

Summary Report

Designing Governance Structures and Transactional
Documentation for Mitigation Outcome
Transactions under Article 6 of the Paris Agreement
January 2021



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1

INTRODUCTION

1-1. Unlocking the potential of Article 6

Trading under Article 6 of the Paris Agreement has the potential to dramatically increase the ambition and cost effectiveness of the global agreement while catalyzing billions of dollars in green investments. Full use of cooperation under Article 6 compared to independent implementation of countries' nationally determined contributions (NDCs) could, for example, reduce the costs of achieving current NDCs by \$250 billion per year in 2030 (IETA, University of Maryland, and CPLC 2019). Moreover, reinvesting these savings into additional mitigation could increase the ambition of the current NDC goals by 50%. This is critical to avoiding the catastrophic impacts of anthropogenic climate change, because the even most ambitious current NDC goals are still more than 12 Gigatons of CO₂ equivalent (tCO₂eq)¹ too high in 2030 to limit global warming to 2°C (UNEP 2020).

International carbon markets have a strong track record in delivering emissions reductions. Of the almost 4 billion tCO₂eq of carbon credits issued in the last two decades, more than 70 percent were from the Kyoto Protocol mechanisms of the Clean Development Mechanism (CDM) and Joint Implementation (JI) (World Bank 2020). The CDM alone has catalyzed more than \$400 billion in low carbon investment in developing countries (Fenhann 2020; Kirkman et al. 2012). At the same time, both CDM and JI have been criticized for potentially weakening global goals by approving projects that might have happened even without crediting (i.e., issuing credits to projects that are not “additional”) (Spalding-Fecher et al. 2017; Michaelowa et al. 2019; Cames et al. 2016; Kollmuss, Schneider, and Zhezherin 2015) – pointing to the necessity of revisiting some of the rules and scope for international crediting. More importantly, there is a need to dramatically scale up international cooperation on mitigation, to close the “emissions gap” mentioned above.

¹ Global GHG emissions in 2019 were approximately 60 GtCO₂eq (UNEP 2020)

One of the fundamental shifts from the Kyoto Protocol to the Paris Agreement is the latter's voluntary commitment by all countries to mitigation actions (Oberghassel et al. 2016). Of the 189 countries submitting Intended Nationally Determined Contributions (INDCs), almost 80% committed to GHG targets of some kind (WRI 2016). This means that the transfer of units from one country to another will have an impact for both countries in terms of meeting their GHG pledges. This is in contrast to the CDM, where the host countries for CDM projects did not have GHG targets, and so were not affected in any way by the transfer and use of the units.

Under Article 6, host countries will have more responsibility and risks than under the CDM. Not only will they need to assess whether the transfer of mitigation outcomes might affect their own NDC goals but, under Article 6.2 they and the buyer countries will largely agree on their own detailed rules for crediting within larger framework. The need for guidance on key policy decisions related to Article 6 participation and developing capacity in host countries to engage effectively in Article 6 is the origin of the guidance documents summarized in this report.

1.2 Getting started with Article 6 pilots

The last session of the global climate negotiations ended in December 2019 without an agreement on the rules for Article 6, which were already held over from difficult and inconclusive negotiations the previous year. The postponement of the next conference (i.e., COP26) until November 2021 – and consequent lack of decision-making around the rules – creates continued uncertainty. However, the Paris Agreement does not prevent countries from starting pilot activities, and even agreement to trade in internationally transferred mitigation outcomes (ITMOs), before the final detailed rules are agreed. With this understanding, many countries are already starting pilot Article 6 programs, and multiple potential buyers (e.g., Sweden, Switzerland's Klik Foundation, the World Bank's Transformative Carbon Asset Facility) have either issued requests for proposals for Article 6 activities or announced pilots (Climate Focus 2019; Greiner et al. 2019). This is possible, in part, because the broad outlines of many key issues in the rules are clear.² Keeping a narrow focus on relatively simple project activities makes piloting easier and is the focus of the work summarized in this report.

1.3 What the GGGI project experience can offer

The Global Green Growth Institute's "Mobilising Article 6 Trading Structures" (MATS) Program is funded by the Swedish Energy Agency. Within the program are several outputs - authored by a consortium of Carbon Limits AS, Pollination Group and Öko Institut - to support the development of Article 6 pilot activities. These include:

- Guidance for host countries on policy decisions related to Article 6 and setting up institutional arrangements³
- Guidance for both potential buyers and sellers of ITMOs on contractual arrangements, both for government-to-government transactions and for private seller-to-government transactions⁴

This summary report highlights key lessons in both streams of work, with more detail available in other project outputs. The purpose of the report is to provide host country decision makers with some background to the key issues and a roadmap toward readiness for Article 6.

² This report and the other outputs of the project refer to the last version of the Article 6.2 negotiating text from COP25 as the "draft Article 6.2 rules" or "draft rules".

³ "Guidance on governance models for host country engagement in Article 6" (include full citation)

⁴ This will take the form of two MOPA templates with guidance on how to apply these, including references to relevant issues in the governance guidance.



