ERCST

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Rulebook for Article 6 in the Paris Agreement:

Takeaway from the COP 24 outcome

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[1] This paper is written under own capacity and does not represent the views or positions of the Government of South Africa

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Some takeaways from this paper

The fact that Article 6 was the last one to be agreed at COP 21 should have been a warning that this will continue to be a challenging issue, and for some, a controversial matter. In Katowice, it was the only part of the Paris Agreement Rule book, which did not get over the finish line. This is also a testimony to the importance that international cooperation has in achieving the goals agreed at COP 21.

Some of the issues that can be seen as having led to the deadlock in Katowice may include, *inter alia*:

- How do we deal with ITMOs in metrics other than CO2e – is there a need for them, and does that lead to other outcomes, such as the need for a buffer account?
- How do we do CA for issuance from "outside NDC", including first issuance under Article6.4? We may need to eliminate that option, or give it a time horizon.
- How do we articulate tracking-CA-reporting if we allow Parties choice in the basis and timing of CA?
- Is it justifiable to add provisions that were not in the Paris Agreement, even if excluding them seems unfair?
- How do we address the single/multi-year NDC accounting? Is there a need for simplifying assumptions to make this while market work and not collapse under the weight of the branches that the diversity in NDCs bring?
- Is the continuity of KP mechanisms something that needs to weigh on the Article 6 rulebook, or this is a political decision This is a longish list, but the real question is whether we are on the right track, and only need some additional technical understanding and final touches to reach an agreement at COP 25, or we actually need to backtrack and re-consider - based on the technical work done so far - how markets will be operationalized in the Paris Agreement?

Are Article 6 rules to be written to meet the variety of NDCs and the complexity of the Paris Agreement, or do we adapt (NDCs) and simplify (Paris Agreement) in order the meet the rules needed for Article 6?

The complexity that the Paris Agreement has introduced needs to be addressed, and it can be addressed through one or more of the following options:

- Political compromise on some issues;
- Simplifications, by assuming that participation is restricted to Parties accepting certain conditions – e.g. NDC in CO2e budgets;
- Centralization of functions.

1. Introduction

The Paris Agreement is a political act, which sets objectives, and the broad instruments to reach them. The Paris Agreement, and the accompanying decision, 1/CP.21, provided for a number of work programmes to develop the Paris Agreement rulebook, which would operationalize the Agreement.

COP 24 was the most important COP following COP 21 due to the anticipated Paris Agreement rulebook, which would operationalise the Agreement. While the Rulebook was indeed agreed in December 2018, it is an incomplete rulebook, with the Article 6 chapter being sent for completion to the next COP. This will take place in Santiago (COP 25).

The work programme for Article 6 was assigned to the Scientific Body for Scientific and Technological Advice (SBSTA) (with other PA components undertaken under other bodies). For the last three years, a Contact Group was convened at each session which focused on the issues in the work programme, most notably: a) how to avoid double counting under Article 6.2; b) rules, modalities and procedures for the Article 6.4 mechanism and c) a work programme for article 6.8. The work could not be completed in Katowice due to the inability to reach consensus on these matters.

Leading to COP 25, Article 6 will certainly capture a lot of attention, and will most likely be the focus of much of the preparatory work for COP 25. While many Parties indicated in their NDCs that they were not ready to use Article 6 approaches, many others, in different ways, and sometimes conditionally, signalled their interest to get involved in cooperative approaches and mechanisms.

In this context, Article 6, , is a tool that many countries would like to use to meet their NDCs, and which will perhaps also assist to enhance and progress their NDCs, even if some significant Parties made it clear that they will not use Article 6 in their first NDC . Importantly, it is also the one signal to investors linked to carbon pricing, which needs to be operationalized at COP 25 for the momentum to continue.

This paper is intended as an analysis of the outcomes in Katowice on Article 6, in order to contribute to broadening understanding to help a positive outcome in Santiago in January 2020.

