

Recommendations for SBSTA49 agenda item 11(b) as it relates to rules, modalities and procedures for the mechanism established by article 6.4 of the Paris Agreement

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In determining the rules, modalities, and procedures for Article 6.4, it is imperative that Parties learn from past experiences and strive for this mechanism to contribute to greater ambition.

Specifically, lessons should be drawn from the Kyoto Protocol's carbon offsetting mechanisms, the Clean Development Mechanism (CDM) and Joint Implementation (JI). The Sustainable Development Mechanism designed under article 6.4 of the Paris Agreement should integrate provisions to ensure environmental integrity, including in the avoidance of double counting, achieve overall mitigation in global emissions, foster sustainable development, and protect human rights.

The Paris Agreement sets a new global dynamic for climate action under which all countries have mitigation targets and should engage in domestic decarbonization activities to the most of their abilities, reflecting the principle of common but differentiated responsibilities. This effort from all countries requires a transition away from the concept of offsetting, notably through a fresh start with the Sustainable Development Mechanism (SDM), coinciding with the end of the Clean Development Mechanism (CDM).

The challenge is to create a framework for the SDM that moves away from the concept of offsetting and incentivises mitigation activities through results based climate finance. This means carbon credits are not claimed towards meeting emission reduction objectives but the financial flows spanning carbon markets are accounted for towards climate finance objectives. In doing so, the rules and modalities of the SDM should benefit from existing structures while learning from the failures of the CDM.

This document provides an overview about key issues - a shift away from offsetting, a controlled transition of Kyoto Protocol mechanisms, governance requirements and human rights safeguards - to be considered in the process of defining the rules, modalities and procedures of the SDM and refers to the Joint reflection note by the presiding officers of the Ad Hoc Working group on the Paris Agreement, the Subsidiary Body for Scientific and Technological Advice, and the Subsidiary Body for Implementation, Addendum 2.

RECOMMENDATIONS

→ Moving away from zero-sum offsetting by establishing the SDM as a tool for results based climate finance, with the objective of using and promoting the use of the mechanism to meet finance commitments under article 9 of the Paris Agreement. This should be promoted while avoiding double counting between mitigation and climate finance objectives.

- At a minimum, a partial cancellation rate should be applied to each credit in order to achieve overall mitigation in global emissions.
- Ensuring environmental integrity by establishing robust criteria for climate projects under the SDM. Also limit the scope of activities to emission reductions, and not removals.
- To avoid double counting of emission reductions, the guidance developed under Article 6.2 should apply to all transferred units, including domestic transfers, e.g. units transferred from a national registry to an airline based in the host country. The International Transaction Log, as well as the national registries, set up under Article 6.2 should also cover SDM credits.
- Limit the scope of eligibility for SDM projects to sectors and gases which are included inside the host Party's NDC.
- Projects registered under the KP mechanisms should be fully re-assessed before they can be transitioned to the SDM. No pre-2020 units should be eligible for use towards emission reductions targets post-2020. Existing KP projects should also not be allowed to issue 6.4 credits unless they are registered under the SDM (using robust criteria for their reassessment). Finally, CERs which have not been cancelled or retired under the KP should not be transferred to the SDM registry.
- Establish accountability by ensuring the constitution and conduct of all SDM governance bodies is impartial, transparent and prevents any conflicts of interest. This should include a limit to the number of terms any member can serve, and rules to prevent conflicts of interests.
- Set up a grievance mechanism governed by an independent body.
- Adopt adequate public participation tools, including clear rules for the conduction of mandatory local stakeholder consultations prior to the implementation of any SDM projects.
- Foster sustainable development by developing an environmental and social policy for the SDM including means for monitoring and validation. At a minimum, this requires Parties to report on how a specific activity contributes to Sustainable Development in the host country.

Increasing ambition

Moving away from the concept of zero-sum offsetting

To fulfil the condition of increasing ambition beyond the concept of offsetting, the SDM should be established as a scheme for results based climate finance (RBCF). This approach would entail that a host country could account for achieved emission reductions while the finance contribution to enable the mitigation activity could be accounted for against the climate finance commitment of the financing party. Contrary to an offsetting system, RBCF schemes can truly lead to increasing ambition because the emissions reduced in the host country will not be displaced by increased emissions from the buyer countries. Parties which purchase SDM credits should use these to meet climate finance targets, as defined inter alia under article 9 of the Paris Agreement. In a post-Paris world where all countries have climate targets, and given that several countries have below-BAU targets, an RBCF system will avoid that emission reductions which would have happened anyway will be used to meet stringent targets in other countries.

At a minimum, units which are transferred to be claimed by a Party or another entity, should be subject to a partial cancellation rate of 50% at the point of first transfer, in order to achieve an overall mitigation in global emissions as called for under article 6.4(d).

