Article 6 – State of Play

DISCUSSION PAPER

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THE ENERGY AND RESOURCES INSTITUTE
Creating Innovative Solutions for a Sustainable Future

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ACKNOWLEDGEMENTS

The authors would like to thank Mr. Dipak Dasgupta, Distinguished Fellow, TERI and Mr. Karan Mangotra, Associate Director, TERI for their constructive comments on earlier drafts.

All opinions expressed, as well as omissions and eventual errors are the responsibility of the authors alone.

SUGGESTED FORMAT FOR CITATION

Tamiksha Singh and Ritu Ahuja, TERI Discussion Paper 2019

Article 6 – State of Play. New Delhi: The Energy and Resources Institute. 12 pp.

Editorial and design: Shikha Dimri, Sudeep Pawar

PUBLISHED BY

The Energy and Resources Institute (TERI)

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Introduction

The advent of COP25 brings a greater sense of urgency than ever before. With the rulebook on operationalization of the Paris Agreement largely accepted, the key and most contentious issues around have now been thoroughly discussed. An analysis of Party submissions and past negotiations since 2017 has shown that the key highly debated and contentious issues are around ensuring environmental integrity with robust accounting methods and mechanisms, specifically through clarifying and detailing the approaches for corresponding adjustments and for avoiding double counting in the process. Upcoming negotiations will determine the finer details of how Article 6 will shape up, but the broader pressing issue at hand remains the constraint of time in the face of exponentially rising global temperatures.

Article 6 of the Paris Agreement focuses on a framework for countries to voluntarily cooperate using market and non-market based approaches to raise ambition, thus providing an opening for carbon markets in the post-2020 regime. Although the rulebook of Paris Agreement was largely agreed upon at COP24 held in Katowice in December 2018, Article 6 was the only one left pending. Two key sections under the Article that are contentious and critical to the functioning of carbon markets and trading going forward are Article 6.2 and Article 6.4.

Article 6.2 is directed towards those mitigation activities that are carried out outside the geographical jurisdiction of a Party but are utilized in achieving its NDCs. This can be done through Internationally Transferred Mitigation Outcomes (ITMOs), which in effect make possible linking multiple emission reduction mechanisms such as Emission Trading Schemes (ETS) and other bilateral cooperation schemes between Parties. The key underlying necessity in this process is that the transfer of ITMOs must be robustly accounted for to ensure environmental integrity.

Article 6.4, informally referred to as a sustainable development mechanism (SDM), is perceived to be a familiar territory. Many consider it to be an improved version the Clean Development Mechanism (CDM), one of the market mechanisms under the Kyoto Protocol. The SDM establishes a centralized mechanism allowing Parties to register mitigation projects and get credits issued for these. The mechanism under Article 6.4 is subject to a provision stating that it shall aim to overall mitigate global emissions. Further, it should enable Parties to implement GHG mitigation activities, which in turn can help fulfil their NDCs and support sustainable development. The Article does not specify the scope of the mitigation activities that can be broadened to include sectors or policies at this stage.

The main point of contention at COP24 was the proposed 'corresponding adjustments' for ensuring that overall global emissions are reducing, especially under the cooperative approaches envisaged to increase climate ambition. This resulted in the issue of international trading of carbon credits, carbon markets, and market mechanisms under Article 6 being pushed to the next COP, which will now be taking place in December 2019 at Madrid. There is a need for robust guidance, rules, modalities, and procedures around these areas, which are being negotiated at the international forum.

Key Issues Around Articles 6.2 and 6.4

Articles 6.2 and 6.4 have the potential to operate in silos. However, there are implicit linkages and overlaps between some aspects of both that require careful treatment as they could help raise overall ambition of Parties. In simple words, Article 6.2 can be understood as 'guidance' on ITMOs and carbon trading for using voluntary action to meet respective Parties' NDCs. Article 6.4 is a type of 'CDM+' or an enhanced CDM as a centralized crediting market based mechanism under the purview of UNFCCC that aims to address weaknesses and gaps existing in the earlier mechanism to make it more robust and effective for achieving global climate goals. A key point of overlap that exists between the two articles is corresponding adjustments of emission reduction units.