This paper is NOT intended as a "landing zone" paper. While some may want that, it is felt that it is too early after COP 24 to seek landing zones. A good understanding, together with a dispassionate discussion, is needed before we can try and land this article.

2. Article 6 outcomes in Katowice

In order to better understand the Article 6 outcomes from Katowice, it is necessary to identify the versions of the texts, which are relevant, and provide a distinct and clear reference to each of them. This paper will examine different versions of the text that emerged at key moments in the two weeks of negotiations, and try to identify evolution and changes in key issues in the text, and discuss and analyze these changes.

Four versions of the Article 6 text will be referred to in our analysis. Working backwards, the final outcome of the Article 6 in the Katowice rulebook is largely procedural, and we will refer to it in this in paper as **KTF (Katowice Text Final).**

It is part of a document, which was issued on Saturday December 15.[2] It was read from the podium as opposed to the other parts of the Katowice Rulebook (KRB) and posted on the UNFCCC website as document L.28, later to be amalgamated in a compilation with all other L documents.

This Article 6 document is largely procedural, but it does contain two important elements. It contains references to two documents, which are "noted", which means that they will have standing in the SBSTA discussions on Article 6, which will continue at SBSTA 50 in June 2019 in Bonn. The two documents that are referred to are elaborated below – the text on the table at the end of SBSTA 49,[3] and the text issued by the Presidency under the title Katowice Presidency Text.[4]

The Article 6 part of the KTF also makes reference to paragraph 77(d) of the Paris Agreement, which is part of the Transparency Framework:

> *Each Party that participates in cooperative approaches that involve the use of internationally transferred mitigation outcomes towards an NDC under Article 4, or authorizes the use of mitigation outcomes for international mitigation purposes other than achievement of its NDC shall also provide the following information in the structured summary consistently with relevant decisions adopted by the CMA on Article 6:*
>
> - *(i) The annual level of anthropogenic emissions by sources and removals by sinks covered by the NDC on an annual basis reported biennially;*
> - *(ii) An emissions balance reflecting the level of anthropogenic emissions by sources and removals by sinks covered by its NDC adjusted on the basis of corresponding adjustments undertaken by effecting an addition for internationally transferred mitigation outcomes first-transferred/transferred and a subtraction for internationally transferred mitigation outcomes used/acquired, consistent with decisions adopted by the CMA on Article 6;*

[2] https://unfccc.int/sites/default/files/resource/Informal%20Compilation_proposal%20by%20the%20President_rev.pdf

[3] file:///C:/Users/sancha/Downloads/l20.pdf

[4] https://unfccc.int/sites/default/files/resource/Katowice%20text%2C%2014%20Dec2018_1015AM.pdf

- *(iii) Any other information consistent with decisions adopted by the CMA on reporting under Article 6;*
- *(iv) Information on how each cooperative approach promotes sustainable development; and ensures environmental integrity and transparency, including in governance; and applies robust accounting to ensure inter alia the avoidance of double counting, consistent with decisions adopted by the CMA on Article 6.*

This reference also specifies that paragraph 77(d) was agreed in Katowice, without prejudice to the final outcome of negotiations under Article 6. This could be interpreted as meaning that there is the expectation that paragraph 77(d) could undergo modifications as part of negotiations for the rulebook for Article 6

A second set of documents are those that were issued on Saturday December 15 in the early afternoon by the Presidency, as L.24, L.25 and L.26, together with all the other L documents that were subsequently incorporated in the KTF. These documents represented an attempt by the Presidency to put forward a compromise based on discussions with Parties and Groups the day before. They were withdrawn when it became evident that they could not form the basis of a compromise, and never incorporated in the KTF (later replaced by the L.28 document, which formed the KTF).

These L texts will be referred to as **KTL (Katowice L text).** They are valuable, as they may be deemed to offer a glimpse into what the Presidency assumed could be a compromise, based on the presumed insight into compromises Parties and Groups were willing to make, at that time, in bilateral meetings with the Presidency. These also give some indication of the "bottom line" of some Parties, bearing in mind these too could have shifted in the last two months.

