

What is standing in the way of a happy ending: reflections on Art 6 before SBSTA 48?

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Almost three years after the closing plenary of the Paris Agreement (PA), Article 6 has changed from being an uninvited, and almost unwanted guest during pre-Paris discussions, to being the toast of the party. Art 6 has become en vogue.

As we head to Subsidiary Body for Scientific and Technological Advice (SBSTA) 48 in May 2018 in Bonn, the scrutiny of Art 6, aiming to help make its provisions operational, is increasing almost every day. And yet, we seem to be far away from delivering a happy ending. Is it substance, or is it politics? It is not that the issues and options have not been discussed and analyzed, they have.

This paper is intended as a reflection on some of the issues that need to be recognized, and may need attention, if we are to deliver at the Conference of the Parties (COP) in Katowice. Some fall in the category of substance, some are process oriented.

One thing that we need to constantly remind ourselves in the course of these discussions is the bottom-up nature of the PA. It is not an absolute, there are top-down elements in the PA, and there will be a need sometimes to deviate from the bottom-up principle or combine it with top-down elements. However, there always needs to be a good debate, and a good rationale provided.

There is no doubt that some or all of the interpretations given to the issues outlined in this paper will be contested. That is welcome, as the best way to move forward and reach common ground is through open debate.

I. Language

Given that most of the technical issues in Art 6 are also political, and that there are over 50-60 countries in the room, it should not come as a surprise that sometimes they might not mean the same thing when they use the same words. In addition, the technicality of the issues, can make things difficult to digest.

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The combination of these two factors has led many a time to confusion and misunderstandings. The SBSTA 47 Third Iteration Informal Notes produced by the co-Chairs, as well as the Informal Documents containing the draft elements produced by the chair of SBSTA prior to SBSTA 48, attempt to address this situation by including a series of definitions, which cover some of the issues. While they will always be contested, they are very useful, and can be improved upon if need be. But they are needed.

There is a second set of issues, which also need definition, but those definitions can only emerge from negotiations. Key among them are tracking, corresponding adjustment, counting and accounting - but there are probably many others.

Accounting. The Oxford Dictionary defines accounting as “the process or work of keeping financial accounts”. That definition clearly does not work very well in the context of the PA and it requires additional elaboration and illustration. In the case of the Art 6, there is the need to always remember that we refer to accounting towards the Nationally Determined Contribution (NDC).

In this case, accounting should be the act of squaring the equation between NDC, inventory, and a number of other relevant variables - such as transfers of mitigation outcomes (ITMOs) between Parties, and others, such as the treatment of Art 6.4 credits issued, but not yet transferred internationally.

The act of accounting under the PA can take place at any time, if the information is available, but is most relevant at the time of NDC compliance.

“Accounting” should not be confused with “counting”. Counting towards the NDC should probably fit in the context of “what counts / (can be counted) towards the NDC”.

In this case, counting refers to the type of mitigation outcomes that can be used towards the NDC (e.g. ITMOs, Art 6 credits, Certified Emission Reductions (CERs), etc.). It may also refer to the quantity - for example, in a 10-year NDC, with one-year target in the last year, if a Party imports/acquires 10 ITMOs every year, how many of those ITMOs can be counted towards the NDC?

Tracking. Tracking is another term that is often used. In the context of the Kyoto Protocol market, as well as in other markets, such as the EU Emissions Trading System (ETS), tracking has referred to the tracking of units as they are transferred from one account to another. That was facilitated by the fact that units were transferred to standardised registries, and that they had unique serial numbers.

That can continue to be the case when domestic ETS are linked, and if the units have serial numbers. In the case of Art 6.2, it seems challenging, at the international level, to track

things/units/ITMOs. At this stage, it appears that ITMOs do not have serial numbers and are therefore not uniquely distinguishable; so, it is challenging to see what can be tracked. Again, the situation changes if the proposal put forward to issue international units with serial numbers, for example in a number equivalent to a calculated budget derived from the NDC, is adopted.

The only things that can be tracked in the context of Art 6.2 are transfers, and that can be done through what is referred to in 1/CP.21 as corresponding adjustments.

Corresponding adjustment. Paragraph 36 of 1/CP.21 states “to ensure that double counting is avoided on the basis of corresponding adjustments”. Tracking transfers through corresponding adjustments, will ensure that we can keep track of the position of each Party (e.g. its surplus or deficit) as related to transfers of ITMOs. It will at the same time make double counting impossible, not unlike the double entry booking which revolutionized finance in the Middle Ages when it was introduced in Genoa.

