



Carbon Market Watch views on rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Paris Agreement

FCCC /SBSTA/2016 /2, para. 100

September 2016

The accredited organization Nature Code / Carbon Market Watch welcomes the opportunity to provide its views on matters relating to Article 6, paragraph 4, of the Paris Agreement.

Following the precedent of the Kyoto Flexible Mechanisms – the Clean Development Mechanism (CDM) and Joint Implementation (JI) – the Paris Agreement established a new ‘mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development’. The new mechanism bears some similarity to the CDM and JI, but will function in a radically changed world where Parties have committed to a new 1.5 C degree target, longer term deep de-carbonization, and a new climate regime in which all Parties make a variety of contributions.

In elaborating the rules, modalities and procedures of the new mechanism, it is essential that Parties flesh out a mechanism that accomplishes three key goals:

- Foster higher ambition for climate action;
- Ensure environmental integrity; and
- Contribute to sustainable development and uphold human rights.

Parties will however not have to build these elements into the mechanism from scratch. The experience with the CDM provided the world with a valuable catalogue of ways to approach mitigation and account for it, as well as lessons regarding the need to prevent perverse outcomes and to protect human rights. It will be up to Parties to make the most out of this experience and improve on them to make the new mechanism fit for purpose. Towards this end, Carbon Market Watch first describes the overall context of Article 6, paragraph 4 and its relation to other provisions and then provides views and recommendations.

KEY RECOMMENDATIONS

To foster higher ambition for climate action:

- *Deliver an overall mitigation in global emissions by applying a discount on actual emission reductions from the mechanism when demonstrating achievement of an NDC.*
- *Deliver an overall mitigation in global emissions by using the mechanism as an instrument for results based finance by purchasing units and cancelling them without using them for compliance or an emissions target.*
- *Exclude fossil fuels, and activities that cause perverse incentives such as improving the profitability of high emitting activities or which create a disincentive for governments to require reductions via a negative list.*
- *Promote actions that further economy and sectoral wide transformation or paradigm shift for truly long term mitigation benefits.*
- *Limit perverse incentives for unambitious NDCs by limiting crediting to least developed countries and small island developing states and use ambitious standardized baselines taking local and national circumstances into account.*

To ensure environmental integrity:

- *Facilitate robust accounting by encouraging Parties participating in the mechanism to move towards a standardized NDC format where mitigation action is expressed in multi annual budget terms covering their economy wide emissions.*
- *Avoid double counting by making accounting rules for the mechanism, cooperative approaches, and the demonstration of NDC achievement equally robust via the mechanism established by Article 15.*
- *Exclude technologies with a low likelihood of additionality via a negative list.*
- *Limit and review crediting periods to account for the working life of technologies and changes in additionality due to technological progress through time.*
- *Ensure impartiality by excluding negotiating Party delegation members from membership in the body designated by the CMA to supervise the mechanism.*
- *Ensure impartiality by inviting nominations from civil society for membership in the body designated by the CMA to supervise the mechanism.*
- *Ensure transparency by making all holding stakeholder consultations for the elaboration of the mechanism, making future meetings open to observers and the public, and publishing all crediting activity documents.*

To contribute to sustainable development and protect human rights:

- *Require activities to monitor and report co-benefits towards the achievement of the UN Sustainable Development Goals.*
- *Parties acquiring units generated by the mechanism should favor mitigation activities that promote the UN Sustainable Development Goals.*
- *Require local stakeholder consultations in a manner that protects the right to full and effective participation of affected peoples and communities for activities conducted under the mechanism.*
- *Establish an institutional grievance process to provide a means of recourse for project-affected peoples and communities.*



RELEVANT PROVISIONS OF THE PARIS AGREEMENT

When providing views on Article 6, paragraph 4, it is insufficient to consider the paragraph in isolation. Article 6, paragraphs 5 and 6 and COP decision paragraph 38 are directly relevant.