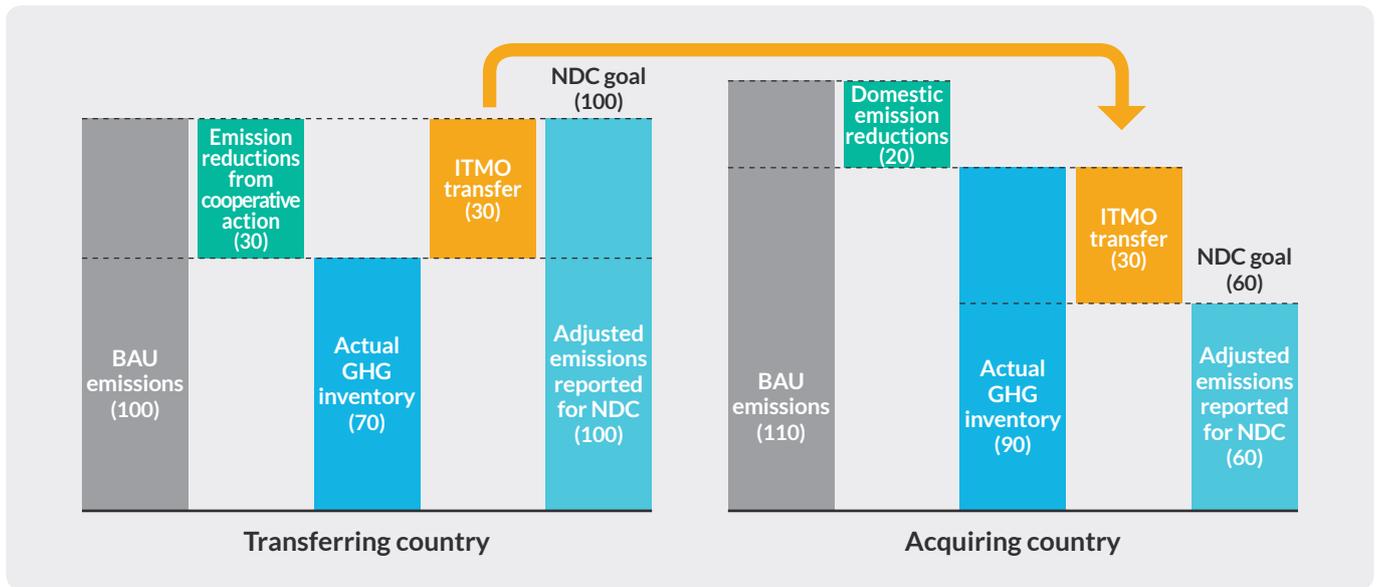
LESSONS ON GOVERNANCE ARRANGEMENTS

This chapter provides lessons learned on governance arrangements. This begins with an explanation of the “corresponding adjustments” and an overview of the process for host country engagement in Article 6. This is followed by sections on key policy decisions related to Article 6, an explanation of the institutional arrangements, and how all these related to reporting on Article 6 activity to the UNFCCC.

2.1 Understanding corresponding adjustments

The Paris Agreement explicitly prohibits the double counting of “mitigation outcomes” (i.e., if the transferred mitigation outcomes are used towards achieving compliance of another country's NDC then this amount must not be used toward the transferring country's pledges). To avoid double counting, the draft Article 6.2 rules includes requirements for “corresponding adjustments” for any transfers for both countries. In other words, if the transferred mitigation outcomes are used to lower the acquiring country's emissions in its NDC performance reporting (i.e., not its actual national GHG inventory), then this amount must be “added back” to the transferring country's NDC reported emissions. Assuming that the mitigation activity lowers the actual GHG inventory figures of the transferring country, the net result is that the transferring country's reported emissions for NDC compliance are unchanged by the cooperative activity. This is illustrated in Figure 1, where the 30 units transferred from the transferring country to the acquiring country are added back to the transferring country's actual emissions when these are reported (i.e., as “adjusted emissions”) for NDC compliance.

Figure 1.
Illustration of corresponding adjustments



Source: Authors

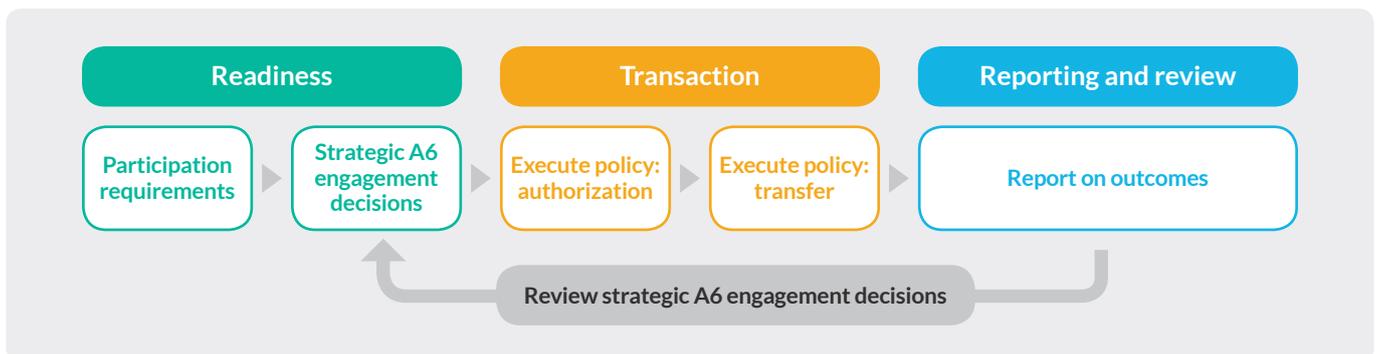
In the figure, if the transferring country’s mitigation pledge was to reach 100 units, then it would still achieve its goal after the transfer was complete. If its goal was to reach 70 units, however, then the transfer would mean that it would miss this target. Even though its actual emissions inventory would be lower than this level, reported emissions for NDC compliance would be higher than the pledge.

