

# Potential for transformation of CDM activities into Article 6 activities under the Paris Agreement with environmental integrity

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## **Disclaimer**

The positions, interpretations and statements expressed in this report are strictly those of the authors and do not represent the opinion of the Swedish Energy Agency.

The assessment is based on the current status of the negotiations: as rules and requirements for the operationalization of Article 6, including on the transition of the CDM, are likely to be agreed upon at the COP 25, to be held in Madrid on 2-14 December 2019, the conclusions of the assessment may change accordingly.

Executive Summary Only

## Executive summary

The potential transformation of selected activities initiated under the Clean Development Mechanism (CDM) into activities under the new market mechanisms of Article 6 of the Paris Agreement (PA) is a key issue in international climate negotiations.

Article 6 of the PA establishes a long-term role for carbon markets within the UNFCCC system. It provides a range of options to use domestic and international carbon market mechanisms for achieving NDC goals. Article 6.2 defines guidance on how to generate and trade internationally transferred mitigation outcomes (ITMOs) through decentralized cooperative approaches. Article 6.4 establishes a multilateral crediting mechanism under the guidance and authority of the UNFCCC, which may emerge as a de facto successor of the CDM. It is expected that the cornerstones of Article 6 rules will be agreed at the COP 25, in Madrid (December 2019). Yet, many elements are still controversial, among others regarding accounting procedures, relationship with the host parties' NDCs (inside/outside problem), metrics of ITMOs and definition of baselines and additionality demonstration. Moreover, the negotiations will have to address whether and how the CDM infrastructure, including methodologies, activities and Certified Emission Reductions (CERs) will be transitioned towards Article 6. The relationship between the CDM and Article 6 is contested as key governments and stakeholders want to limit such transitioning because they fear that an overhang of accumulated CERs could weigh on the prices, and that many CDM activities do not fulfil Article 6 requirements e.g. with regard to environmental integrity. However, others want to build on the experience and investments generated through the CDM and work towards pathways defined by robust eligibility criteria for transforming selected CDM activities into Article 6 activities that enable upscaled mitigation. Moreover, it is clear that the NDCs will fundamentally redefine the context in which Article 6 activities take place if corresponding adjustments will be required. If this is the case, mitigation sold needs to be mobilized elsewhere by the host country government to achieve the NDC target. As long as the NDC target does not contain "hot air", this will lead to a much more careful approval practice compared to the CDM where non-additional credits did not have any negative repercussion for the host country

Given these open questions, developing a more in-depth analysis of two CDM activities can generate important lessons for a potential future transformation<sup>1</sup> from the CDM to Article 6 and help identifying critical elements that must be considered carefully. Against this context, this report assesses two activities from the CDM portfolio of the Swedish Energy Agency (SEA) in Africa regarding their potential to transform into Article 6 activities – an improved cookstove programme and a landfill gas (LFG) collection and flaring project.

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<sup>1</sup> The term transformation is used in this report to indicate the potential for one activity to be transitioned from the CDM to Article 6 taking into account a set of stringent criteria that can potentially go beyond the final requirements and limitations that will be defined by negotiation process to ensure highest quality of the activities and related CERs.

In order to perform the assessment and evaluate the potential for transformation under Article 6, a set of eligibility criteria has been developed to analyze key aspects of the activities that enable a tentative assessment of how these activities would be performing against anticipated international eligibility criteria for their transformation into Article 6 activities. Criteria and related indicators are grouped in three main areas:

- 1) **Description of the activity**, providing general information on the activities such as, among others, location and description of the host country, methodology used and current status (crediting period);
- 2) **Relationship with NDC and other policies in the host country**, which allows the assessment of the alignment of the activities to national priorities;
- 3) **Mitigation performance and future potential**, which describe the current and expected mitigation contribution of the activities, but also the performance towards Sustainable Development (SD), as well as the transformation and replication potential of the activities.

Both qualitative and quantitative criteria and indicators are used. The latter will be provided as a score (i.e. min-low-high) value indicating the performance of the activity.

Our key assessment criteria include the replication potential of the activity in the respective country, the continued additionality of the intervention, its contribution to SD, the alignment and coverage of the activity and its sector with the NDC and whether the activity can contribute to the transformation of the sector over time. The assessment was carried out through desk review of available documents and through semi-structured interviews with the project developers (PDs). These sources provided further insights on the selected CDM activities with a forward looking view at potential developments in the short-mid-term.