The intent of Article 6.2 is clear. It is meant to account for emission reduction that occurs outside a central market based mechanism such as that proposed under Article 6.4. These emission reductions are likely to be from other voluntary cooperative mechanisms among parties. This Article proposes to account for them via ITMOs as a means of tracking such mitigation outcomes. While the intention is largely well placed, the following are some key issues in Article 6.2 that have been widely discussed over the past COPs without reaching at a consensus:

i. How broad or defined is the scope of ITMOs and its institutional form?

ii. How to design and operationalize robust accounting to avoid double counting?

iii. How best to ensure transparency and environmental integrity as required under the Paris Agreement?

Issues pertaining to Article 6.4 are less compared to Article 6.2 owing to its familiar nature and based on the previous experience with Kyoto Protocol mechanisms. However, key issues that still remain to be finalized with regard to Article 6.4 are the following:

i. How integrity will be ensured?

ii. How the mechanism will be governed?

iii. How will old mechanisms (primarily CDM) transition to 6.4?

Scale of Contention

As a run up to COP25, this paper provides an overview of some issues that have continued to be sticky points during negotiations among Parties. There have been three rounds of submissions by Parties on inputs to operationalize Article 6 (between 2015 and 2017), on the basis of which informal notes have been prepared for Articles 6.2 and 6.4. These were first circulated following the SBSTA meeting in May 2018. The notes were further discussed in Bangkok in September 2018, with the aim of building consensus on their operationalization before discussions at COP24 in December 2018. For the purpose of this brief, submissions by Parties to SBSTA over the past few years starting from 2015,[1] informal drafts for discussion of Articles 6.2 and 6.4 issued by the chair, and SBSTA final reports[2] over the past years were used to detail the key issues. Based on the known stances taken by different groups of Parties and a 'tonality' assessment of their submissions, this paper presents a 'scale of contention' of the key issues under Articles 6.2 and 6.4, highlighting the observed degree of agreement or disagreement that Parties have had on the various nuanced issues of the articles (Figure 1).

[1] *Details available at https://unfccc.int/documents?f%5B0%5D=body%3A1957&f%5B1%5D=document_type%3A3501, last accessed on 20 November 2019*

[2] *Details available at https://unfccc.int/process/bodies/subsidiary-bodies/sbsta, last accessed on 20 November 2019*

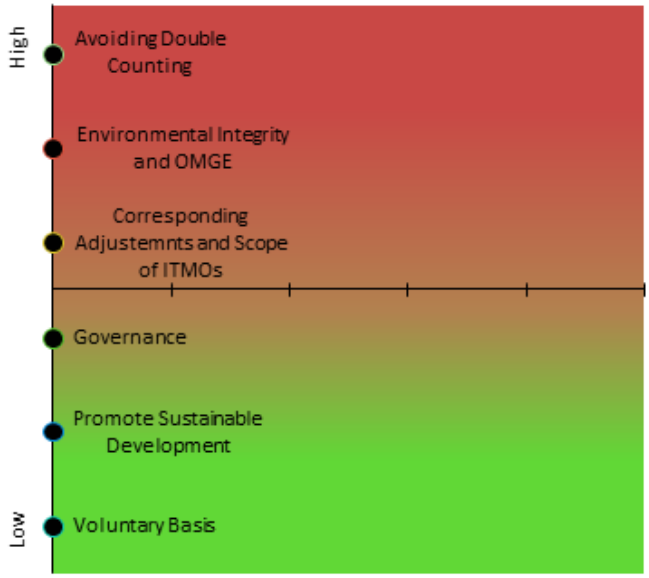

Figure 1: Scale of contention on some key issues of Article 6

High Contention Issues

Taking up from the scale of contention, this section discusses the most debated issues. The issues include environmental integrity, accounting, and corresponding adjustments, which are highly interlinked and fundamental in retaining the essence of the global climate agreement. Each of these issues is discussed in greater detail, focusing on the sticky points and common points of disagreement among developed and developing countries.