Corresponding adjustments were not necessary for the CDM because only the acquiring countries had mitigation pledges to meet, so only one country needed to claim the emission reductions for compliance. For the Paris Agreement, however, corresponding adjustments are an essential component of the cooperative approaches. Avoiding double counting will require robust accounting and tracking of units, not only those used for NDC compliance but also those used for other international obligations (e.g., CORSIA). Such accounting may require additional measures and infrastructure (e.g., international registries for tracking units), as well as government oversight of transactions, to ensure that all the necessary adjustments are complete.

2.2 Overview of the process of Article 6 engagement

Article 6 engagement can be thought of as including readiness, transactions and reporting and review (Figure 2). Within these stages, the major phases of engagement include meeting Article 6 participation requirements, making strategic Article 6 engagement decisions, executing those policy decisions for specific projects (e.g., for ITMO authorization and transfer), reporting on outcomes and, finally, reviewing the strategic Article 6 engagement decisions in light of those outcomes. Key issues in these phases are highlighted in the subsequent sections below.

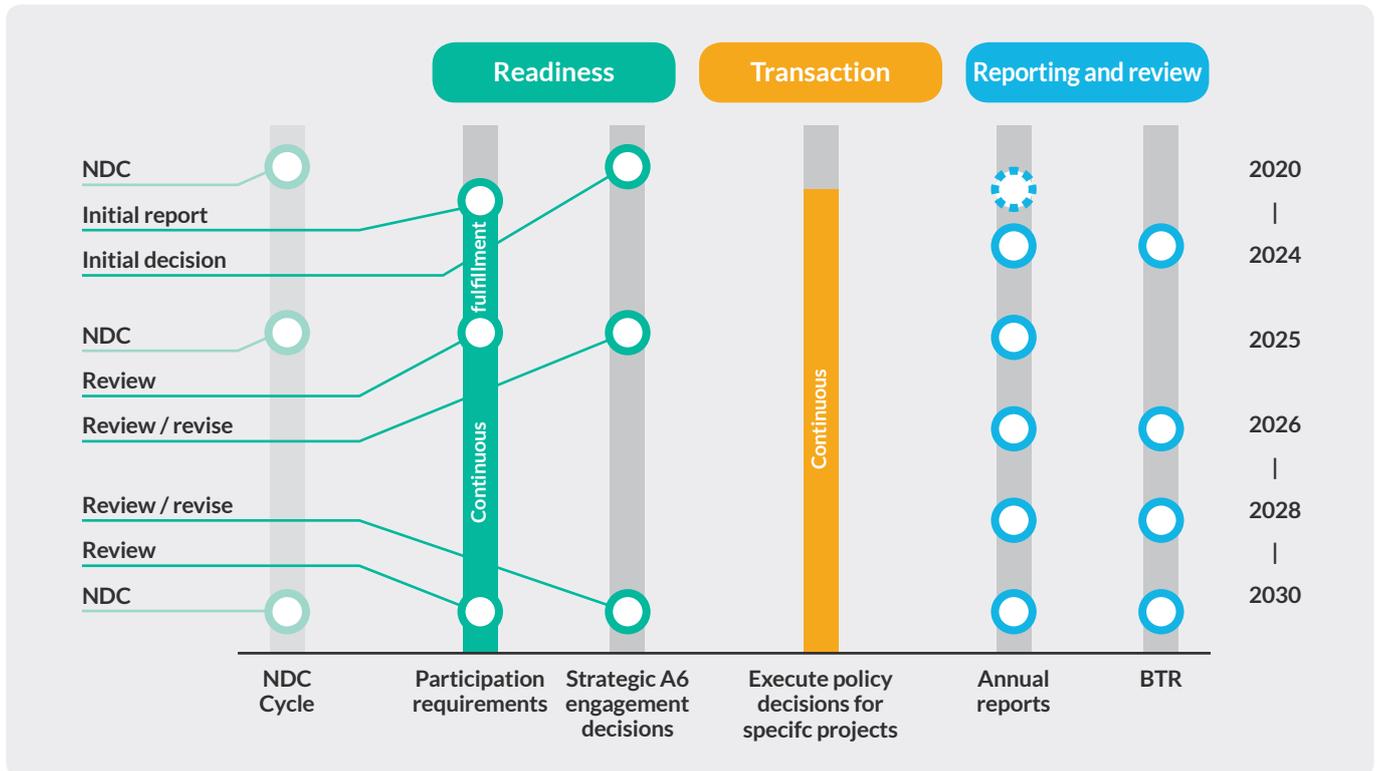
Figure 2.
Overview of major phases in Article 6 engagement



2. LESSONS ON GOVERNANCE ARRANGEMENTS

Although Figure 2 shows a process mainly from readiness through to reporting and review, in practice these phases may be revisited periodically throughout the NDC cycle (Figure 3). Even though a country might meet the participation requirements and make strategic decisions early in the cycle, the participation requirements should be fulfilled continuously throughout the NDC period, and the strategic decisions may be reviewed periodically on the basis of the outcomes reported in the biennial transparency report (BTR). The execution of policy decisions for specific projects will also occur continuously, while the reporting on those outcomes (e.g., authorization and transfers) will occur annually. The NDC accounting will be part of the BTRs.