Both CDM activities are highly relevant case studies for the broader question of CDM transformation as they exemplify activity types that are representative of the African CDM portfolio. In addition, the emerging Article 6 pilot portfolio also includes improved cookstove and LFG activities. Therefore, the two activities are relevant beyond the individual cases at hand as they can serve to illustrate how to deal with CDM transformation.

Regarding the LFG project the assessment led to the following conclusions:

- The project in its current design is not really appropriate for the Article 6 transformation as it is not replicable in the host country due to the small size of other potential target cities, resulting in small quantities of waste that would not permit sufficient generation of emission credits.
- LFG capture and flaring at the project site continues to be additional to both economic BAU and host country's NDC and policy requirements for the foreseeable future.
- If power generation from LFG is introduced at the project driven by a sufficiently high feed in tariff, LFG capture and destruction (once established) would remain financially viable in the

absence of carbon finance. Given the high mitigation costs and high feed in tariff needed as confirmed by the PD, the country probably would benefit more from an alternative use of funds.

- For an effective waste sector transformation, a sector-wide and integrated programme promoting measures to reduce waste volumes at source (i.e. re-use and recycling) and decentralized composting or biogas plants would have to be set up. Composting is only viable if farmers trust the quality of the compost: creation of a stable market for compost products and ensuring high quality of these products is a challenge that is generally not overcome. Therefore, the emissions reduction potential of these activities is rather limited. Given the very different skillsets needed for such alternative waste treatment technologies, this would require a fundamental change in the business model of the existing landfill operator or the involvement of new players in waste treatment.

Regarding the improved cookstove PoA, the assessment led to the following conclusions:

- There is a clear need for further international support for the activities supported by the assessed PoA in the host country, which makes future additionality and potential for Article 6 transformation highly probable, in particular considering the host country's LDC status
- The huge gap between cookstove dissemination policy targets and current status offers significant upscaling potential, in particular given the host country's high population.
- There is a potential to expand the current PoA in scale and scope both within the CDM or as part of a transformation to Article 6. The PD has already advanced plans for including 3 additional CPAs into the CDM PoA and has expressed a high degree of potential upscaling (up to 50 CPAs) provided there are sufficient resources. The PD has demonstrated a high degree of organizational capacity to deal with a range of carbon standards, and has consistently been a frontrunner in innovative and well-performing carbon markets activities. This leaves little doubt that the Coordinating/Managing Entity (CME) would manage to navigate Article 6 requirements provided there is sufficient budget and potentially some technical assistance.
- Final decisions should be made based on COP25 outcomes, feasibility, organizational capacity of the CME, as well as available resources.
- While efforts to build the institutional readiness for Article 6 in the host country have not yet commenced, there is a willingness on the side of the DNA to cooperate with international partners and to engage in Article 6. Technical assistance for ensuring all Article 6 requirements are met should accompany any CDM transition to Article 6, provided such provisions are not already being undertaken at the time of such a transition process.

**The assessment of the two CDM activities generates lessons that are relevant beyond the selected activities.** Since Article 6 places a higher level of responsibility on host countries, especially under Article 6.2, continuous interaction with national institutions and stakeholders will be needed over time to evaluate the readiness for approving and implementing Article 6 activities, as well as to ensure the required institutional and technical infrastructure for NDC accounting. Moreover, as NDCs are to

be revised by 2020 and then every five years, it is important to ensure that the Article 6 cooperation is duly taken into account during the revision. This particularly relates to the specification of conditional/unconditional contributions as well as changes in the type of NDC target given their potential impacts on ITMO accounting under the Article 6 cooperation. Especially for low-income host countries with limited human, technical and financial resources meeting such requirements will be a challenge that can only be overcome with substantial capacity building.

On the activity level, the current lack of clear rules for transforming CDM activities into Article 6 activities creates uncertainty on the actual steps that need to be undertaken. For instance, the lack of guidance on how additionality under Article 6 is to be tested generates uncertainty on whether specific CDM activities will meet future additionality requirements. This uncertainty may persist until the Article 6 work programme has been concluded. Moreover, PDs need to be transparently informed about the consequences of transformation on the design of the activity and related MRV requirements, as well as engagement with host country institutions as any exported credits needs to be captured in NDC accounting if corresponding adjustments become mandatory.