There is further discussion of double counting in the section entitled “Art 6.2 three shall(s)”. The main issues in discussing corresponding adjustment are what gets adjusted (discussed), and the timing of the adjustment.

Accounting and corresponding adjustments: two different issues

Corresponding adjustments help to ensure that there is no double counting, as well as providing the quantitative position of each Party (e.g. its surplus or deficit) as a result of transfers under Art 6.2.

There are issues which are separate from accounting – which is, **what** do you count, and **how** do you count towards NDCs? This issue demands decisions on:

- What transfers can be counted towards the NDC (e.g. CERs, Art 6.4 reductions, Emission Reduction Units (ERUs), ITMOs?);
- How the transfers that each Party undertakes are counted towards its NDC? This may depend on the timing of these transfers, and the type of the NDC. In simple language, how is the net position of each country resulting from transfers in and out, recognized towards the NDC? For illustration, for a single year NDC, if there are 10 ITMOs transferred every year for the 10-year NDC period, does the NDC recognize a 100, or some other number, say an average of 100/10?

II. UNFCCC process

The UNFCCC’s arcane politics, does matter, and cannot be ignored. “Markets” under Art 6 is one of three topics, together with Response Measures and Technology Framework, to receive a mandate last November at COP 23, to produce an informal text, which may be used as the basis for negotiations.

Consequently, Art 6 is now, to some degree, being closely monitored as a “test case” for how other issues that emerged from the PA work programme may be treated. It is seen as one of the wagons getting ahead of the train of issues from the PA work programme. In the world of UNFCCC negotiations, that is something that negotiators watch closely to ensure that all issues are treated equally, and all move together.

As an example, at COP 23 in Bonn last year, markets in Art 6 got tangled in the tactical tug-of-war with the highly politicised issue of Response Measures (negative social impacts of mitigation measures), and they had to be solved together, or they were going to fail together. Simply wishing such challenges away, may not work.

III. What comes first?

Parties are moving in circles and seem to have a hard time determining what issues to address first. This is especially important as Parties struggle to determine the scope and the related governance and infrastructure of Art 6.2 (and Art 6.4).

It is clear that the scope of Art 6.2 will be a work in progress, as different types of cooperation will emerge over time. We hope that all Parties understand that it is meant to be that way, as that is the ethos and DNA of Art 6.2, is supposed to allow Parties to find new ways to cooperate. Struggling to define the scope may be a futile if not counter-productive effort.

The governance and infrastructure will not be determined in a vacuum, they will need to be fleshed out when the mode of operation of Art 6.2 is defined, as well as answering the questions about what functions are needed. That will determine who does what, and what is needed in terms of infrastructure.

The alternative is making some simplifying assumptions, such as those included in the Brazil proposal, that Art 6.2 is for Parties only, and that they will issue, and subsequently transfer international units equal to the NDC quantified in an equivalent budget. Although, with this, many headaches disappear indeed, but one needs to justify such assumptions in the Nationally Determined context of the NDCs, and on essentially down playing or excluding the role of the private sector in cross-border markets.

IV. Governance of Art 6.2 & Art 6.4

As discussed above, governance is an issue that will need to be settled once we have defined how Art 6.2 and 6.4 function. However, the discussion sometimes focuses on the difference between Art 6.2 & 6.4. While there is no doubt that they have different roles, one significant difference is also in their governance.

It is clearly stated that the Art 6.4 mechanism is under the authority of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA), while Art 6.2 largely makes reference to Parties.

Art 6.2 and 6.4 were developed to be complementary with a generally accepted vision that Art 6.4 credits will be following Art 6.2 guidance at some point (which is under debate).

But they were also developed as alternatives, since they both deliver mitigation outcomes transferred from one Party to another, for use towards its NDC. The difference is in their governance, where Parties have the significant role in Art 6.2, while the CMA has the final say in Art 6.4.

It must be remembered however that Art 6 refers to the authority of the CMA but leaves the CMA the discretion on what functions it keeps to itself, and what it devolves to the Secretariat, Supervisory body, as well as Parties. Given the ethos of the Paris Agreement, it would not be unexpected if more functions were devolved to Parties and regional bodies, when compared to the Clean Development Mechanism (CDM) & Joint Implementation (JI), which are largely seen as precursors to the Art 6.4 mechanism.

V. In/out of the Paris Agreement

In terms of substance, in broad terms, we know what the issues and options for each issue are – one could say that the picture COULD be clear, and negotiations and decisions possible.