Further, for an accurate and holistic understanding of the mechanism, multiple other Articles and COP decisions have a direct and indirect bearing and should be taken into consideration when elaborating rules, modalities and procedures for Article 6, paragraph 4. Though non exhaustive, these include: the preamble, notably regarding human rights, the rights of indigenous peoples, local communities, migrants, children, persons with disabilities, and people in vulnerable situations and the right to development; Article 2 on the long term 1.5 C goal; Article 3 on NDCS and ratcheting up through progression over time; Article 4 on de-carbonization; Article 13 on transparency; and Article 14 on stocktaking.

In particular, in shaping the role of the mechanism in the overall context of the Paris Agreement, it is important to remember that the remaining carbon budget to limit average temperature increase to well below 2°C and pursue best efforts to limit the temperature increase to 1.5°C (as expressed in Article 2), and achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gasses in the second half of this century (Article 4) calls for much higher ambition and urgent action in all sectors: “and-and” strategies. Compared to the CDM, this requires a rethinking of what role the mechanism should play and how it operates.

In **Article 6, paragraph 4 of the Paris Agreement**, “*a mechanism to contribute to the mitigation of greenhouse gasses and support sustainable development*” is established “*under the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement*” (CMA) and is to be “*supervised by a body designated by the CMA*”. Parties can use the mechanism “*on a voluntary basis*” and it shall aim:

- a) *To promote the mitigation of greenhouse gasses while fostering sustainable development;*
- b) *To incentivize and facilitate participation in the mitigation of greenhouse gas emissions by public and private entities authorized by a Party;*
- c) *To contribute to the reduction of emission levels in the host party, which will benefit from mitigation activities resulting in emission reductions that can also be used by another Party to fulfill its nationally determined contribution; and*
- d) *To deliver an overall mitigation in global emissions.*

Article 6, paragraph 5 stipulates that “*Emission reductions resulting from the mechanism ... shall not be used to demonstrate achievement of the host Party’s nationally determined contribution if used by another Party to demonstrate achievement of its nationally determined contribution.*” In contrast to Article 6, paragraph 2, the avoidance of double counting as a principle also finds its place in

the text in Article 6, paragraph 4 on the “mechanism”, but is rather rephrased explicitly in terms of parties not using the same emission reductions being used to “demonstrate achievement” of their NDC’s.

According to **Article 6, paragraph 7** “a share of proceeds from activities under the mechanism... 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”. Such a share of proceeds follows the example of the CDM, which also used a share of proceeds for adaptation (Article 12, paragraph 8, of the Kyoto Protocol).

Decision 38 “Recommends that the CMA adopt rules, modalities and procedures for the mechanism” on the basis of:

- a) *Voluntary participation authorized by each Party involved;*
- b) *Real, measurable, and long term benefits related to the mitigation of climate change;*
- c) *Specific scopes of activities;*
- d) *Reductions in emissions that are additional to any that would otherwise occur;*
- e) *Verification and certification of emission reductions resulting from mitigation activities by designated operational entities;*
- f) *Experience gained with and lessons learned from existing mechanisms and approaches adopted under the Convention and its related legal instruments;*

VIEWS AND RECOMMENDATIONS

Foster higher ambition for climate action

Any role for markets must be to increase ambition (as expressed in Article 6, paragraph 1). This means that if and when international units are used, they should be in addition to and beyond domestic action. Markets theoretically help seek out the cheapest mitigation options, but in and of themselves do not increase ambition beyond the overall cap set. The ability to buy units from elsewhere when those mitigation options are cheaper further poses a danger of lowering a carbon price which may lead to investment decisions that lock economies into high emitting fossil fuel infrastructure for the foreseeable future. Therefore, in the elaboration of the mechanism, it will be important that the mechanism is designed to not only seek out cheap mitigation options, but also increases ambition beyond current national contributions. In order to do so, three elements are key: producing a net atmospheric benefit, promoting a paradigm shift, and limiting perverse incentives for unambitious NDCs.

Deliver an overall mitigation in global emissions

Article 6, paragraph 4 (e) calls for “an overall mitigation in global emissions”, which means that the use of transfers from the mechanism must result in more emissions reductions than without the use of the mechanism or “net mitigation”.



