Carbon Market Watch briefing for ministerial discussions on Article 6 of the Paris Agreement

- July 2021

The UK COP Presidency has planned informal ministerial consultations on July 7 and July 12, in order to make progress on Article 6, which is still in stalemate despite recent technical discussions. Ministers have been asked to discuss a set of framing questions on three key sticking points: double counting of emissions, possible transition of Kyoto Protocol units, adaptation finance.

Given that this ministerial could close the gaps on these important issues and that progress in negotiations must not come at the expense of environmental integrity, Carbon Market Watch has prepared a briefing for ministers and their teams to guide their reflections and propose solutions.

The busy minister's summary

1) Double counting of emission reductions under Article 6:

- Double counting (includes double claiming) is expressly forbidden under Article 6 since any form of it would undermine the Paris Agreement.
- Countries and decision makers in favour of allowing double counting are eroding the environmental integrity of Article 6.
- To avoid double counting, corresponding adjustments must apply to all Article 6 mitigation activities, whether for domestic compliance or international transfer.

2) Use of pre-2020 Kyoto Protocol units to achieve Paris Agreement NDCs:

- The Paris Agreement is not a continuation of the Kyoto Protocol (KP). It is a unique international agreement without any mandate to transfer KP market mechanisms.
- Carrying over KP units would increase emissions overall, which is simply unacceptable and even untenable in the Paris Agreement text.
- A carry-over would also flood the new 6.4 market with junk credits. This would erode confidence and market activity, ultimately stifling new business development.

3) Finance for adaptation under Article 6:

- Article 6 requires adaptation finance to be delivered to developing country Parties, through a share of proceeds (SOP) on credits.
- SOP for adaptation should be an in-kind *and* monetary contribution to generate stable revenue. The "in-kind only" model of the CDM produced poor results.
- SOP must apply to Article 6.4 but should also apply to 6.2. If Parties cannot find agreement, then a clear mechanism is needed for developed countries to channel adaptation finance to developing countries.
- Failing to guarantee stable adaptation finance flows will continue to harm trust between developed & developing countries. This will bar progress on a deal, today and in the future.

Introduction

In this briefing, Carbon Market Watch provides a concise explanation of key points and considerations in response to the UNFCCC's three guiding questions for ministerial discussion.

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Guiding question #1: How can we avoid the double claiming of emission reductions from the Article 6.4 mechanism, in a way that respects the nationally determined nature of NDCs and is consistent with the aim to move over time towards economy-wide emission reduction or limitation targets?

Double counting undermines the Paris Agreement and cannot be accepted

- Double claiming of emission reductions (a subset of double counting) cannot be allowed under Article 6. Any double claiming undermines climate ambition, the Paris Agreement, and especially the 6.4 mechanism
- Article 6.5 expressly forbids double counting. No exceptions can be made. Moreover, from a strict accounting perspective, double counting simply doesn't add up.
- Article 6.2 establishes an accounting framework applying to all Internationally Transferred Mitigation Outcomes (ITMOs). Article 6.4 establishes a mechanism which will enable the transfer of emission reductions, so these transfers should be subject to article 6.2 accounting provisions and article 6.4 credits should be considered ITMOs.

Corresponding adjustments are "a must" to prevent double counting

- To ensure no double counting, Host Parties must apply corresponding adjustments for all mitigation outcomes, including Article 6.4 emission reductions.

- Applying corresponding adjustments comes down to integrity and sound accounting:
    - First, it guarantees emissions reductions aren't double counted.
    - Second, it provides greater transparency so long as the corresponding adjustments are reported.
- In turn, corresponding adjustments will generate confidence in the future Article 6.4 mechanism, so long as they are consistently applied and fully reported.

<u>Corresponding adjustments must apply to all of Article 6, as soon as the rulebook is finalised</u>

- If Parties agree that 6.4 emission reductions can come from sectors/gases outside the scope of a host Party's NDC, then corresponding adjustments are mandatory also for those reductions:
    - Otherwise, a perverse incentive is created whereby Parties may delay moving towards more ambitious and economy-wide NDCs.
    - It is also difficult to define and track what exactly falls within or outside the scope of a NDC owing to the general nature/language of NDCs. This lack of clarity also provides perverse incentives.
    - Hence, corresponding adjustment should apply to any and all 6.4 emission reductions, whether within or outside an NDC's scope.
- Corresponding adjustments must apply once Article 6 rules are finalised. No transition period is warranted during which corresponding adjustments would be optional.
- Applying corresponding adjustments may require capacity building in certain countries and will require regular monitoring to ensure proper accounting.

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Guiding question #2: How can we balance recognising the investments of existing market actors whilst protecting overall ambition, when considering the potential use of pre-2020 units against NDCs?