A third document that we will refer to, also issued by the Presidency, is one of those that was noted in the final Article 6 document (KTF). It was issued on December 14. We will refer to it as **the KTP document**. It is not different from the Presidency text issued on Thursday December 13, which Parties referred to, during their discussion in the Sejmik setting on Thursday evening.

Finally, a fourth document is the document that was presented to the SBSTA plenary on Saturday December 8, and will be referred to in this paper as **KTSB**.

The final outcome on Article 6 was certainty disappointing, and represented the choice between what we now have, and an outcome (whose outline we see in KTL) that would have left many issues open, or half open, and would have almost certainly required the re-opening at COP 25 of many issues that would have been included in the decision part, that is, the part that would have considered as "agreed" in Katowice.

The patchy nature of such a decision, the lack of clarity, the likely need to go back and re-do the work anyway, led to the decision, on the face of it, to have a procedural decision. Is KTF truly a procedural decision only, or does the paragraph 77(d) reference give it more traction that it can be assumed at first glance?

One interpretation of paragraph 77(d), agreed and introduced at the last minute by Parties, is that it provides the outlines of the approach needed to avoid double counting under Article 6.2. It could be seen as vague, although it makes the obligatory reference to *"consistent with decisions adopted by the CMA on Article 6"*. However, it can be argued that paragraph 77(d) is about reporting, and provides no direction for accounting under single year/multiyear NDC scenarios.

However, in the absence of any further decisions for the Article 6 rulebook, could these provisions become the framework for reporting to ensure that the provisions of Article 6.2 are in principle met? In other words, can paragraph 77(d) be enough in the face of nothing else? If there is still no agreement under Article 6 in Santiago at COP 25, can some Parties start developing their own approaches, based on paragraph 77(d)? This may lead to a lack of urgency for some to negotiate on Article 6 at future COPs.

However, it is debatable if this would be sufficient. One view, not shared by all, is that there may well be a high-level guidance framework to avoid double counting under 77(d), but there would still be significant documentation and precise guidance that would need to be further agreed to for this to be considered good enough for avoidance of double counting. In addition, the use of these cooperative approaches must follow a sound accounting methodology that some see as developed under Article 6.2 – which 77(d) may not cover.

The second question that the Katowice outcome for Article 6 raises is whether we are inches away from a solution, or if we need to seriously examine if we ploughed the right field, and need to retrace our steps, and go back to fundamentals.

Again, some may say that we were inches away and a final push will put the ball over the goal line. However, while in Katowice all eyes were on Brazil and the issues it raised, with the (somewhat logical) conclusion that if that issue could be addressed or forced through, then we could have a positive outcome.

That may or may not be true, as there were other Parties, who quietly shared that position. In addition, there were other issues that were of great concern, and which stayed out of the limelight of the last minutes discussions, but were still present.

Maybe not red-lines, and maybe those Parties were not willing to be seen as sinking the deal, but once we go back to a renewed process in June at SBSTA 50, they are bound to re-emerge.

Based on these realities, we are again faced with the "anything is possible" dilemma. We may be able to breeze through starting in June from the KTP text. However, it is equally possible that we may have to backtrack, and go back to revisit many issues that were conceded to make a deal happen.

Some of the issues that are still unsolved, and that will be an important imprint for the DNA of Article 6 may include, *inter alia*:

- Metrics: the issue of what ITMOs can be denominated in
- Corresponding adjustments: will be done at each transfer or at time of use
- Double counting and the relationship between Article 6.2 and 6.4
- Accounting for single year and multi-year NDCs
- Scope of NDCs: The inside outside debate
- Legacy of Kyoto Protocol mechanisms

Some also feel that these are issues that need to be addressed in order to have a successful conclusion to Article 6.2, but their legitimacy in Article 6.2 itself, not a solution, is being contested:

- Overall Mitigation in Global Emissions
- Share of proceeds

A very good example of some of the issues that will need addressing can be found in two places. One is the KTL text, where the issues listed in the work programme for 2019 were deemed sensitive enough not to be tackled in 2019, if there was to be a chance for an agreement. They are issues that will need to be addressed in renewed negotiations.