Avoiding Double Counting

Double counting[3], a case when the same credit can be accounted for twice under the separate bookkeeping mechanisms, is the key hurdle in ensuring environmental integrity in the process of cooperative approaches. This means that robust accounting processes and mechanisms should be put in place for the international transfer of emission reductions, via a centralized or decentralized market-based mechanism, so that these do not lead to higher total emissions than if the participating countries or entities had met their targets individually. This remains equally crucial for both Articles 6.2 and 6.4.

Parties have wrangled not only over how double counting should be avoided but also what constitutes double counting. One of the key discussion points is which Party is to account for corresponding adjustments and when. Some Parties argue that seller countries should not have to apply corresponding adjustments if the emission reductions are generated under the new mechanism – SDM of Article 6.4. Brazil, as one of the main proponents, has argued that by virtue of SDM, the credits generated under 6.4 will naturally be additional, thereby eliminating the need for corresponding adjustment by the seller party. If this is the case, then accounting will happen as it did under the Kyoto Protocol, that is, by the developed countries. Other Parties argue that both seller and buyer must account simultaneously because unlike the Kyoto Protocol, the Paris Agreement has NDC commitments by both developed and developing countries.

[3] *Double counting may include double claiming, double issuance, double purpose, or double use. For further details, refer to https://www.teriin.org/sites/default/files/2018-10/market-based-%20approach_Paris-agreement.pdf, last accessed on 20 November 2019*

The other sticky point in this context has been avoiding double counting across different United Nations regimes, such as that for aviation sector under CORSIA. A majority of the Parties are concerned about the lack of clarity on how to apply corresponding adjustments for emission reduction sold to the aviation industry. There is the risk of emission reductions being double counted (i.e., once by the selling countries to achieve their Paris targets and once by airlines to achieve their obligations under ICAO). However, a few Parties, including Saudi Arabia, argue that Article 6 refers only to transfers of emission reductions to achieve Paris targets and not transfers to airlines, and therefore these must not be interlinked for adjustments.

Environmental Integrity and Overall Mitigation in Global Emissions

Environmental integrity refers to ensuring that mitigation efforts that occur under the purview of market-based mechanisms, whether voluntary (such as under Article 6.2) or under a centralized mechanism (such as under Article 6.4), must lead to emission reduction that is real, measurable, and additional to what would have been achieved in the absence of these mechanisms. Therefore, normatively, environmental integrity must be attained in order to make mitigation efforts effective in reducing global warming.

While all Parties agree on the necessity of achieving environmental integrity, they are divided on the method by which this ought to be ensured. The issue of environmental integrity is closely linked with how mitigation outcomes (ITMOs and Article 6.4 credits) are accounted for and reported. This issue, therefore, moves in parallel with the issue of accounting methodologies and transparency. Broadly, there can be four factors that can threaten environmental integrity. They include (i) improper accounting, (ii) transfers being un-additional (i.e., not following required standards to ensure that emission reduction units are real, additional, measurable, and verifiable), (iii) ambition and scope of the NDC targets of the transferring country, and (iv) incentives or disincentives for future mitigation action (such as possible disincentives for transferring countries to define future mitigation targets less ambitiously or more narrowly in order to have more units available for sale).[4]

Article 6.4 builds on the concept of integrity by asking to ensure overall mitigation in global emissions (OMGEs). It refers to the emission reduction that occurs not only over and above a BAU scenario but is also additional to mitigation outcomes out of market-based mechanisms. While agreeing to this, Parties remain divided on the methodology to ensure such OMGE. There are largely two alternatives. Some Parties, such as Japan, have argued that an over-conservative crediting mechanism must be in place to capture the mitigation activity done by the home country and not transferred. Other Parties have argued that OMGE can be ensured by Parties cancelling credits which can neither be used by the home country nor be transferred to another Party.