Figure 3.
Timeline of major phases of Article 6 engagement



2.3 Meeting participation requirements for Article 6 on an ongoing basis

Readiness includes all the steps a country needs to prepare for ITMO authorization and transfer, and covers both requirements based on the Article 6 rules as well as strategic issues that host country should address (see sections 2.4 and 2.5). Host countries will need to fulfill the participation requirements for Article 6 on an ongoing basis. These include the following:

- Participating in the Paris Agreement and maintenance of an NDC: host countries should ensure that their current NDC is uploaded to the interim NDC registry.
- Choosing an ITMO metric: host countries should specify the metric for ITMOs to be authorized and transferred. Those could include units of tCO₂eq or other metrics if they are also used in their NDC. The GGGI project outputs only address Article 6 transactions that are in units of tCO₂eq.
- Describing and quantifying the NDC in tCO₂-eq metrics: Host countries should clarify the coverage of their NDC goals in terms of the gases, emissions sources and sinks, and implementation period. For each target or action communicated in the NDC, the country should choose indicators that will be used to track progress. Any country that has communicated actions or targets expressed in terms other than absolute emission levels will need to quantify its various NDC elements in the metric of tCO₂eq. This includes presenting relevant quantitative information, including the emissions level in the reference year, the quantification of the reduction level and relevant information sources and assumptions used in the calculation.

- Defining the accounting approach in relation to single-year and multi-year targets: host countries that have a single year target can choose between a multi-year trajectory or an averaging approach to accounting for ITMO transfers during the NDC period. The implications of this choice are discussed in the Governance Guidance.
- Establishing institutional arrangements for authorization, transfer and reporting: host countries must develop a proposal for which institutions – both within and outside government – will take responsibility for specific Article 6 functions (see section 2.6).
- Providing the most recent national inventory report: host countries should publish a national inventory report using the new Paris Agreement reporting guidelines.
- Choosing infrastructure for tracking ITMOs: host countries should decide whether to use the anticipated international registry for Article 6 provided by the UNFCCC (when this is available), a national registry for tracking ITMO authorizations and transfers and/or the registry system of an existing international or independent crediting program⁵ (i.e., to issue and cancel under that standard as the basis for ITMO transfers).

2.4 Developing authorization criteria that support an NDC compliance strategy

While the previous section addresses the minimum requirements for the host country's participation in Article 6, it does not address a more fundamental question: on what basis should the country decide whether or not to authorize ITMO transfers? To answer this question, the country needs to consider what types of mitigation activities can be used as the basis for ITMO transfers without compromising the country's ability to meet its NDC pledge. For example, the host country may not want to transfer ITMOs based on mitigation activities with very low abatement costs if this would require it to implement more expensive mitigation activities to still meet its NDC pledge. On the other hand, the country may want to start pilot activities for Article 6 as soon as possible, so could explore other options to avoid overselling, even while starting with early transactions.

Recent research (Spalding-Fecher et al. 2020; New Climate Institute 2018; Howard 2018; Fuessler et al. 2019) provides several strategies for managing the overselling risk and facilitating the enhancement of the ambition of NDCs. These include the following:

- **Sharing emission reductions:** authorize only a portion of the potential emission reductions as mitigation outcomes to be transferred. The remainder of the emission reductions could then be used by the host country to achieve its NDC or to enhance the ambition of its NDC.
- **Negative list of interventions set aside for NDC:** not allow Article 6 cooperation using the set of mitigation interventions that have been chosen as the best approach for meeting its NDC. This would be to ensure that the host country did not have to replace these with higher-cost actions, if these mitigation interventions were to be used as the basis for transfers under Article 6 and therefore be subject to corresponding adjustments. This approach would focus Article 6 cooperation on the more costly activities (or those which were not part of the national NDC plan for other reasons), exactly where additional funding is most needed.
- **Limited crediting periods:** shorter crediting periods can limit the number of years during which a transferring country would sell its mitigation outcomes from a given cooperative program. The means that the transferring country would still use the mitigation activity to increase the ambition of its NDC in the latter part of the NDC cycle (i.e. after the end of the crediting period).
- **Baselines derived from NDC goals:** incorporate NDC targets into the baseline to ensure that only mitigation activities that go further than the interventions identified for the NDC goal would be eligible for crediting. In other words, only use Article 6 cooperation for actions beyond the those planned for NDC compliance. Depending on how the transferring country's NDC goals are articulated, this could potentially be complex (see references cited in the second paragraph of this section).

⁵ "Independent crediting program" refers to international and national crediting programs that are not managed by governments, such as the Verified Carbon Standard (VCS), Gold Standard and Climate Action Reserve (CAR). "International crediting programs" run by governments would include the Clean Development Mechanism (CDM), Joint Implementation (JI) and even potentially the systems created for Article 6.4.

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- **Charging a levy to support mitigation in the country:** set aside a portion of the revenue generated from ITMO transfers to support additional mitigation activities in the country, or possibly ITMO acquisitions, in the event that the country risked missing its NDC goal.

Host countries may choose to include additional criteria for ITMO authorization and transfer, where this is necessary to ensure that the project activity is in line with the principles for Article 6, national regulatory and legal requirements, and the country's overall climate and development policy. Criteria related to general principles for Article 6 might include, at a minimum, that the project activities demonstrate the following:

- Promoting sustainable development
- Ensuring environmental integrity⁶, such as ensuring additionality, conservative quantification of mitigation outcomes, and non-permanence
- Avoiding double counting⁷, in particular double issuance and double use. Note that double claiming is addressed through the application of corresponding adjustments by both countries.
- Requirement for independent verification
- Requiring emission reductions to be generated from 2021 onwards
- Resulting in a contribution to adaption financing
- Contributing to overall mitigation in global emissions

Criteria related to national priorities could include the following:

- Alignment with relevant national and sectoral policies and strategies
- Preventing negative social and environmental impacts
- Compliance with anti-corruption laws and conventions
- Compliance with other local regulatory requirements relevant to the project type (e.g., environmental impact assessment, technical standards)

2.5 Other strategic decisions on Article 6 engagement

Host countries may also choose to decide upfront (i.e., as part of an Article 6 policy process) on the following strategic choices:

- **Timing of authorizations:** whether to authorize ITMOs only ex ante (i.e., prior to the emission reductions being achieved and verified), subject to specific conditions and limited in volume; either ex ante or ex post; or only ex post (i.e., after the emission reductions have been verified).
- **Other uses of ITMOs:** host countries may choose to always authorize ITMOs for all uses (i.e., so that the project proponents have more flexibility in which markets they access, including CORSIA and the other international markets). They could also establish certain criteria by which uses other than for NDCs will be authorized, or possibly specify the use or uses authorized on a case-by-case basis.
- **Role of host country in transaction and financial flows:** where a host country government authority is the project participant, it must decide whether the Article 6 administrator will be the party to the MOPA, or the actual government authority that will manage the project would do this. On the other hand, where a private sector project participant implements the mitigation intervention, the host country government must decide whether or not it will require payment of a fee for administrative costs of the Article 6 governance system.

⁶ Environmental integrity in the context of carbon markets is generally understood to mean that global emissions should not be higher as a result of engagement in carbon markets, compared to a situation without any transfers (Schneider and La Hoz Theuer 2019).

10 ⁷ Double counting means that the same emission reductions are counted more than once towards the mitigation goals. This includes double issuance (i.e., more than one unit issued for the same emission reductions), double claiming (i.e., more than once country or entity claims the mitigation toward its goal) and double use (i.e., using the same unit twice to achieve a mitigation goal) (Schneider and La Hoz Theuer 2019).

- **Contribution to adaptation and overall mitigation of global emissions (OMGE):** countries should specify whether they will set aside a percentage of ITMOs (e.g., similar to under the Article 6.4) as contributions for adaptation and/or OMGE.

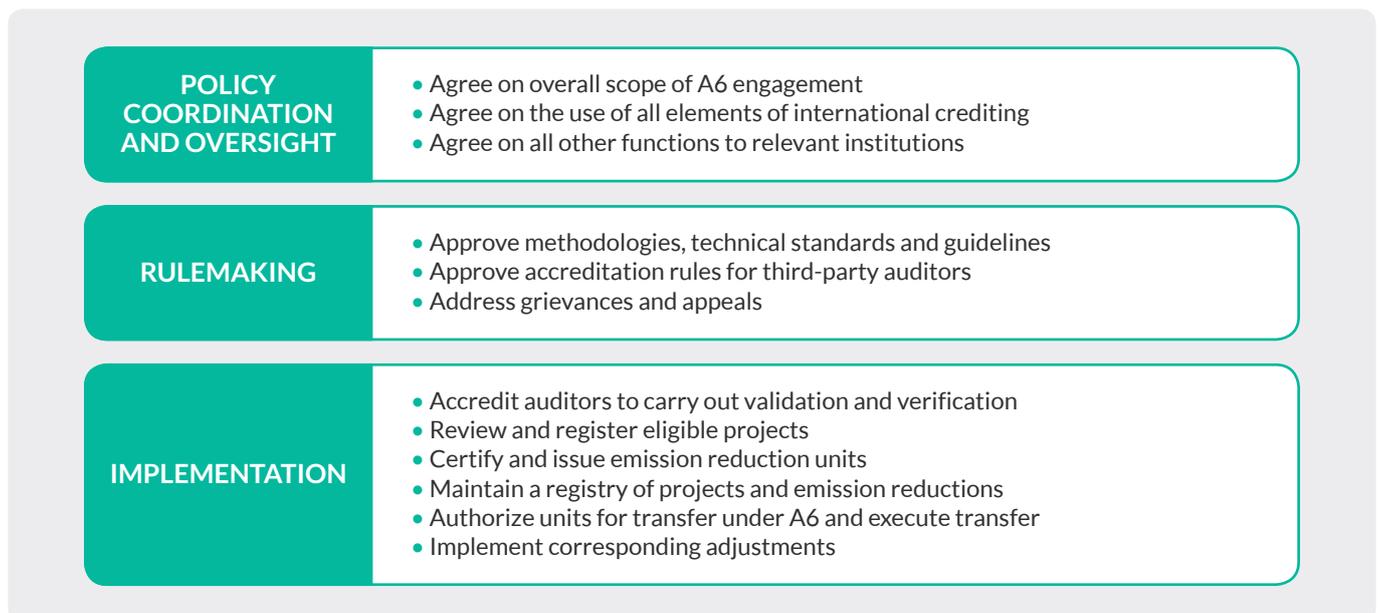
2.6 Setting up effective institutional and governance arrangements

Host countries will need to designate government institutions to perform specific functions related to Article 6. The host country's framework for Article 6 cooperation should consider what functions are required as a transferring country, and how they could be allocated to new or existing bodies. Building on existing institutions has important benefits in terms of leveraging capacity, minimizing costs, and drawing on existing relationships. In this context, the need for fostering collaboration and coordination between related ministries cannot be overestimated.