The second illustration are the six questions that were put by the two Ministers charged with addressing Article 6 (Minister Shaw of New Zealand and Minister Schmidt of Chile) during the consultation they had with Groups.

- Can you agree to the following landing zone for 6.2: that no corresponding adjustment is required outside NDC until 2031, after which, corresponding adjustment required?
- Can you agree to the following landing zone for 6.4: that activities can be inside and outside, but that outside will be correspondingly adjusted only after 2031?

- Can you agree that CDM project transition will be time limited to 2023 and require certain conditions so that the project takes into consideration the NDC?
- Can you agree silence on use of pre-2020 units?
- Can you agree that for use other than for NDCs, if it comes from outside the NDC, there will be a requirement to make a corresponding adjustment after 2023?
- What other steps are needed to tighten this package from the perspective of environmental integrity?

The questions themselves, and the texts that will be examined below, show that some Parties were willing to provide what can be seen as Band-Aid solutions in order to reach an agreement (2023 and 2031 as sunset for corresponding adjustment). The silence on the pre-2020 units was another compromise – in itself, silence is ambiguous: silence in some jurisdictions implies permission; in others, silence may be interpreted as that action not being allowed.

3. Article 6.2

The format of the Article 6.2 largely maintained from the KTSB text onward, can be considered an indication that the negotiators were moving down the right road.

3.1 ITMO definition

A definition of an ITMO can help clarify and resolve many issues, but can also lead to a number of unnecessary "fights", which in some cases can be resolved by having a de facto definition in the operational part of the text, while minimizing the Definitions section.

In this case, there is an ITMO definition in KTSB, which is relatively elaborated, and included references to all options that Parties wanted:

> *"Be in the form of anthropogenic emissions by sources [and removals by sinks] [avoidance], including mitigation co-benefits resulting from adaptation actions and/or economic diversification plans [, or the means to achieve them];*
>
> *Be measured in metric tonnes of carbon dioxide equivalent (CO2e) in accordance with the methodologies and common metrics assessed by the IPCC and adopted by the CMA and/or in other metrics [determined by the participating Parties] [consistent with the (national determined contributions (NDCs) of the participating Parties];*
>
> *[Include emission reductions under the Article 6.4 mechanism;]"*

There are a few remarks that may be useful, which could highlight some possible interpretations. Removals and avoidance were included, which met the needs of

those Parties that wanted to pursue REDD+, as well as those that may have a special type of cooperation, which would be impossible without the inclusion of avoidance.

At the same time, there was also reference being made to options in metrics. For the non-CO2 metric, however, the text refers to *"consistent with the (national determined contributions (NDCs) of the participating Parties."* This reference can be interpreted as meaning that a transfer cannot be made in a metric other than CO2e, unless both Parties have their NDC in that non-CO2e metric. While this allows some cooperation to take place in non-CO2e metrics, it would severely limit market activity to only Parties that have NDCs in a particular non-CO2e metric. The KTP text issued included a definition of ITMOs, but without reference being made to avoidance and removals.

The ITMO definition is absent from the KTL text, and was moved to the decision part of the text to be addressed as part of the work programme (WP) during 2019. This signals recognition of the difficulties with reaching agreement in Katowice on issues included in the Definition of an ITMO, and the fact that there were Parties attached to the options included – for some close to a red line.

Another definition that was present in KTSB was that of overall mitigation under Article 6.2 – and was not there anymore in KTL and KTP. In the KTL and KTP, the overall mitigation was moved to the chapter on Participation Requirements, but made voluntary, with the wording of *"Parties are encouraged to deliver overall mitigation"*. This is a clear compromise aimed at those for whom this is an important issue, while recognizing the strong opposition by many Parties, as well as the lack of any reference to overall mitigation in Article 6.2 in the Paris Agreement text.