The issue of additionality had been a major concern since CDM. Therefore, concerns around this aspect overlap with some of the larger issues under transitional arrangements from Kyoto Protocol to Article 6.4 mechanism. Some Parties have expressed concern that the lack of additionality of projects and their respective credits under the Kyoto Protocol might threaten environmental integrity of Section 6.4 under the Paris Agreement. Other Parties have suggested that Kyoto Protocol activities should be subjected to an additional level of authorization by the supervisory committee to check for additionality and robustness and only then be allowed to transition. Broadly, additionality in the context of Article 6.4 revolves around baselining of projects. Projects under the CDM were not considered additional because it was felt that the baseline was kept very high. Therefore, to enhance additionality, baselining methodologies may have to be revised. These may overlap, conflict, or

[4] *Details available at https://www.tandfonline.com/doi/full/10.1080/14693062.2018.1521332, last accessed on 20 November 2019*

build upon the baselining methodologies used under CDM. Even regarding transition of methodologies, Parties have reached no consensus on whether the methodologies used for baselining the projects under Kyoto Protocol should be used for those under Article 6.4 mechanisms.

Most developing country groups and island groups have expressed concerns regarding non-transition of past projects and credits under the CDM, citing that it might lower the private sector confidence. A key issue of concern for India and a few other developing countries is that if these are unable to transition to the new mechanism, the nearly 2000 million CDM credits issued by projects across the world, of which a large proportion are estimated to be unsold, will completely lose their economic value. This will create a feeling of distrust for carbon markets and may hamper the scaling up of mitigation projects involving private sector actors.

Corresponding Adjustments and Scope of ITMOs

This issue has been under discussion for a long period and is yet to reach a consensus among Parties. There are various aspects to the issue of ITMOs. These include definitional issues, issues around the scope of metric inclusion (i.e., which metric of emissions reduction is looked at), scope of NDC inclusion, and whether ITMOs can be used for other voluntary mechanisms such as Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

The means of corresponding adjustments proposed under Article 6.2 is via ITMOs. Lacking a formal definition, under Article 6.2, ITMOs broadly refers to a transferable unit that may have been achieved by mitigation activities outside a Party's geographical jurisdiction or via voluntary trading among Parties. It represents a unit of emission reduction that may have been achieved by a myriad of activities within various trading schemes and can be claimed by Parties to meet their respective NDC targets under Article 6.2. Corresponding adjustments refer to the simultaneous adjustments that Parties must undertake upon trading international units of emission reductions. Since under Article 6.2 Parties have the freedom to engage in bilateral or multilateral trading schemes and use those emission reduction units to meet respective NDCs, ITMOs could emerge out of a variety of cooperative approaches that parties may associate themselves with. Under Article 6.4, a simpler and standardized cooperative approach for Parties in the form of a centralized market based mechanism, informally known as the SDM, is offered. In both cases, corresponding adjustments of traded emission reduction units is imperative in deciphering the actual emission reduction due to the market based mechanisms under Article 6, thereby ensuring integrity and transparency. Some key aspects to be decided regarding this issue are the following:

» An issue around the scope of ITMOs, on which Parties are split, is whether ITMOs should be dealt only for emission reduction as CO_2 equivalent or under other metrics (e.g., energy efficiency) as well, which might be suitable for a broader range of submitted NDCs.

» Another issue is that currently ITMOs do not have a well-defined standard or methodology for eligibility, such as other emission reduction units (e.g., certificates of emission reductions (CERs) from CDM), due to their undefined status. Some Parties, such as South Africa, insist on the need for having standards and methodologies regarding the use and flow of ITMOs. The current lack of standardization has also led to some Parties vehemently opposing the use of ITMOs by private entities to fulfil commitments (e.g., under CORSIA). They argue that ITMOs on their own lack the required qualifications to be considered as a carbon credit/commodity under the Paris Agreement.