Pure offsetting does not reduce emissions beyond a cap and therefore contributes to neither an overall mitigation in global emissions, nor an increase in ambition. If the mechanism is going to serve its purpose to allow for greater ambition, the use of the mechanism must reduce emissions beyond what countries have pledged in their NDCs leading to a net atmospheric benefit. The traditional use of the CDM did not accomplish this and therefore must be adapted to the post Paris world by either discounting or by using the mechanism for results based finance to purchase units and cancel them. Discounting can be done pre-issuance (on the supply side) issuing fewer units than reductions or post issuance where for every ton reduced in a host country, the buying country or entity is able to use less than a ton towards their reduction goals. Net mitigation can be accomplished by not crediting emission reductions anywhere, but by using the mechanism as a vehicle for results based finance to buy units and cancel them without applying them to any emissions reduction pledge or target.¹

Recommendations:

- *Deliver an overall mitigation in global emissions by applying a discount on actual emission reductions from the mechanism when demonstrating achievement of an NDC.*
- *Deliver an overall mitigation in global emissions by using the mechanism as an instrument for results based finance by purchasing units and cancelling them without using them for compliance or an emissions target.*

Promote a paradigm shift

The mechanism must work in concert with international commitments for climate finance, capacity building, and technology transfer and must help enable developing countries towards a paradigm shift towards de-carbonization and a low carbon economy (Article 4). In order to truly promote the mitigation of greenhouse gas emissions in both the short, medium, and long terms, the mechanism cannot be used for investments that would lead to a fossil fuel lock-in or towards unsustainable growth, as these plainly do not lead to a low carbon economy. Fossil fuels should therefore be excluded from the scope of the mechanism.

Promoting a paradigm shift further means that activities supported by the mechanism should not cause perverse incentives such as improving the profitability of high-emitting activities or by creating a disincentive for governments to mandate reductions through climate legislation in their respective countries.

A paradigm shift means moving far beyond small deviations from business as usual and towards programmatic interventions with high mitigation potential on the economy wide or sector wide scale, delivering long term reductions by fundamentally transforming behavior patterns, sectors, markets, and investment patterns, these could include modal shifts for mobility; fundamental changes in energy production,

¹ For further information, see the Stockholm Environment Institute's Policy Brief on „Potential for International Offsets to Provide a Net Decrease of GHG Emissions, available at <https://www.sei-international.org/mediamanager/documents/Publications/Climate/SEI-PB-2013-New-Market-Mechanisms.pdf>.



distribution, and consumption; and or agricultural practices; or adoption of new technologies.

Recommendations:

- *Exclude fossil fuels, and activities that cause perverse incentives such as improving the profitability of high emitting activities or which create a disincentive for governments to require reductions via a negative list.*
- *Promote actions that further economy and sectoral wide transformation or paradigm shift for truly long term mitigation benefits.*

Avoid perverse incentives for unambitious NDCs

When it comes to being able to sell credits without double counting. The lower the ambition of an NDC - either through an unambitious mitigation target or with a very limited scope - the more a country is able to credit and sell. While keeping in mind historic responsibility, this also creates a perverse incentive against ambitious NDCs in the present and in future, undermining future ambition and the progression of efforts over time (Article 3). In order to maximize ambition and limit this perverse incentive, crediting should be limited to least developed countries and small island developing states. Further, credits should always be on the basis of ambitious standardized baselines taking national and local circumstances into consideration.

Recommendation:

- *Limit perverse incentives for unambitious NDCs by limiting crediting to least developed countries and small island developing states and use ambitious standardized baselines taking local and national circumstances into account.*

Ensure environmental integrity

Article 6, paragraph 1 calls for Parties choosing to voluntarily cooperate do so while promoting environmental integrity. Environmental integrity in this context should be defined as making sure that the outcome of the cooperation does not lead to more emissions than would have occurred without the cooperation. In order to guarantee that this is the case, it is important to make sure that: double counting is avoided, that emission reductions are truly additional, that emission reductions have real, measurable, and long term benefits, and to ensure impartial governance of the mechanism.