The picture, however, gets blurred, sometimes willingly, sometimes involuntarily. A simple example is that of provisions that were negotiated and then clearly left out of the Paris Agreement, and that now come back to life in negotiations, being reintroduced by Parties. Discussions get stalled, as some Parties are simply not willing to renegotiate the Paris Agreement.

VI. Art 6 in the Paris Agreement

Another issue that complicates the picture is the lack of communication and coordination between different groups working on the PA work programme, which cover issues relevant to each other.

For illustration purposes, Art 4 is meant to address accounting, and help track progress towards NDC through the Transparency Framework. For that purpose, it will not only need NDC and inventory information, but also quantitative information on the position of each Party (e.g. its surplus or deficit) through transfers of mitigations outcomes governed by Art 6. That position will be provided by information collected through provisions in Art 6.

It is not foreseen at this time for the groups responsible for accounting, and the one responsible for Art 6, to come together in the negotiating process, and agree what information is needed, and ensure that the information is made available.

Consequently, while it is the job of Art 6 to ensure, through corresponding adjustments, that there is no possible double counting of a mitigation outcome transferred, and to provide quantitative information on the position of each Party, it is also taking on the highly complex burden of making rules on how that information is accounted towards an NDC.

For illustration purposes, single year NDC raises the concern of what happens during the NDC period since all that seems to matter is the snapshot in the target year. Art 6 discussions are also trying to address what to count towards the NDC from the possible transfers that take place during the NDC period – with a number of proposals being put forward, such as only using the average of the total net transfers over the NDC period.

The same situation can also be said to exist in relation to Art 13, and the information that is reported from Art 6 through the Transparency Framework.

There needs to be some clarity and discipline on who decides what information is needed, who needs to ensure that provisions exist to collect that information and make it available, and who decides on how the information is presented and reported.

Currently, with little coordination and communication, we take the approach of defence in depth, with everyone responsible for everything, and Art 6 getting burdened with issues that could be addressed in other rooms.

VII. Art 6.2 three “shall(s)”

There are some key issues that need to be highlighted and that would benefit from common understanding in respect of both Art 6.2 and Art 6.4.

Art 6.2, which was baptized “cooperative approaches”, has a mandate to govern the transfer of mitigation outcomes (ITMOs) between Parties, which could then be used to meet the Acquiring Party’s NDC. There are 3 conditions that are explicitly mentioned in the text (“shall conditions”) and that need to be operationalized.

Sustainable Development

The first “shall” is that Art 6.2 transfers need to “promote sustainable development”. Sustainable development is generally accepted as being the prerogative of each Party. Parties can report their views on how their activities meet that condition and can use the Transparency Framework of Art 13 for that purpose.

Environmental Integrity

The second “shall” refers to environmental integrity, and there are still different interpretations on how that will be operationalized. While by no means a consensus, it is becoming increasingly accepted that cooperating Parties will need to provide, through the transparency framework, information on how the mitigation outcomes were derived. This may include information on

baselines setting, Monitoring, Reporting and Verification (MRV), stakeholder participation, additionality test when appropriate, etc.

Corresponding Adjustment & Accounting towards NDC

The third “shall” in Art 6.2 refers to ensuring robust accounting, and avoiding double counting through corresponding adjustments. This has been somewhat more difficult to pin down, but one interpretation is that with each transfer there is an adjustment that is made to a variable, by both the transferring out Party, and the acquiring Party, akin to a double entry ledger (+/-). That quantity will provide information on the up-to-date position of Parties (e.g. its surplus or deficit) taking part in transfers.

One issue that is still not well understood is what would be the basis for adjustment – what is being adjusted, what is the quantity that is being adjusted? One approach is to adjust the **NDC** with each transfer. That would result in an **NDC Adjusted Number**, which may be politically sensitive. However, at all times there would be information on the position of the Party in achieving its NDC. It also has the advantage that the NDC is a number known ex-ante.

A second approach is to adjust the Party’s **Inventory**. That would result, with each transfer, in an **Inventory Adjusted Number**, which would also provide information on the position of the Party, versus its NDC. One drawback is that the Inventory is an ex-post number, known with significant delay, while the NDC is an ex-ante number.

A third approach dubbed the **Interchange/Buffer** account approach, would see the adjustment made to an **Interchange** account for each Party, with the initial setting at 0, and adjusted (+/-) every time there is a transfer.