Ensuring Environmental Integrity

Even when moving beyond carbon offsetting, ensuring the environmental integrity of units from the SDM is important. In light of this, the rules, modalities, and procedures of Article 6 need to ensure that project activities generate emission reductions which are real, verifiable, permanent and additional, and do not incentivise technologies that prevent the transition towards a low-carbon society or have negative environmental impacts, such as coal. Project activities should further contribute to sustainable development and foster the transition towards low emissions development strategies of participating Parties communicated in accordance with article 4 paragraph 14.

For the unique case of aviation's offset market, where a claim will be made on units to achieve their goal of carbon neutral growth above 2020 levels, strict double counting rules should apply (see our recommendations for Article 6.2) as well as the application of a partial cancellation rate in order to achieve overall mitigation in global emissions.

Finally, in order to avoid creating perverse incentives against NDC expansion, and distorting GHG reporting from sectors and gases not covered by a Partie's NDC, crediting activities should be limited to sectors and gases which are *inside* the scope of NDCs, i.e. for which there is a clear and quantified emission reductions target.

Enacting a controlled transition into post-2020 markets to end the Kyoto Protocol mechanisms

The Sustainable Development Mechanism under article 6.4 aims to serve to increase climate ambition among Parties, and contribute to overall mitigation of GHG emissions. This goal marks a clear break from the logic of offsetting and calls for the end of the CDM, which is based on the concept of zero-sum offsetting.

A key question relates to the fate of the almost 8.000 projects, currently registered under the CDM, and the associated units from these projects. While finance for pre-2020 projects at risk of discontinuing mitigation should be secured, the SDM needs a fresh start to ensure the uptake of new projects post-2020 for an overall environmental benefit in line with the environmental integrity criteria above.

This means that all CDM projects should be re-assessed against stringent environmental integrity and sustainable development criteria before they can be transitioned post-2020. Only projects which are vulnerable to discontinuation *and* which have no other sufficient sources of support, could be transitioned to the SDM. No pre-2020 units should be eligible for use towards achievement of a mitigation target post-2020.

KEY RECOMMENDATIONS

→ Moving away from zero-sum offsetting by establishing the SDM as a tool for results based climate finance, with the objective of using and promoting the use of the mechanism to meet finance commitments under article 9 of the Paris Agreement (**as laid out in Section XVII, sub-section A., Option A, paragraph 112**). This should be promoted while avoiding double counting between

mitigation and climate finance objectives (as laid out in Section XVII, sub-section A., option A, paragraph 113, item (c)).

- At a minimum, a partial cancellation rate should be applied to each credit in order to achieve overall mitigation in global emissions, as laid out in Section XV, option B, paragraph 98.
- Ensuring environmental integrity by establishing robust criteria for climate projects under the SDM. **Maintain all items of Section XII, sub-section B., paragraph 70;** also define additionality as under **Section XII, sub-section D., paragraph 74, option A2;** limit the scope of activities to emission reductions by **selecting only item (a) in Section III, option A, paragraph 3;** adopt conservative and dynamic baselines by **combining options A2 and A3 in Section XII, sub-section C., paragraph 72.**
- To avoid double counting of emission reductions, the guidance developed under Article 6.2 should apply to all transferred units. **Section XVI, option A (paragraph 105) should therefore be selected, and amended to delete “internationally”,** to ensure that also units transferred from a national registry to an airline based in the host country are covered by the corresponding adjustment requirements. The International Transaction Log, as well as the national registries, set up under Article 6 should also cover SDM credits.
- Limit the scope of eligibility for SDM projects to sectors and gases which are included inside the host Party’s NDC, as laid out in section XII, sub-section A, option A, paragraph 65.
- Projects registered under the KP mechanisms should be fully re-assessed before they can be transitioned to the SDM, as laid out in option B of Section XVIII, sub-section A, paragraph 124, while developing the requirements under paragraph 125 to establish a list of robust quality criteria which are no less ambitious than the requirements set out under the RMPs of article 6.4. No pre-2020 units should be eligible for use towards emission reductions targets post-2020, as laid out in Section XVIII, sub-section B., option D (paragraph 128); also in Section XVIII, sub-section C., option D (paragraph 130). Existing KP projects should also not be allowed to issue 6.4 credits unless they are registered under the SDM (using robust criteria for their reassessment), as laid out in Section XVIII, sub-section B, paragraph 129, option B; and Section XVIII, sub-section C, paragraph 131, option B. Finally, CERs which have not been cancelled or retired under the KP should not be transferred to the SDM registry, hence option B of Section XVIII, subsection C, paragraph 132 should be preferred.

SDM Governance Requirements

Learning from governance structures under the CDM and JI

The central body overseeing the rules and implementation of the Sustainable Development Mechanism can learn from the CDM Executive Board.