3.2 Governance

There was simplification between the KTSB and KTP and KTL, with some options being dropped out. There are no changes between KTP and KTL, which would signify that this was not seen as a problem area in reaching an agreement.

The choice between an Article 6 technical expert review (TER), and an expert review pursuant to Article 13, which were options in KTSB, concluded with the Article 6 technical review, to be forwarded to the Article 13 technical review process.

It is not totally clear how the review under Article 6 will be undertaken, but any functions that are in Article 6 will require some structure, and potential support, and therefore additional centralization.

It is important to note the role that the Secretariat takes on, which is significant, as not only it will produce a synthesis reports, but will also identify recurring themes and lessons learned from the Article 6 technical expert review process.

There is no role for the Article 6.4 Supervisory Body in 6.2, as some may have wanted (or an overarching Article 6 Supervisory Body), but the TER, in time, is likely to take on an increasingly significant role, and will require additional effort, structure and resources especially as more and more Parties engage in cooperative approaches.

3.3 Participation Responsibilities

Participation responsibilities is not a new item. It can be found in the KP, where all mechanisms had eligibility requirements. The eligibility requirements are the same under KTL and KPT, also signalling that this was not an issue in reaching an agreement at COP 24.

One interesting element is that the KTSB refers to providing and obtaining authorization for the use of ITMOs. The KTP and KTL only refer to providing authorization, which seems more logical, and in line with Article 6.3 of the Paris Agreement.

3.4 Tracking ITMOs

The tracking and identification of ITMOs is to be done through Registries, which are detailed in the Infrastructure chapter. The items listed to be tracked through the Registry are almost the same for all the three texts that we examine, which also shows stability.

It is unclear how a Registry would do the tracking, as registries are in principle an instrument to record and keep units, and not to track the transfer of units. In the KP, tracking was the function of the ITL, which is not present in the Article 6.2 text. How tracking is done will require elaboration, but such further elaboration was not captured in the KTL work plan for 2019.

The KTP text includes also a provision for tracking ITMOs for the share of proceeds for adaptation. This is missing from the KTL text and may indicate that there was a thought being given to try and introduce this provision, which cannot be found in the Paris Agreement itself under Article 6.2, but was removed when there was an attempt to find a deal through KPL text.

There is also a difference in the wording on overall mitigation, from “cancelling ITMOs for overall mitigation” in KTSB text to “voluntary cancelation” in the KTP text

and the KTL text. This is clearly a much softer language, in order to address the concerns of those that do not see this as a legitimate provision.

3.5 Corresponding Adjustments

a) Basis for corresponding adjustment

Corresponding adjustment (CA) will continue to be a contentious issue, given the different views on the basis for corresponding adjustments – the question is, does it really need to be?

The concept in 1/CP.21 is simple enough: there is to be corresponding adjustments in order to ensure that we avoid double counting. Essentially, this provision (CA) is intended to make sure that a mitigation outcome cannot be in two registries at the same time or used towards two NDCs.

The text is vague, and does not specify when the corresponding adjustment is to be made, leaving this operational decision to the work programme.

The arithmetic is simple: the initial NDC (promises) = (what was achieved in NDC) +/- (the Net ITMO position at the end of the NDC period).

Whether the net position at the end of the NDC is a number, or it is a de facto calculation built by adding/subtracting with each ITMO, is, as some view, a matter of form rather than substance.

The main bones of contention are:

- What gets adjusted:
    - An intermediate number which will be used to adjust the NDC at the end of the NDC period
    - The NDC inventory (it is unclear which inventory, the NDC starting inventory?)
- When the adjustment is done:
    - Every time there is a transfer
    - At the time of use of the ITMO towards the NDC

The options present in the KTL and KTP text are the same, signalling that this was a generally accepted way forward, even if it is unclear how these options would function together, unless some assumptions are made. The KTP and KTL text have essentially the same provisions, which represent a step forward from the KTSB text – it eliminates two options from the KTSB text, and provides for a more compact and clear text.