While more abstract to many, the Interchange/Buffer account approach may be seen as a cleaner and more flexible solution. This may also be seen as an intermediate step, which would allow the benefit of giving Parties the choice of using the Interchange number together with the NDC and/or an Inventory, to judge where the Party stands at any time in relation to its commitment.

It is abundantly clear that all three approaches will ultimately show the same position, and the choice will be dictated by reasons other than its effectiveness.

VIII. Art 6.2 & 6.4: Inside outside NDC

It seems generally accepted that Art 6.2 will only cover mitigation outcomes from inside the NDC. What is more controversial is the discussion on where Art 6.4 reductions can originate from, and when, if at all, they become ITMOs, governed by Art 6.2 guidance?

One view is that Art 6.4 reductions can only be additional if they are produced “beyond the NDC” (for example in non-NDC covered sectors). In this case they can only be subject to Art 6.2

guidance on corresponding adjustments after they are transferred from first acquiring Party, at the time of a second transfer.

The second view sees any transfers without any corresponding adjustment as unacceptable, and either would not accept reductions originating from outside NDCs or would try and find a way to capture that transfer and report it.

IX. Prioritization

There are also those that are seeking to “prioritize” – “we cannot do everything in time for Katowice, let’s prioritize” they say. At the level of granularity presented by the informal text issued by the Chair of SBSTA in mid-March, that is rather difficult to really justify. That text contains “big boxes”, that is decisions that will either allow components of Art 6 to become operational or allow work to continue in order to define higher levels of detail.

Glossary of Terms for Article 6.2

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This Glossary of Terms is meant as a starting point for discussion and will be improved as we get comments and as negotiations progress. It is intended to take a number of terms that have appeared both in documents, as well as in discussions, and provide an explanation of what is meant by it, to the degree that an explanation is generally accepted at this stage. That is why we want this to be an evolving paper, interns of substance, and in terms of coverage. We encourage feedback, as well as any suggested additions in terms of topics covered.

Accounting. Accounting, when referred to under Art 6.2, is understood to be accounting towards the Nationally Determined Contribution (NDC). Accounting is the process/act of squaring the equation between NDC, the inventory, and a number of other relevant variables, which may include transfers of mitigation outcomes (ITMOs) between Parties, mitigation outcomes under Art 6.4, Clean Development Mechanism Certified Emission Reductions (if they can be counted), as well as the treatment of Art 6.4 credits issued, but not yet transferred internationally, REDD+, etc. Accounting is done depending of timing of NDCs.

Acquiring Party. A Party that is participating in a Cooperative Approach, who receives, by way of transfer-in, an ITMO from another participating Party, and who may or may not also be the Using Party (i.e. use the ITMO towards their NDC).

Additionality.

- An activity is deemed additional if emissions are reduced below those that would have occurred in the absence of the activity;
- An activity is deemed additional if the reduction of emissions goes beyond what would be achieved through the delivery of the NDCs of the host Party.

Article 6.4 emission reduction. An emission reduction issued pursuant to Article 6, paragraphs 4-7 of the Paris Agreement.

Buffer/interchange/tracker-based Approach. This is an approach for how to do corresponding adjustments. An adjustment is made to a Buffer/Interchange account associated

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with each Party, which has the initial setting at 0. This Buffer Account (BA) is adjusted (+/-) with the appropriate quantity, every time there is a transfer.

Cooperative Approaches. Two or more Parties working together on a voluntary basis, towards the implementation of their NDC, through the transfer of mitigation outcomes.

Corresponding Adjustment. A corresponding adjustment (CA) is the method by which Transferring Parties and Acquiring Parties, participating in Cooperative Approaches, avoid double counting of their respective anthropogenic emissions by sources and removals by sinks covered by their respective nationally determined contributions under the Agreement. A CA is an adjustment that is made to a variable, by both the transferring-out Party, and the acquiring Party, akin to a double entry ledger (+/-). That variable will provide information on the up-to-date position of Parties taking part in transfers (e.g. its surplus or deficit). Four types of approaches have been identified and they should provide, from a quantitative point of view, the same information, but in different formats: NDC; inventory; buffer/interchange account; emissions reductions.

Double claiming. Is a type of double counting. When the Acquiring Party transfers-in an ITMO without a corresponding adjustment from the Transferring Party (if the mitigation outcome originates inside the NDC).

Double Counting. Is the counting of a mitigation activity or its outcome for more than one purpose. For definition purposes, double counting includes double claiming; double issuance; double registration; and double use.

Double issuance. Is a type of double counting. When a double registration leads to the issuance of mitigation outcomes, under multiple regulatory regimes or cooperative approaches, representing the same mitigation action.