» Further, regarding the use of ITMOs to achieve goals outside the NDCs, some Parties have insisted that such a provision should be allowed but need not be accounted for to the same extent as those goals that are within the NDCs. Some Parties argue that achievement outside

NDCs would, by its very virtue, be additional and therefore need not be an issue for double accounting. Others argue that the use of ITMOs must be limited to meeting NDC targets.

» Finally, ITMOs offer a unique feature for Parties to link international mitigation schemes and account for every mitigation activity that is taking place. This comes with the threat of double counting of emission reductions among various platforms. Parties are also divided on what should be the means of tracking and holding ITMOs. Options for this include tracking ITMOs in a registry by unit or using a unique serial number to track the flow between transferring Parties. In the most recent negotiations, Parties have now included the option of cancellation of ITMOs voluntarily or mandatorily in favour of OMGEs or otherwise.

Low Contention Issues

In contrast to the earlier section, this section discusses the lesser contentious issues. These have relatively wider agreement and are more likely to reach consensus.

Governance

Governance refers to the nature of oversight – centralized or decentralized – that is to be laid out to ensure that all Parties, which voluntarily engage in market mechanisms other than the SDM, comply with common guidelines. To ensure the larger objectives of a global climate deal, that is, ensuring environmental integrity, a strong governance mechanism is a prerequisite, but ambiguity remains regarding the design of such a governance mechanism, especially for Article 6.2.

For Article 6.2, Parties are to agree upon the degree of centralization of governance mechanisms. On the one hand, there is a completely decentralized regime with no global standards for governance of Article 6.2. On the other hand, there is a centralized governance regime that will have global standards set and enforced under the larger oversight of the CMA [5]. A common middle ground could be the proposal of having set standards but no institutionalized authority to monitor compliance. However, since not all Parties have made submissions on the issue of governance, it remains less contentious as compared to some other aspects for Article 6.2.

For Article 6.4, there is much less ambiguity on this aspect, as a centralized mechanism governed by a body set up by the UNFCCC is a clear requirement, as per the text: "Shall be supervised by a body designated by the Conference of the Parties serving as the meeting of the Parties to this Agreement". Parties agree that such a body must have equal representation of all or most regions. Further, some Parties recommend that this central body must also review the methodologies for setting project baselines and verification processes and for ensuring that these projects make significant contributions to SDGs.

Promote Sustainable Development

Promoting sustainable development is an inherent requisite of international mechanisms addressing climate change, and all Party groups agree on the need for cooperative approaches to ensure sustainable development. Article 6.2 emphasizes this objective for voluntary mitigation action among Parties through ITMOs and Article 6.4 ensures this by the nature of project activities under the purview of the market mechanisms. Both Articles 6.2 and 6.4 require a tool (such as the voluntary CDM sustainable development co-benefits tool) or robust reporting mechanism for Parties to show the achievement of sustainable development via their mitigation activities. This could be shown as an improvement in Sustainable

[5] *CMA refers to the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement. All states that are Parties to the Paris Agreement are represented at the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA), while states that are not Parties participate as observers. The CMA oversees the implementation of the Paris Agreement and takes decisions to promote its effective implementation.*

Development Goals (SDGs) of Parties, or centralized criteria issued by the UNFCCC could be followed to show how a mitigation activity has enhanced sustainable development. Some Party groups, such as the African Group of Negotiators (AGN), require that such reporting be voluntary in nature, while others, such as the Alliance of Small Island States (AOSIS), propose having common reporting criteria to be followed, with the Host Parties[6] to have the flexibility to decide on standards for sustainable development for assessment.