While there was consistency, it also shows a desire to accommodate, to some degree, those who were in a minority, but were deeply attached to the concept of a "buffer/registry/account". The buffer account allows Parties to have transfers in multiple "currencies", and in some way protects the nationally determined nature of the NDC.

However, the options below cannot be taken in isolation, they need to be take into account with the provisions in the Definitions (in the case of the KTP) which limits transfer to both Parties having NDCs in the same (non-CO2e metric), which is rather severe limitation, probably difficult to bridge.

One option in the KTP and KTL texts is proposed for ITMOs in metrics determined by participating Parties. This has the support of Parties concerned with maintaining the "sanctity" of the national determined part of the NDCs, that is, to adjust a number, which is initialized at 0, every time there is a transferred out/in. This in previous text versions was known as the "buffer registry" option. Perhaps the more accurate name is the "buffer account option." For some reason, the designation "buffer" was dropped from the KTP and KTL texts. It may be because the term "buffer" was seen by some, rightfully or wrongfully, as misleading as they believed that it did not really describe the compromise that was reached as the texts progressed.

The text does not make it very clear either that the buffer account is not an end in itself, but rather, an intermediate step that will produce a net ITMO position, to be used in adjusting the NDC, at the end of the NDC period. The rationale is also that it may the only viable way to have an Article 6.2 that has more than CO2e denominated ITMOs.

The second option, applicable to ITMOs denominated in CO2e, and which has a large support among negotiators, points to the 1/CP.21 text paragraph 36: "*that double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks covered by their nationally determined contributions under the Agreement*". This approach is to adjust the accounting balance for ITMOs using the inventory as the starting. What is unclear is which inventory is being referred to – the logical one would be the inventory at the start of the NDC period, which then could be tested against the most recent inventory the end of the NDC period.

It is interesting to note that within the CO2e metric option, there are two options with respect to timing – one would be to do the CA at the time of use of the ITMOs towards an NDC by the using Party, while the second option mirrors the approach for non-CO2e metrics, that is, a CA every time there is a transfer.

Using CO2e and non-CO2e as metrics are listed as options. The proposed text also referred to "each Party shall consistently apply its corresponding adjustment". It is unclear if this means that both Parties involved in a transaction have to use the same approach, or the same Party has to apply the same method all the time throughout the NDC period. What of the option of using one option in one transfer and another option in another transfer? It is somewhat difficult to see how these options would co-exist, except through an assumption that a CA can be done only between Parties that have the same NDC metric, CO2e or otherwise.

b) Multi-year and single-year NDCs

The basis for CA, discussed above, opens different ways of ensuring that double counting is avoided. It shows differences in the basis for CA, which cannot be bridged, and therefore needed to be co-opted in order to be able to find a solution for the Article 6 rulebook.

This is a regulatory problem that needs to be solved, but one that the non-state actors involved will only need to observe, as it does not affect the economics of the cooperation (projects based or otherwise). It is important for non-state actors in order to be reassured of the solidity of the regulatory system and its acceptance.

The multi-year/single-year issue is different. While listed under the heading of CA, it would seem to be more of an accounting issue, which may have significant commercial implications. It basically discusses how much of the transfers (ITMOs) can count towards an NDC.

This will dictate if ITMOs have any value for NDC compliance, and therefore if Parties are likely to allow these ITMOs for domestic compliance. If they cannot be used for international compliance, it is unlikely that they will be used for domestic compliance, or the sovereign would need to do the backstop. If they have no international compliance value and there is no backstop, then they will not have financial value – or the financial value will be significantly affected by the outcome of this discussion.

The texts that are examined for the purpose of this paper show that a number of approaches are under consideration when it comes to addressing the multi-year/single-year NDC. The proposed texts also referred to "*each Party shall consistently apply its corresponding adjustment*". The question remains what "consistently" refers to: both Parties have to use the same approach; one Party has to use the same approach throughout the NDC period. In the KTL document, there is no reference to additional elaboration on this topic, which is probably one of the most important issues for market participants.