Double registration. Is a type of double counting. When the same mitigation activity or mitigation outcome is registered with multiple regulatory frameworks (e.g. UNFCCC, ICAO) or with multiple cooperative approaches.

Double use. Is a type of double counting. When the same mitigation outcome is used more than once towards mitigation objectives, for the same, or different, mitigation obligations.

Emission reductions based Approach. This is an approach for how to do corresponding adjustments. Each Party calculates the total quantity of emission reductions required in order for it to achieve its NDC. This quantity is adjusted (+/-) with the appropriate quantity, every time there is a transfer.

Environmental Integrity. Environmental integrity is understood to mean that cooperative approaches which include the transfer of mitigation outcomes between Transferring and

Acquiring Parties will not result in a net increase in global emissions. While by no means a consensus, the Issuing Party will have to provide, through the Transparency Framework, information on how the mitigation outcomes were derived. This may include information on baselines setting, Monitoring, Reporting and Verification (MRV), stakeholder participation, additionality test when appropriate, etc.

International Transaction Log. A mechanism/software which connects registries and can verify/authorize transfers in conformity with the terms of the regulatory regime under which it operates (e.g. Kyoto Protocol, EU Emissions Trading System). Keeps track and stores information based on the serial number of the units/mitigation outcomes being transferred. In most ITLs, the units being transferred have an unique serial number in order to keep track of transfers and log the information. An ITL which would keep track of transfers when there are no serial numbers assigned, could keep track of the quantities or net quantities transferred between Parties.

Internationally Transferred Mitigation Outcome (ITMO). ITMOs are mitigation outcomes transferred between Parties, voluntarily, and that are eligible to be used, under CMA rules, if any, towards the NDC of the receiving Party. The metric of the NDC can be any metric that is agreed on by the cooperating Parties. ITMOs used towards any NDC must be expressed in the NDC of the Party that is using that ITMO towards its NDC.

Inventory-based Approach. This is an approach for how to do corresponding adjustments. A variable is created whose starting point is the Inventory (starting NDC period inventory/most recent inventory). This new variable is labelled Inventory Adjusted Number (I(AN)). This I(AN) is adjusted (+/- number of ITMOs transferred in/out).

Issuing Party. A Party that is participating in a Cooperative Approach, in whose jurisdiction the mitigation action has occurred. Could also be called the First Transferring Party.

NDC/Target based Approach. This is an approach for how to do corresponding adjustments. A variable is created whose starting point is the NDC. This new variable is labelled NDC Adjusted Number (NDC(AN)). This NDC(AN) is adjusted (+/- number of ITMOs transferred in/out).

Registry. In the context of Art 6.2, a registry is an electronic database used to house accounts for participants in a carbon market and where units, such as credits or allowances, are stored. In different regulatory regimes, both Parties and non-Party actors have had accounts in Registries.

Registries could be National Registries as well as International Registries. International Registries (e.g. CDM Registry), have been used by the Regulator (the CDM EB) to issue credits from CDM projects. In the KP, only Annex I (developed countries) had Registries, and they were connected to the ITL, which transferred units between Registries. It can be expected that under the Paris Agreement all Parties may have Registries. Under the Paris Agreement it could be

envisaged that Parties may have simple bilateral connection between registries without going through an ITL.

It could be envisaged that registries could be owned by a Party and physically housed in a separate facility owned by that Party. Alternatively, Parties which are unwilling, or unable, to host a registry could have it hosted by another Party or by an international organization (e.g. UNFCCC Secretariat).

Sustainable Development. Sustainable development is generally accepted as being the prerogative of each Party, within the context of international agreements that Parties subscribe to. Parties can report their views on how their activities under Art 6.2 promote SD and use the Transparency Framework of Art 13 for that purpose.

Tracking. The process of tracking transfers from one Party to another. It is seen as necessary a) in order to ensure the avoidance of double counting; b) to ensure that unit ownership is kept accurately, including the accurate location of any unit. Tracking units implies that they have a unique serial number. Tracking transfers can be done through corresponding adjustments.

Transferring Party. A Party that is participating in a Cooperative Approach and transfers out an ITMO to an Acquiring Party, for potential use towards its NDC. For the avoidance of doubt with respect to the very first international transfer of an ITMO, the Issuing Party is also the first Transferring Party.

Using Party. A Party that is participating in a Cooperative Approach who has received the ITMO, accounted for the receipt in accordance with Article 6.2 accounting guidance, and applied it towards the NDC.