<u>No mandate to transition Kyoto Protocol units to the Paris Agreement framework</u>

- Kyoto Protocol flexible mechanisms simply have no mandate to continue under the Paris Agreement. Parties concluded the Paris Agreement as a new and distinct agreement, guided by more ambitious goals and different rules, including on carbon markets.
- Just before the Kyoto Protocol's second commitment period ended in December 2020, the CDM Executive Board decided to halt the operation of the CDM (pending a future decision at COP 26). De facto, this means no new CDM project can be registered, no crediting period renewed and no credit issued for reductions post-2020.

- A final decision will be made on the CDM at COP 26, but the provisional cessation of the CDM confirms many Parties' contention that there is no basis for Kyoto Protocol units to continue to be used under the completely distinct framework of the Paris Agreement.

Use of pre-2020 units against NDCs would extend flawed methodologies and increase emissions

- Kyoto Protocol units largely did not meet criteria for additionality. An analysis of three-quarters of all CDM projects in 2016 found that 85% likely overestimated emission reductions and were not "additional" in nature.
- Even when Kyoto Protocol units led to the claimed additional emission reductions, these occurred many years ago. "Claiming" these against NDCs, years after the fact, is problematic.
- Modelling exercises confirm that the transition of Kyoto Protocol certified emission reductions (CER) would lead to an increase in global emissions:
    - A new report conducted by 3 leading think tanks and commissioned by the Least Developed Countries group finds that each CER transitioned would lead to a corresponding increase in global emissions. This occurs even for CERs issued after a 2016 cutoff year.
- Using Kyoto Protocol units against NDCs would increase emissions overall, which simply cannot be allowed. It is clearly at odds with the Paris Agreement's stated goals to increase climate ambition and reduce emissions overall.

Carrying over Kyoto Protocol units would flood the market and stifle new activities

- Under the Kyoto Protocol there was a vast oversupply of CERs, which greatly drove down the price of credits to the detriment of project developers. Allowing Kyoto Protocol units to transition would replicate the same result under the Paris Agreement.
    - To be precise, allowing CERs to transition could flood the new market with up to 4 billion junk credits. Obviously, this is bad for the climate, but it would also significantly depress prices and demand for credits under the 6.4 mechanism.
    - A market flooded with junk credits is bad for all project developers, but especially those seeking to implement new projects that are compliant with Article 6.4.
- Carrying over Kyoto Protocol units is thus not in Parties' interests, since it will make it less attractive for new businesses and project developers to enter the system. It would only reward legacy project developers who implemented projects in the past, but it would actively dissuade new actors from engaging in new mitigation activities.

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Guiding question #3: How can activity under both Article 6.2 and Article 6.4 support adaptation action, including through generating finance for adaptation, and could this be achieved differently between the two instruments?

Scaling up climate adaptation via a "share of proceeds" (SOP) is a key goal of Article 6

- Article 6 sets out that voluntary cooperation should achieve higher ambition in adaptation and mitigation actions, and promote sustainable development. Mitigation tends to be the focus of Article 6 discussions, but there is a clear mandate to deliver adaptation benefits.
- As mandated in Article 6.6, SOP must be levied on the Article 6.4 mechanism to assist developing country Parties to meet the costs of adaptation.

SOP must deliver stable adaptation finance and shouldn't be an "in-kind" contribution only

- SOP for adaptation should be a combination of in-kind and monetary contributions rather than purely in-kind. This would correct the problems of a solely in-kind model experienced under the Kyoto Protocol.
    - Under the CDM, SOP for administrative expenses was a monetary contribution, generating revenue in excess of actual administrative costs by a factor of three. However, the 2% in-kind levy on CERs for adaptation was directly impacted by the crash in CER prices and hence produced far less revenue overall.

SOP for adaptation is required for Article 6.4 but should also apply to Article 6.2

- While SOP for adaptation must apply to Article 6.4, it should also apply to 6.2. Article 6.2 states that it shall promote sustainable development and ensure environmental integrity. Extending SOP for adaptation to 6.2 would provide these co-benefits and more.
    - Not doing so could even jeopardise Article 6.4 mitigation and adaptation benefits, given that emission reductions from 6.4 and internationally transferred mitigation outcomes from 6.2 can both be used towards NDCs or other international purposes, and are effectively interchangeable.
- To go beyond statements and actually ensure additional adaptation finance is delivered, SOP for adaptation in the 6.2 mechanism must be included in the Article 6 rulebook.
- If Parties don't agree to apply SOP to 6.2, then at a minimum, a clear mechanism and channel are needed through which developed countries will provide adaptation finance.

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