Countries should consider how to develop suitable overarching coordinating and decision-making bodies on domestic climate policy (i.e., including NDC updates, reporting under the enhanced transparency framework, etc.) and participation in Article 6 activities. Article 6 institutional arrangements should also consider building on existing national infrastructure established to regulate the country's engagement with the CDM or JI. To allow existing institutions to execute these functions, however, could require changes of their mandate, authority, composition, and skills. There are significant opportunities to build on the experience of international and independent crediting programs in developing institutional arrangements and the implementation of Article 6 cooperation. The benefits of this could include faster implementation, reduced costs, and greater credibility in new international markets.

The main functions that must be covered by the host country government authorities are shown in Figure 4. In addition, independent auditors will be needed to perform validation and verification of the performance of Article 6 activities, while technical advisory bodies may be needed to provide additional outside expertise to the government bodies.

Figure 4.
Governance functions for Article 6 in host countries



2. LESSONS ON GOVERNANCE ARRANGEMENTS

The detailed governance arrangements for Article 6 to cover the functions above will vary across countries, but would generally include:

- A high-level “Article 6 decision body” with overall authority to design and revise the program and international cooperation (i.e., the “policy coordination” functions). This would generally require ministerial authority and would only occur at the start of Article 6 engagement and periodically (i.e., every few years) as the country’s overall performance was reviewed. This might be implemented by a single ministry, a high-level inter-ministerial body, or even the cabinet.
- An “Article 6 executive body” that would develop and approve rules based on the overall regulatory environment and mandate (i.e., most of the “rule-making functions” above). This body would include middle- to senior level members, often with relevant specialist knowledge, and would meet more regularly to address some rule-making functions. It might also include members from outside of government.
- An “Article 6 administrator” to execute the rules and guidance on a day-to-day basis. This could be a department, government agency or even an outsourced third-party with appropriate oversight.
- An “Article 6 technical committee” to provide technical advice and inputs to all these other bodies.

2.7 Procedures for ITMO authorization and transfer

The host country government must have a process to approve project proponents and/or mitigation activities and to authorize mitigation outcomes that may be transferred to another country. Note that the term “authorization” in the Article 6 rules only applies to mitigation outcomes, and not projects or project proponents. The term “approval” is used here to refer to national approval for projects or project proponents.

The steps for the authorization process are shown in *Figure 5*. The institutional options mainly differ in terms of whether the authorization process is essentially an administrative process, based on clear rules established in the readiness phase, or whether each authorization request requires evaluation by a technical committee or executive body in government. The choice of options will depend on how transparent and objective the authorization criteria are, as well as on whether the government entity charged with administering the Article 6 process in the host country has the legal mandate to authorize mitigation outcomes.

Figure 5.
Institutional options for ITMO authorization

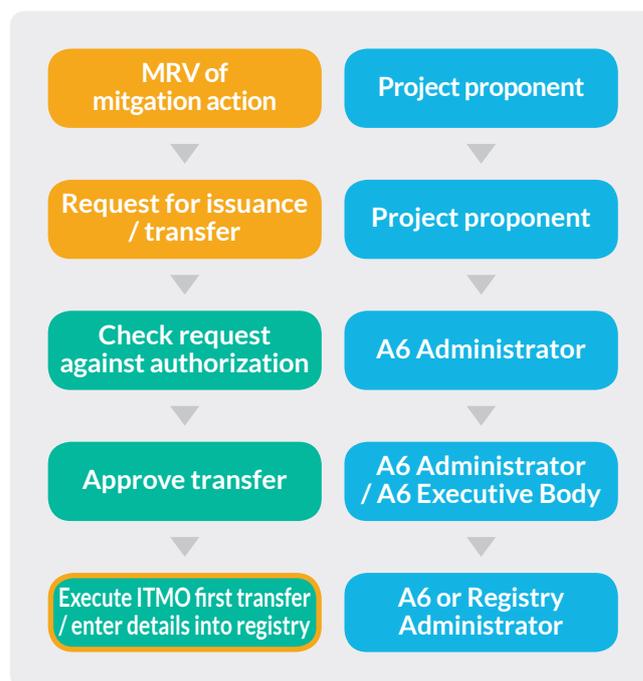


Note: MRV = monitoring, reporting and verification; outlined boxes are required by draft Article 6.2 guidance.

The steps for the ITMO transfers process are shown in Figure 6. The institutional arrangements for this should be straightforward, but one policy question here might be whether a higher-level authority must approve each transfer (i.e., even if there is already an authorization granted, including any conditions that must be met prior to the transfer).

Note: MRV = monitoring, reporting and verification; outlined boxes are required by draft Article 6.2 guidance.

Figure 6.
Institutional options in ITMO tracking and transfers



2.8 Tracking and reporting for transparency and delivering on contracts

The rules for the Article 13 “enhanced transparency framework” of the Paris Agreement and the draft Article 6.2 rules outline important reporting requirements for host countries engaging in Article 6 cooperative activities. This includes not only reporting on ITMO authorizations and transfers, but also on corresponding adjustment and emissions balances.

Countries must first provide an “initial report” on Article 6, which should include much of the information and policy decisions from the earlier Article 6 readiness phase (see sections 2.3 to 2.6). Much of this information will be submitted to a centralized accounting and reporting platform that the UNFCCC will develop and maintain.

Countries will then submit “annual information” (in electronic format) to the Article 6 database, which will include all of the relevant information on ITMO authorization, transfer, use, etc. – as well as information about the underlying mitigation activities. Note that while annual information does not specifically mention corresponding adjustments, the draft guidance does say that corresponding adjustments must be applied annually and that the Article 6 database will include all corresponding adjustments, so it seems likely that the countries will report this information annually in practice.