The multi-year approach has three possible approaches: emissions trajectory; CA for each year; end of the NDC period for all transfers.

It has to be noticed that the option with the CA at the end of the NDC period was modified in the KTL document to include the wording "*calculating a multi-year emission budget for the period of the NDC implementation*" which went some way to the requirement that was put forward by some Parties to have a budget calculated for the NDC period as a condition for NDC participation. The NDC budget condition is also not present in the KTL as an eligibility condition.

For the single year NDC, the same three methods are also proposed, with the addition of two other approaches: averaging the ITMOs of the NDC period; use only ITMOs of the same vintage as the Party's NDC.

The results from these approaches can be very different, and will deeply impact the way Parties will use cooperative approaches. It could, in theory, change how Parties will design and define their NDCs.

What can also be safely said is that any of the approaches that are proposed have some significant level of subjectivity included. Consequently, it can be argued that should a choice be made for any particular approach, some will be unhappy. Given that state of affairs it may be better to make a choice and at least ensure consistency between Parties, instead of allowing a choice of approach, which would result in inconsistencies and possible arbitrage.

3.6 ITMOs from sectors and GHG covered by NDCs

This has been one of the most difficult issues as it was, on the face of it, a very binary choice, resulting not from preferences, but from different views of the world.

The issue was known as I/O of the NDC (inside/outside the NDC), but in itself had different interpretations: was it referring to sectors and/or gases outside the NDC, or how some see it, mitigation outcomes "beyond" what the NDC proposes to do? While theoretically it could be defined, the operational definition of "beyond" has been tricky to pin down. The texts themselves seem to address the I/O the NDC covered sectors.

Some argue that essentially, creating ITMOs (and Article 6.4 units) from sectors outside the NDC is not dissimilar to creating a KP non-Annex 1 Party under the Paris Agreement (for the purpose of markets). You can create and export, and on the face of it, there is nothing to adjust, as what is adjustable, according to 1/CP21 needs to be under the NDC. In addition, 1/CP.21 says that CA are done in order to avoid

double counting towards an NDC, and for what is under the NDC. But it is silent to what happens outside the sectors covered the NDC. However, this does not address the issue if the inventory is used as a starting point – also, this depends whether it is NDC inventory or the Party inventory.

The flip side of this argument is that, also according to 1/CP.21, any transfer seems to entail a CA: therefore, no CA, no transfer.

Given the level of controversy, the KTL document, which was an attempt at compromise, sent the issue to the 2019 work programme. In contrast, KTSB and KTP show a number of elaborate approaches, which attempt to show clear options, and/or bridging proposals.

The KTSB text refers to:

> *"In addition, a Party may transfer ITMOs for emission reductions and removals from sectors and greenhouse gases that are not covered by the NDC of the Party, subject to the application of corresponding adjustments pursuant to section VII (Corresponding adjustments) [from 2026 onwards] [from 2031 onwards] [from the subsequent NDC period]"*

The KTP text is somewhat different:

> *"A Party that transfers ITMOs from emission reductions and removals from sectors and greenhouse gases that are not covered by the NDC of the Party [shall apply corresponding adjustments pursuant to section V (Corresponding adjustments)] [is not required to apply corresponding adjustments pursuant to section V (Corresponding adjustments) until 2031]."*

The KTSB document has a variety of approaches proposed: that a CP has to be done only from inside the NDC; that it could be done from outside the NDC with CA, without specifying how it would be done; that it could transfer from outside the NDC but from 2026/2031/subsequent NDC only; can transfer from outside the NDC without any CA.

In contrast, KTP, which had already simplified many of the text aspects, has two options only: that it can transfer from inside the NDC only; does not need to do a CA from outside the NDC until 2031.

The texts, as they currently stand, make it clear that the attempt at compromise was made through the provision of a time threshold for ITMOs from outside NDCs – which is attempt at a band aid in order to avoid the perceived ideological divide.