Avoid Double counting

The new context of the Paris Agreement, where all Parties have NDCs, is complex. Under the Kyoto Protocol, the Parties with mitigation commitments had them expressed in multi-year CO₂e budgets. In Copenhagen and Cancun, many more Parties put forward various kinds of targets vastly expanding participation, but also increasing diversity and complexity. This is now reflected in the NDCs in the Paris Agreement.

Avoiding double counting in this context calls for a clear overall structure for NDCs and how cooperative approaches, the mechanism, and the framework for non-market approaches relate to each other. A robust oversight accounting and transparency regime



(Article 13) will be essential to stocktaking (Article 14), and implementation and compliance (Article 15) where, it is essential to have the most accurate understanding possible of and to what extent NDCs have been accomplished and how much further they can progress over time (Article 3).

While implementing NDCs and demonstrating their accomplishment in and of itself will be a challenge, using traded credits towards NDCs is a far greater challenge. Multiple Parties counting the same emission reductions towards their NDC target due to poor accounting leads to a net increase of emissions undermining environmental integrity. In order to ensure that the emission reductions from the mechanism are not double counted with other transfers, or in the phrasing of Article 6, paragraph 4 “*used to demonstrate achievement of the host Party’s NDC if used by another Party to demonstrate achievement of its NDC*” (paragraph 4(c)), it will be important that no provision of Article 6 or the Paris Agreement undermines another and international oversight and guidance be equally robust for the mechanism and for guidance for Article 6, paragraph 2.

For transfers between Parties with NDCs expressed in multi-year budgets of CO₂e, transfers under the mechanism could conceivably function like JI, where activities are carried out in one Party but transfers are subtracted from that Party’s NDC “budget” when another Party acquires it for use in its NDC. Accounting in this case is fairly straightforward and Parties should therefore be encouraged to express future NDCs in multi-year CO₂e budget terms.

Recommendation:

→ *Facilitate robust accounting by encouraging Parties participating in the mechanism to move towards a standardized NDC format where mitigation action is expressed in multi annual budget terms covering their economy wide emissions.*

COP decision 37 calls for the avoidance of double counting for Article 6, paragraph 2 via a “corresponding adjustment of both anthropogenic emissions by sources and removals by sinks” covered by their NDCs. Although no such guidance is given for accounting for transfers of emission reductions under the mechanism, such an approach should be expanded to the mechanism as well. Oversight for the issuance, transfer and use of units should be overseen by the mechanism established by Article 15 on implementation and compliance.

Recommendation:

→ *Avoid double counting by making accounting rules for the mechanism, cooperative approaches, and the demonstration of NDC achievement equally robust via the mechanism established by Article 15.*

Ensure additional, real, measurable and long-term emission reductions

Historical experience with JI however and the transfer of vast sums of non-additional emission reduction units shows that such transfers between parties will require very strong international oversight and governance given the hot air in NDCs and the



perverse incentive of both buyer and seller to inflate calculations of emission reductions for transfer. Therefore, a number of further measures will be required to guarantee environmental integrity as called for in Article 6, paragraph 1, for the “real” and “measureable” benefits referred to in COP decision 38 (b), and that they be “additional to any that would otherwise occur” in decision 38 (d).

Additional emission reductions with environmental integrity means that the atmosphere sees no difference between the reduction of a ton of emissions, or the emission of that ton but its full compensation elsewhere. The additionality of projects or interventions that produce units is critical. If projects or interventions are in fact no better than a business as usual scenario (would have occurred anyway), when used as an offset, the mechanism, like the CDM would actually contribute to a net increase in emissions. CDM and JI had very mixed results, with some projects highly likely to have actually reduced a ton, but many others very plainly not. Proving and testing for additionality proved to be a problematic, controversial, and sometimes a more political than scientific exercise in the CDM. To guarantee additionality, a number of measures should therefore be taken. Activity scope eligibility (as under COP decision 38(c)) should be restricted to project types that have a high likelihood of being additional, e.g. by introducing a negative list to exclude technology types with low likelihood of additionality and reviewing the list to account for technological progress.

