions, given that authorized reductions can be used for more purposes than mitigation contribution reductions. In Example A, the Adaptation Fund might have sold the emission reductions in 2026, at a time when they were not yet authorized. If emission reductions had been authorized prior to their issuance, the Adaptation Fund would likely have been able to achieve a higher price on the market.

Example B: Article 6.4 emission reductions are issued in 2024 for a project implemented in host country A. In the issuance process, in accordance with the RMPs, a share of 5% of the issued Article 6.4 emission reductions is forwarded to the Adaptation Fund, and a share of 2% is transferred to a cancellation account for OMGE. In 2025, the remainder of the Article 6.4 emission reductions are transferred within the mechanism registry to different accounts of private sector entities. In 2026, some of these emission reductions are cancelled or used for different purposes. Subsequently, in 2028, the host Party issues a statement that the Article 6.4 emission reductions are authorized for use towards other international mitigation purposes (OIMP). In accordance with the provisions of paragraph 2(b) of the Annex to decision 2/CMA.3, the host country A defines the “cancellation or use” of the Article 6.4 emission reductions as the “first international transfer”.

This example raises questions as to whether the host Party would need to apply corresponding adjustments for those units that have already been canceled or used, prior to their authorization. One could argue that, at the time of their cancellation or use, these Article 6.4 emission reductions were not yet authorized, and therefore their cancellation or use does not constitute a “first transfer” in the sense of the Article 6.2 guidance. One could also argue that these Article 6.4 emission reductions were authorized by the host Party and the host Party determined that the cancellation or use should be considered as the “first transfer” and hence corresponding adjustments should be applied retroactively.

There are more examples that could occur and would involve questions with regard to the application and reconciliation of corresponding adjustments. As there could be multiple scenarios, it would be difficult to address all these scenarios in respective guidance by the CMA in order to ensure that corresponding adjustments are appropriately applied. We therefore believe that the statement on authorization should be provided prior to the issuance of Article 6.4 emission reductions.

Information to be included in the statement

In terms of the information to be included in the statement, we believe that it should include at least the following:

- The name of the host Party and the institution issuing the statement, including its contact details;
- The date of the statement;
- The identification of the specific mitigation activity and the specific Article 6.4 emission reductions to which the statement applies;
- Whether the relevant Article 6.4 emission reductions should be "mitigation contribution Article 6.4 emission reductions" or "authorized Article 6.4 emission reductions"
- In the case of "authorized Article 6.4 emission reductions":
    - The relevant cooperative approach;
    - The purposes for which the Article 6.4 emission reductions are authorized, including whether they are authorized for use towards achievement of NDCs and/or for use towards other international mitigation purposes (OIMP);
    - As an option, the possibility for the host country to further specify the authorized use, e.g. that only a specific country may use the emission reductions to achieve its NDC or that OIMP may only include specific purposes, such as use under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA);
    - As an option, any conditions established by the host country that the Supervisory Body shall implement for considering the Article 6.4 emission reductions as being authorized (e.g. a limit on the number of Article 6.4 emission reductions that may be deemed as authorized);
    - In the case of authorization for use towards OIMP, a specification of the definition chosen by the Party for "first transfer", in accordance with paragraph 2(b) in the Annex to decision 2/CMA.3.

Revisions to the statement

Lastly, with regard to any revisions to the statements, we believe that caution is needed as revisions could undermine the effective functioning of the Article 6.4 market. The possibility to provide revisions could create uncertainty for investors and undermine the appropriate application of corresponding adjustments. A revision that authorizes Article 6.4 emission reductions that were previously mitigation contribution Article 6.4 emission reductions would raise the same issues as explained above with regard to retroactive application of corresponding adjustments. A revision that declares authorized Article 6.4 emission reductions as only being mitigation contribution Article 6.4 emission reductions would open many issues, in particular if the reductions would have already been sold, transferred or used.

We therefore believe that revisions to the host country statements should either not be allowed or only apply to *future* issuances. The latter would ensure that corresponding adjustments are appropriately applied but would still create considerable uncertainty for market actors who wish to engage in early transactions – which are important for many mitigation activity proponents to finance the implementation of the activities.