



# CARBON MARKET WATCH<sup>1</sup> RECOMMENDATIONS FOR AWG-KP18

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We are now on an emissions path that could lead to warming of 4°C or more.<sup>2</sup> In addition, impacts associated with even 2°C of warming have been revised upwards and are now considered “dangerous” and “extremely dangerous”.<sup>3</sup> A world beyond 2° will threaten the very existence of civilization as we know it. The urgency and importance of this matter cannot be overemphasized.

This paper outlines key issues under discussion at the WG-KP 18<sup>th</sup> session. Carbon Market Watch provides recommendations in particular on the following issues:

1. **Increasing ambition and closing loopholes**
2. **Carry- over of assigned amount units (AAUs)**
3. **Eligibility issues relating to CP2**
4. **Review of the clean development mechanism (cdm)**
5. **No CP1 AAUs for Joint Implementation During The Gap Period**

## 1. INCREASING AMBITION AND CLOSING LOOPHOLES

The window of opportunity to prevent catastrophic climate change is rapidly closing. Several studies show that current pledges are woefully insufficient to keep warming below 2°C. The first Kyoto commitment period (CP1) is estimated to be oversupplied by 14 billion tonnes of CO<sub>2</sub>e. The countries that have expressed willingness to sign up to a second commitment (CP2) period make up less than 15% of global emissions. The pledges they have made, are so weak that at current levels they will lead to another estimated 3-10 billion tonnes of CO<sub>2</sub>e surplus by 2020. In other words, business-as-usual emission trajectories are lower than the pledged emission reductions. This threatens the viability of a second commitment period and will stifle progress of a new climate treaty under ADP.

**Carbon Market Watch urges:**

- **All countries to significantly increase their emission reduction commitments to ensure the world has a reasonable chance to stay at below 2° Celsius of warming.**
- **All Annex 1 countries to join a second commitment period under the Kyoto Protocol with reduction commitments that are well below their 2012 emissions.**
- **Annex B countries to resolve any remaining issues that could hamper a second commitment period under the Kyoto Protocol. These include, inter alia, eligibility and the carry over rules of the surplus.**
- **Annex B countries to include language in the Kyoto Protocol as proposed by the EU (Article 15)<sup>4</sup> that would enable Annex B countries to increase their pledges at any time during the second commitment period.**

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<sup>1</sup> Formerly CDM Watch

<sup>2</sup> Betts R., Collins M., Hemming D., Jones C., Lowe J., Sanderson M., (2011). When could global warming reach 4°C? Phil. Trans. R. Soc. A 2011 vol. 369, 1934 p.67-84 doi: 10.1098/rsta.2010.0290

<sup>3</sup> Anderson K., Bows A. (2011). Beyond ‘dangerous’ climate change: emission scenarios for a new world. Phil. Trans. R. Soc. A 2011 vol. 369, 1934 p.20-44, doi: 10.1098/rsta.2010.0290

<sup>4</sup> 15. Parties included in Annex I may, at any time, revise their quantified emission limitation and reduction objectives inscribed in Annex B, with a view to strengthening their commitments under this Protocol. In order to ensure that such revision is immediately effective, by means of a decrease in a Party’s quantified emission limitation and reduction objective, the concerned Party may forfeit part of its assigned amount units, transferring these units to a cancellation account established for this purpose, under its national registry, and communicating such a transfer to the UNFCCC secretariat thereafter. See: <http://unfccc.int/resource/docs/2012/awg17/eng/crp01.pdf>

## 2. CARRY-OVER OF KYOTO SURPLUS UNITS

Kyoto Protocol rules allow countries to carry over any unused Assigned Amount Units (AAUs) into the next commitment period. A number of countries, such as Russia, Ukraine and Poland, have very large surpluses of AAUs. The surplus from the first Kyoto commitment period is estimated to be 13.1 billion tonnes of CO<sub>2</sub>. Russia (5.8), Ukraine (2.6) and Poland (0.8) are the largest surplus holders, followed by Romania (0.7), the UK (0.5) and Germany (0.5).<sup>5</sup> The carry-over of CDM and JI offsets further increases the size of the surplus.

This surplus threatens the viability and effectiveness of international climate policy regimes.<sup>6</sup> If the issue is not resolved, a second commitment period under the Kyoto protocol may not be possible. It is therefore of vital importance that this issue be resolved in Doha.

At the negotiations in Bangkok in August 2012, G-77 and China presented a joint proposal which would allow full carry-over of the surplus but limit its use, not allow trading, and require the cancellation of the remaining surplus by the end of the second commitment period.

***Carbon Market Watch urges Parties to the Kyoto Protocol to agree to a carry-over solution that will protect the environmental integrity and viability of future global climate deals, including a second commitment period under the Kyoto Protocol. Parties should therefore agree to a solution of the surplus issue in line with the G-77 proposal and ensure that:***

- ***No new “hot air” AAU surplus is accumulated in the second commitment period. To be eligible to use any surplus AAUs, CERs and/or ERUs at all, a Party must have a reduction target for the second commitment period that is lower than its 2012 emissions.***
- ***The already insufficient pledges are not further weakened through the use of surplus. The use of surplus must be severely restricted. Furthermore, any surplus should only be used for domestic compliance and should not be traded.***
- ***All surplus is cancelled permanently by the end of the second commitment period.***

## 3. ELIGIBILITY ISSUES RELATING TO THE SECOND COMMITMENT PERIOD UNDER KP

Countries still have to agree whether Parties that do not sign up to CP2 should have access to the Kyoto Mechanisms. In other words, Parties still have to agree who should be able to buy or sell emissions rights from Emission Trading, the Clean Development Mechanism (CDM) and Joint Implementation (JI).