Voluntary Basis

A consensus exists among groups on the use of ITMOs towards NDCs being available for Parties on a voluntary basis, contingent to the approval of the participating Parties, as long as such participation and the mitigation actions are consistent with the broad objectives and agreed upon guidelines. Between Articles 6.2 and 6.4, Parties have a choice of how they would like to use or trade their mitigation outcomes for the achievement of their NDCs. In this regard, both the articles allow for voluntary action, with the nature of engagement that Parties may have with either other Parties or with emission trading schemes other than that under Article 6.4, to be framed on the principle of voluntary basis. Article 6.2 by its very essence is seen to provide the means for linking voluntary action by other Parties to the NDCs and accounting them in their overall mitigation activity.

[6] *It refers to that Party or group of Parties that house the project, geographically, and therefore generate credits that may be traded. In the context of sustainable development, the host party is obligated to show how the project activities undertaken by it are contributing to overall sustainable development.*

Conclusion

Article 6 provides the means for Parties to be ambitious in their mitigation goals, whether they themselves have the means and capacity to support such ambitious actions or not. This is especially essential for developing countries, providing their policy-makers the wherewithal to strengthen domestic actions. While some aspects of Articles 6.2 and 6.4 overlap and the distinction between them is likely to blur in the future, it is a boon for Parties to have both alternatives. The most critical aspect that must be ascertained under both mechanisms is that emission reduction from different approaches leads to additional overall emission reduction, thereby retaining the integrity of the climate deal. Therefore, accounting mechanisms and governing their implementation are highly crucial in attaining the much needed goal of keeping emissions below 2 degree Celsius. This is what the current contention boils down to as different Parties seek to ensure this within the context of their development and previous experiences.

This COP25 remains crucial for finalization of the rulebook on operationalization of Article 6. Since it is the last COP before the Paris Agreement comes into effect, it is vital that the sticky points discussed earlier in the paper are addressed and a robust rulebook, with the required due diligence incorporated, is achieved. With this aim, some resolutions might be safely anticipated. Issues such as choice of metric for ITMOs, scope of ITMOs inside or outside NDCs, and governance mechanisms of both Articles 6.2 and 6.4 may be successfully resolved. However, some of the issues that might still take more discussion space will continue to be around corresponding adjustments, double counting, and transitional arrangements from Kyoto Protocol to Paris Agreement. The subtext of all negotiations around these matters will automatically touch upon the integrity discourse.

TERI's Centre for Global Environment Research (CGER) has core competencies in research on global, national, and sub-national climate policy, outlining effective policy initiatives that integrate developing country concerns in addressing global environmental challenges. The Centre builds on a strong interdisciplinary team comprising economists, physical scientists, engineers, and social scientists to aid in holistic climate change planning and decision making. The Centre is actively involved in advocating policy actions for implementing the India's nationally determined contributions. The Centre through its research on the various articles of the Paris Agreement has developed options for operationalizing the agreement. The team is also exploring linkages between climate-induced migration to develop understanding on the results.

The Centre has been regularly carrying out outreach and capacity-building programmes for various stakeholders on different subjects such as mainstreaming climate action in development policies, understanding role of co-benefits in meeting climate action targets, etc.

The team is also currently assisting various bilateral, multilateral, and government donor agencies in implementing projects related to greenhouse gas (GHG) inventories, domestic monitoring, reporting, and verification of mitigation and adaptation actions, enhancing energy efficiency, assessing the key climate finance models and schemes on achieving climate goals and to understand and provide inputs for developing carbon markers, and developing stakeholder-driven cooling platform for devising techno-economic feasible options for cooling sector.

The Centre extended its research and capacity-building activities to other developing countries and emerging economies through a strong research-based collaborative programme in Fiji. A number of international collaborations with institutions of global repute have ensured that there is exchange of knowledge and expertise and strengthening of the core competencies within the area. For the ensuing years, the Centre is prioritizing research on market-based mechanisms for climate change mitigation, managing hydrological disasters, sub-national actions through State Action Plans on Climate Change in India, and efficient refrigerant transitions.

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