The constitution and conduct of the supervisory and supporting bodies of the Sustainable Development Mechanism: The SDM has to be governed in a professional, transparent, accountable and independent manner. Experience has shown that the two primary goals of the CDM (real, additional and verifiable emission reductions and sustainability benefits) are not always sufficiently considered by the CDM Executive Board. To ensure good governance, particular attention must be paid to establishing:

- Robust codes of conduct for all members of the SDM governance structure including boards, working groups or teams assisting the Board, and members of the UNFCCC Secretariat
- Prohibiting nominations from representatives with vested interest in the SDM, including any project which is or is seeking to be registered under the mechanism, in order to prevent potential conflicts of interests.
- Ensuring that quota rules on composition of the Board are established that ensure that members from environmental and academic organisations are represented.
- Establishing cumulative term limits so that Board members may only serve a maximum of two terms of two or three years each.

The establishment of an independent body to address grievances: There is a need to address the social and environmental impacts of future activities under the SDM during implementation. This includes considering and addressing concerns about human rights impacts of a particular activity raised by or on behalf of individuals and communities. An independent body is required to carry out such work in a fair and impartial manner.

The creation of public participation channels: The structure of the SDM should ensure frequent and open channels with outside stakeholders. This can be provided for in the SDM decision making process through open meetings, public documentation and public calls for input, which is standard practice in the UNFCCC. An essential addition to these functions will be establishing a local stakeholder consultation process to ensure proper implementation of projects and the protection of human rights.

Social and Human Rights safeguards in the SDM

Protecting human rights

The Paris Agreement's accompanying COP decision recognizes the significance of building on the experiences gained and lessons learned from existing mechanisms and approaches adopted under the Convention.¹ To prevent repeating old mistakes and to help ensure the SDM's success, human rights must be at the core of the new mechanism's modalities and procedures. This means that rules should include the design of an institutional SDM grievance process to allow stakeholders to seek recourse against the impacts of mitigation projects. This mechanism should be operational to protect inter alia against human rights infringements. To that end, Section XIII, subsection J of the draft RMPs should be further developed to lay out the process which must be followed when a human right violation or other type of grievance is brought to the attention of the independent body in charge of managing the grievance mechanism.

In addition, these stakeholders should be involved throughout the design and implementation stages of the project to avoid or minimize such negative impacts. This requires the inclusion in the rulebook of detailed rules for conducting local stakeholder consultations in the context of SDM projects. The existing references to local stakeholder consultations in the draft RMPs (paragraphs 48(m) and 70(f)) should be

¹ UNFCCC, Paris COP Decision, Decision 1/CP.21, 2015, para. 38(f)

kept in the final rulebook, but they are insufficient and a more detailed description of how stakeholders must be consulted should also be included in the rulebook.

Without these rules and channels for decision making, stakeholders - including all governments, civil society and carbon market actors - may be shut out of ensuring that the SDM ensures environmental integrity, establishes social safeguards, and contributes to sustainable development. Essential consideration to ensure sustainable development is elaborated in the following section.

- Establish accountability by ensuring the constitution and conduct of all SDM governance bodies is impartial, transparent and prevents any conflicts of interest. This should include a limit to the number of terms any member can serve (for example **as described in Section VI, subsection B., paragraph 20, option C1**). It should also include the prevention of conflicts of interests, including **as suggested in Section VI, subsection B., paragraph 22, item (a), and all items of paragraph 24 under the same section.**
- Set up a grievance mechanism governed by an independent body. To this effect, establish and further define the roles of this independent body **under Section XIII, subsection J, items 1 and 2 (paragraphs 89 and 90)**.
- Adopt adequate public participation tools, including clear rules for the conduction of mandatory local stakeholder consultation prior to the implementation of any SDM projects, **as laid out in section XII, subsection B, item (f) of paragraph 70.**

Sustainable Development

The SDM is intended not only to deliver an overall mitigation in global emissions, but also to foster sustainable development. The development of the SDM rules need to learn from the challenges of its predecessor, the CDM, which suffered from a lack of definition and clarity for validation and verification towards its goal of contributing to sustainable development in host countries.

Learning from this experience, the SDM modalities and procedures should clarify the role of host country governments in ensuring that SDM projects foster sustainable development, by developing sustainable development criteria, including requirements for sustainable development action plans and means for monitoring and validation.

The SDM development should also import elements from other existing mechanisms, such as from the environmental and social policy of the Adaptation fund, which requires environmental and social management systems for identifying and assessing environmental and social risks in an open and transparent manner with appropriate consultation, including assessing compliance with principles of domestic and international law related to marginalized and vulnerable groups, human rights, gender equality and women's empowerment, core labour rights, indigenous people, and public health.

Promoting sustainable development is intrinsically linked to the imperative of including strong provisions for the social implications of climate mitigation projects. Parties issuing credits under the SDM should therefore be able to demonstrate that the projects they implemented did not result in adverse impacts on the environment or violated human rights. References to human rights in the Draft RMPs should therefore be kept in the final rulebook, including Paragraphs 48(j), 70(k) and 90.

→ Foster sustainable development by developing an environmental and social policy for the SDM including means for monitoring and validation. At a minimum, this requires Parties to report on how a specific activity contributes to Sustainable Development in the host country, **as laid out in Section VIII, subsection B., option A, items (d) and (e).**



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