***Carbon Market Watch urges Parties to decide that:***

- ***Only Parties that join a second commitment period (i.e. that do submit a legally binding QUELRO) should be able to buy or sell Assigned Amount Units (AAUs). Such a provision ensures that countries not joining the second commitment period cannot sell their surplus AAUs (“hot air”) from the first commitment period.***
- ***Only Parties that join a second commitment period (i.e. that do submit a legally binding QUELRO) should be able to use CDM offset credits for compliance. Without international binding targets, countries should not be able to benefit from UN offset carbon credits.***

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<sup>5</sup> Carry-over of AAUs from CP1 to CP2 –Future Implications for the Climate, by Thomson Reuters Point Carbon, September 2012. <http://bit.ly/AAUsurplusPointCarbon>

<sup>6</sup> The Phantom Menace: An introduction to the Kyoto Protocol Allowances surplus. CDM Watch and CCAP Policy Brief: July 2012. <http://bit.ly/SurplusPhantomMenace>

- **Only Parties that have submitted a legally binding QELRO for the second commitment period that is lower than their 2012 emissions should be able to sell JI credits in the second commitment period.** This requirement helps minimise the laundering of AAU surplus. Only countries with high ambition levels have an incentive to set robust and stringent criteria for additionality and baselines. Requiring a CP2 commitment with emission cuts below 2012 emission levels is therefore the single most important measure that needs to be taken to ensure the environmental integrity of JI.

#### 4. REVIEW OF THE CLEAN DEVELOPMENT MECHANISM (CDM)

Strong evidence points to the fact that the CDM has not delivered on its two goals of delivering emission reductions and bringing sustainable development to non-Annex 1 countries (see Carbon Market Watch's recommendations to the CMP8 on the CDM). Research done for the Policy Dialogue estimates that up to 3.6 billion CERs could be issued until 2020 from non-additional and/or over-credited CDM power projects.<sup>7</sup>

**Carbon Market Watch urges Parties to agree to initiate a thorough review of the modalities and procedures for the CDM with a view to:**

- **examining and significantly improving the environmental integrity of the CDM, limiting the CDM to project types which clearly provide real, measurable and additional emission reductions;**
- **ensuring that the CDM moves away from an offsetting mechanism and will provide significant net reductions for the atmosphere;**
- **ensuring that Board members are free of conflicts of interest, are selected based on professional expertise in a transparent process, and adhere to a robust code of conduct;**
- **introducing requirements that ensure that CDM projects adhere to the principles of other international law, such as human rights laws and environmental treaties on biodiversity, ozone layer protection, etc;**
- **introducing requirements in the modalities and procedure to assess whether CDM projects contribute to sustainable development;**
- **ensuring a more meaningful participation of affected stakeholders in the CDM throughout the lifecycle of a project;**
- **introducing of a grievance mechanism for environmental and social concerns related to CDM projects;**
- **ensuring that DOEs are paid by the UNFCCC secretariat taking into account their performance, in order to avoid the inherent conflict of interest that DOEs are paid by project developers and to address the significant shortcomings in the quality of work of DOEs.**

#### 5. NO CP1 AAUs FOR JI PROJECTS DURING THE GAP PERIOD

For each ERU sold, the host country has to retire one of its AAUs to avoid double counting. Since AAUs are tied to the Kyoto commitment period, it is not clear what will happen to the JI in the absence of a second commitment period, or what types of AAUs be used to "shadow" ERUs during the so called gap period, after the end of the first Kyoto commitment period and before a second commitment period will enter into force and Annex B countries under CP2 have received their AAUs.

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<sup>7</sup> Assessing the Impact of the CDM. Report Commissioned By The High-Level Panel On The CDM Policy Dialogue. July 2012. [http://www.cdmpolicydialogue.org/research/1030\\_impact.pdf](http://www.cdmpolicydialogue.org/research/1030_impact.pdf)

In paragraph 21 of the [JISC annual report to CMP8](#) the JISC recommends that either AAUs from the first commitment period can be used or that future AAUs from the second commitment period be deducted from future emission reduction targets adopted by Parties hosting JI project.

Using AAUs from the first commitment period is highly problematic, as current experience under Track 1 shows: Countries with large amounts of AAU surplus have started to use JI Track 1 to convert a significant number of AAUs to JI credits. In other words, countries with large AAU surplus can use the JI for “hot-air laundering.” This not only undermines environmental integrity but also threatens the viability of carbon markets.

The second option is also problematic in terms of preserving environmental integrity: Given the uncertainty of future pledged and QELROS, it does not seem prudent to shadow ERUs during the gap period with future AAUs.

The cleanest solution is to only allow issuance of CP2 ERUs once CP2 AAUs have been issued. However, the issue of how to treat JI credit issuance during the gap period is less problematic if the recommendations to strengthening the environmental integrity of the JI as elaborated in this document are implemented.

Carbon Market Watch furthermore recommends that Track 1 ERUs from countries with large amounts of surplus AAUs should not be bankable.

***Carbon Market Watch urges Parties to:***

- ***Decide that CP1 AAUs cannot be used to shadow ERUs issued in CP2;***
- ***Decide that ERUs can only be issued once a Party has been issued its AAUs for CP2;***