Recommendation:

→ *Exclude technologies with a low likelihood of additionality via a negative list.*

Further, the length of crediting periods can pose difficulties since the lifetimes of many technologies are shorter than the crediting periods used under the CDM, which did not reflect that economic, political and/or technological circumstances inevitably change and may therefore render some projects – and therefore their credits – no longer additional, undermining the environmental integrity. Therefore, appropriate limits should be set on individual project crediting periods, defined per project type in the respective methodology that take into account, inter alia, the rate of innovation and change in the relevant sectors as well as relevant market and socio-economic developments.

Recommendation:

→ *Limit and review crediting periods to account for the working life of technologies and changes in additionality due to technological progress through time.*

Strengthen governance and transparency

To ensure impartiality, the body designated by the Conference of the Parties to supervise the mechanism should be nominated and selected transparently with stakeholder consultations on the elaboration of the mechanism. Board members should be free, independent, and not associated with Parties’ negotiating delegations. Civil society should have the opportunity to nominate board members, all meetings of the supervisory body should be open to the public and all documentation on crediting activities of the mechanism should be freely published.



Recommendations:

- *Ensure impartiality by excluding negotiating Party delegation members from membership in the body designated by the CMA to supervise the mechanism.*
- *Ensure impartiality by inviting nominations from civil society for membership in the body designated by the CMA to supervise the mechanism.*
- *Ensure transparency by making all holding stakeholder consultations for the elaboration of the mechanism, making future meetings open to observers and the public, and freely publishing all crediting activity documents.*

Contribute to sustainable development and protect human rights

Sustainable Development

Criteria by which sustainable development could be measured was lacking under the CDM, which led to different outcomes in different countries. Since the 2015 UN agreement on universal Sustainable Development Goals, the world has now found consensus on what sustainable development is, which can serve as a basis to evaluate efforts undertaken through both the CDM and future instruments such as the mechanism. Sustainable development before and especially after the agreement on the UN Sustainable Development goals means much more than reduced emissions. Public and private entities authorized by a Party that participate in the mechanism under Article 6, paragraph 4 should, in addition to building on inventories and accounting, report on how they promote and effectively further the variety of UN sustainable development goals. Further, it is vital to create incentives for sustainable development co-benefits that should be taken into account in the consideration of mechanism activities.

Recommendations:

- *Require activities to monitor and report co-benefits towards the achievement of the UN Sustainable Development Goals.*
- *Parties acquiring units generated by the mechanism should favor mitigation activities that promote the UN Sustainable Development Goals.*

Human Rights

The preambular reference to human rights in the Paris Agreement reinforces existing human rights obligations and provides a clear directive for States to operationalize human rights in the post-2020 climate regime. From the social and human rights perspective, great improvements must be made over current practice in the CDM to protect human rights, including but not limited to the right to participation (e.g. global and local stakeholder consultations) and the right of access to justice (e.g. grievance process). In multiple cases, CDM projects have caused grave social implications and were directly linked to human rights violations in local communities. Proper planning in the design and implementation —each with full and effective participation and, when applicable, free, prior and informed consent of affected peoples and communities— are crucial elements to avoiding harmful consequences of mitigation interventions.

Recommendation:



- *Require local stakeholder consultations in a manner that protects the right to full and effective participation of affected peoples and communities for activities conducted under the mechanism.*
- *Establish an institutional grievance process to provide a means of recourse for project-affected peoples and communities.*

There is a lack of capacity in many countries to ensure compliance and enforcement and therefore, in addition to effective public participation, access to judicial review in cases where negative impacts occur is a fundamental element to ensure sufficient social integrity of emission reductions. Due to a missing grievance mechanism in the CDM there is no way civil society and affected local communities can seek redress in case national or international rules are not followed or in the event a registered CDM projects has other negative impacts. This must therefore be included in the mechanism.

Recommendation:

- *Establish an institutional grievance process to provide a means of recourse for project-affected peoples and communities.*