Finally, every two years host countries will submit “regular information” on Article 6 activities as part of the BTRs. This will include both general information on Article 6 cooperation (e.g., updates on NDC progress and how ITMO transfers will affect this) and specific information on each cooperative approach (e.g., methodological approaches, contributions to sustainable development, and how it ensures environmental integrity). The BTR will also include reporting of corresponding adjustments. The country will report the following information in the structured summary:

- The annual level of emissions by sources and removals by sinks covered by the NDC;
- An emissions balance reflecting the level of emissions adjusted on the basis of corresponding adjustments (i.e., addition for ITMOs transferred and subtraction for ITMOs used/acquired);
- Information on how each cooperative approach promotes sustainable development; and ensures environmental integrity and transparency, including in governance; and applies robust accounting to ensure the avoidance of double counting.



3

LESSONS ON CONTRACTUAL ARRANGEMENTS

Parties will transfer ITMOs vis-à-vis contractual arrangements known as Mitigation Outcome Purchase Agreements (MOPAs). These arrangements could take different forms, depending on the types of parties involved. Below we outline two transactional scenarios and discuss certain aspects of the accompanying contractual arrangements.

3.1 Scope of the MOPAs

Template MOPAs were drafted to account for two different Article 6 transaction scenarios—(1) a sovereign seller of ITMOs sold to a sovereign buyer; and (2) a private seller of ITMOs sold to a sovereign buyer. For the first scenario (sovereign seller to sovereign buyer), the MOPA includes key provisions related to the purchase and delivery of ITMOs as well as requirements under Article 6, like maintaining an NDC, the application of corresponding adjustments and preparing a BTR.

For the second scenario (private seller to sovereign buyer), a MOPA and an accompanying sovereign to sovereign Framework Agreement were drafted. The private seller to sovereign buyer MOPA includes provisions related to the purchase and delivery of ITMOs authorized by the host country and sold by a private seller. The Article 6 reporting and other actions described above are not included in the private seller to sovereign buyer MOPA because they are activities that only a sovereign can take.

While the host country authorizing the private seller's transfer of ITMOs would be required to comply with the reporting requirement as part of its Paris Agreement compliance and apply the corresponding adjustment when required, some buyers may seek contractual assurances that such reporting and adjustment occurs when entering into a MOPA with a private seller. As such, a Framework Agreement between the sovereign buyer and the host country was drafted to accompany the private seller to sovereign buyer MOPA. The sovereign-to-sovereign Framework Agreement includes representations, warranties and commitments related to the host country's responsibility to undertake NDC-related actions (e.g., accounting approaches), application of corresponding adjustments, reporting obligations, and tracking of overall NDC achievement. In addition, payments to the host country by the sovereign buyer for undertaking Paris-related actions (e.g., application of corresponding adjustments, other reporting obligations) are included in the Framework Agreement. The Framework Agreement is intended to establish a sovereign-to-sovereign relationship

regarding Article 6 responsibilities that would be overarching to any transactions between the same buyer and various private sellers in the host country.

We note throughout both MOPAs and the Framework Agreement that they should be read in conjunction with the Governance Guidance as understanding certain MOPA provisions would benefit from the more detailed discussion of the concept as elaborated in the Governance Guidance. Footnotes are provided with cross-references throughout the MOPAs and Framework Agreement so the relevant discussion in the Governance Guidance can be easily found.

Throughout the MOPAs, some text is bracketed where there exist different options for parties, depending on the transaction specifics. With both MOPAs, legal counsel would be necessary to review the provisions and ensure suitability for the particular parties and the transaction at hand.

3.2 Unique aspects of ITMO transactions

3.2.1 Timing lag between transfer of ITMOs and corresponding adjustment

As described above, the Paris Agreement explicitly prohibits the double counting of “mitigation outcomes” (i.e., if the transferred mitigation outcomes are used towards achieving compliance of another country's NDC then this amount must not be used toward the transferring country's pledges). To avoid double counting, the draft Article 6.2 rules include requirements for “corresponding adjustments” for any ITMO transfers. The corresponding adjustment would be applied by the transferring country and reported in the Article 6 Database, which would occur after the transfer of the ITMOs to the buyer.

The timing lag between the ITMO transfer and the submission of information in the Article 6 database could be up to a year or more, depending on the type of NDC target a country has in place. For countries with NDC targets that are multi-year (or single year based on a trajectory approach), corresponding adjustments could be applied in the Article 6 Database up to twelve months after transfer. For countries with a single year target using an averaging accounting method, indicative corresponding adjustments are applied annually. For these countries, corresponding adjustments are then applied at the NDC target year, which could be many years after the ITMO transfer. This lag in timing between the ITMO transfer and the adjustment at the UNFCCC level presents a risk that the ITMOs delivered under the MOPA may not be adjusted. The value of the ITMO, as well as the ability to use the ITMO as intended, could be affected by this timing risk. In the template MOPAs, this risk has been mitigated by using a staggered payment structure for the ITMOs, in which the host country receives a partial payment on delivery and the remainder upon the application of the corresponding adjustment or indicative corresponding adjustment in the case of a country with a single year target using an averaging approach).

3.2.2 Obligations and responsibilities of host countries

In the sovereign-to-sovereign MOPA, because a sovereign is a seller of ITMOs, requirements under the Paris Agreement like applying the corresponding adjustment can be contractual obligations.⁸ To address this risk regarding the timing of corresponding adjustments, the sovereign-to-sovereign MOPA creates payment milestones in connection with application of corresponding adjustments for each ITMO transferred. With payments conditional not only on ITMO transfer but on the subsequent application of corresponding adjustment, there exists financial incentives for the seller to apply the corresponding adjustments.

In a private seller and sovereign buyer transaction, the private seller is not able to apply corresponding adjustments for ITMOs transferred because that is a Paris Agreement obligation for sovereigns. Similarly, if the adjustment did not occur for ITMOs sold by the private seller, the private seller could not fix the failure. As such, the private seller-sovereign buyer MOPA does not have payment milestones related to Paris reporting. Instead, the corresponding adjustment responsibilities of the host country are found in the Framework Agreement between the host country and buyer that would require corresponding adjustments for any private seller transactions to the sovereign buyer in a particular host country. The requirement to correspondingly adjust any ITMOs sold would also be part of the host country's authorization of a private seller's mitigation outcomes.

⁸ Note that the adjustment is required by the draft Article 6.2 guidance. However, because the Paris Agreement does not contain an enforcement mechanism, some buyers may seek contractual remedies for a failure to adjust transferred ITMOs.

3. LESSONS ON CONTRACTUAL ARRANGEMENTS

3.2.3 Authorization of Mitigation Outcomes

As described above, a host country must authorize the mitigation outcomes in order for them to be considered ITMOs under the Paris Agreement. This authorization functions as government approval of the mitigation outcomes generated by the mitigation activity and a commitment to apply the necessary corresponding adjustment. Government authorization is especially important for private seller contracts (and related buyers) to ensure that the host country approves of the mitigation activity and the international transfer of the mitigation outcomes.

Contractual provisions related to the content of authorization and the requirement to obtain and maintain an authorization are included in both MOPAs and the Framework Agreement. An authorization letter template is also included as an annex to the sovereign-to-sovereign MOPA and the Framework Agreement.

3.2.4 Environmental integrity

Environmental integrity is a critical principle embedded within the Article 6 text and draft Article 6.2 guidance, but no detailed requirements are set forth. Parties to ITMO transactions will agree bilaterally on many aspects of the ITMOs to be transferred, including how to ensure environmental integrity. The concept of environmental integrity is included, at a high level, in the sovereign-to-sovereign MOPA and, for the private seller to sovereign buyer scenario, in the Framework Agreement such that seller's authorization process must include principles related to environmental integrity to the satisfaction of the sovereign buyer.

In addition, in the sovereign-to-sovereign MOPA and the private seller to sovereign buyer MOPA, the parties would agree to a methodological standard or carbon crediting program pursuant to which the mitigation outcomes would be generated. Standards and programs used by Article 6.2 parties could include monitoring and verification requirements along with other requirements that impact environmental integrity (e.g., conservativeness in baseline setting).

3.2.5 Nexus between ITMO transfers and NDC achievement

Article 6 cooperative approaches are intended to raise ambition under the Paris Agreement. However, the Paris Agreement does not dictate the number of ITMOs countries can sell, so it is possible that a country may fail to meet its NDC target by virtue of selling too many ITMOs. This could occur separately and independently from a particular ITMO transaction. Because Article 6 is designed to enhance ambition, if countries fail to meet NDC targets due to overselling ITMOs, Article 6 may be negatively impacted. This risk will concern both sovereigns and authorized private sellers of ITMOs.

In the event a NDC target is not met, the Paris Agreement does not state that previously transferred ITMOs are cancelled or otherwise affected. However, a buyer purchasing ITMOs from a country that has not met its NDC target could be viewed as contributing to the NDC failure, which could result in reputational risk to the buyer. As such, both the Framework Agreement and the sovereign-to-sovereign MOPA contain provisions related to the enhanced monitoring and reporting of the country's progress toward meeting its NDC. If the Biennial Transparency Report demonstrates a change in NDC achievement trajectory, the parties will come together to consider suitable actions. This could include such measures as pausing ITMO deliveries in an attempt to address the issue.

3.3 Change in Law and Article 6.2 Draft Guidance

Article 6.2 guidance has not yet been finalized by the parties to the Paris Agreement. The MOPAs are intended to assist parties who are interested in exploring ITMO transactions in advance of such final guidance. Both MOPAs and the Framework Agreement rely on Article 6.2 draft guidance from COP25 for certain reporting and other obligations. When Article 6.2 guidance is finalized, MOPA provisions should be reviewed and may need to be revised to account for any changes between the final guidance and the draft guidance.

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CONCLUSIONS

While international cooperation under Article 6 of the Paris Agreement has the potential to increase climate ambition and support important mitigation action in developing countries, this next generation of carbon markets comes with greater responsibility for host country governments. This is not only based on the need for more comprehensive and timely reporting on mitigation action, but also on the responsibility for governments to decide what type of mitigation activities should be used for Article 6 cooperation. Any transfers of ITMOs will directly impact the host country's NDC performance, so the governance arrangements and authorization criteria in the country must be designed with NDC compliance in mind. Similarly, the contractual arrangements for Article 6 transfers will be more complex than under the CDM, because of the key roles that government will play even in transactions among private parties. Countries may need to develop framework agreements with partners, for example, to facilitate this private sector engagement and promote market development.

The outputs of this GGGI project can support countries in setting up their institutional arrangements and procedures, and in building the necessary capacity to run an Article 6 cooperation program that supports both short- and long-term ambition raising and national sustainable development goals. The MOPA templates and guidance can similarly support host countries in important policy and implementation decisions and reduce risks for public and private actors by clearly allocating all responsibilities and future obligations. Taken together, these outputs are the starting point for a robust capacity building program for host countries, while at the same time supporting early action through pilot Article 6 transactions.

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