This was a difficult pill to swallow for many Parties who regard any ITMOs from outside NDCs as double counting. In addition, one may also argue that creating ITMOs from outside NDCs may bring us back to the CBDR definition many felt was

left behind in the KP, and replaced with a strong decentralization of governance in the Paris Agreement. Further, many felt that "allowing" for sectors outside the NDC would compromise the Article 4 requirement for NDCs to be progressive and could in fact lead to pervasive behaviour. However, for others still there was a genuine argument that sectors were excluded due to lack of data or capacity to include these sectors.

This issue was difficult to land, and will continue to be so, if no comprise solution, temporal or otherwise, can be found.

3.7 Special circumstances of LDC and SIDS

This is a provision that was not contested, appears in all texts, and may be useful if extended to a broader set of circumstances to other groups. While the intention is not to dilute the special treatment of SIDS and LDCs, it is nevertheless important to recognize that some compromises may be unlocked, by recognizing the special circumstances of some groups such as LDCs and REDD+ countries, which may have little space to create ITMOs, outside some very specific type of MO.

The work programme under KTP, contains

> *"Further elaboration if required, of the special circumstances of least developed countries and small island developing States"*

3.8 Reporting

a) Initial reporting

Three of the provisions are present in all three versions of the text

a) Demonstrate that it fulfills the participation responsibilities referred to in section III (Participation responsibilities);
b) Communicate its period for NDC implementation, including the start and end date;
c) Communicate its basis for corresponding adjustments pursuant to section V.A (Basis for corresponding adjustments) and its method pursuant to section V.B (Multi-year and single-year nationally determined contributions) to be applied consistently throughout its period for NDC implementation.

There is one provision, which is not present in the KTL text, but present in the KTSB, and in the KTP text (below):

- *Quantify its NDC in tonnes of CO_2e, including the sectors, sources, greenhouse gases and time periods covered by its NDC, the reference level of emissions and removals for the relevant year or period, and the target level for its NDC; where this is not possible, provide the methodology for the quantification of its NDC in tonnes of CO_2e*
- *Quantify its NDC, or that portion of its NDC, in a metric determined by each participating Party applying corresponding adjustments in metrics other than greenhouse gases pursuant to section V (Corresponding adjustments)."*

As the KTL represented an attempt at finding a working compromise, this quantification, not dissimilar to a KP budget, was seen as too narrow and too divisive and was eliminated – and in that text version it was therefore sent to the work programme for 2019.

b) Regular information

There is variation between different texts on what needs to be reported on a regular basis.

The first four provisions, which refer to standard approvals necessary, and which appear in the Paris Agreement, stay the same in all texts. There are however provisions which appear in the KTSB and KTP, and which tended to be more inclusive and ensure that all needs were met. In some cases, these provisions disappear from KTL, in the same attempt, seen before, to eliminate what was seen as divisive, and strike a deal. Some provisions were eliminated between KTSB and KTP, as they were pointing into a direction that seemed to include too many requirements.

The avoidance of unilateral measures is present in all texts. It is not clearly stated what kind of unilateral measures it is referring to - it may well be a reference to general trade measures, or a narrower interpretation on the banning of certain type of ITMOs (similar to HFC CERs in the KP).

The same is true for the provision on the avoidance of negative social and economic impacts, which it is assumed to be a link to Response Measures. A reference to secretariat collaboration with the forum on Response Measures is also included in the work programme.

Reporting on sustainable development, albeit with recognition of national prerogatives, is also present in all texts – the KTSB text was broader, and also referred to the Sustainable Development Goals.

Other provisions, such as human rights obligations, are included in KTSB and KTP, but are omitted completely from the KTL text, and does not appear in the work programme either.

One provision that is missing from the KTL text is that of measurement in non-CO2e metrics. This provision is present in the KTP text, but in that case, there is also a provision of this nature in the Definition, which is, as discussed, missing from the KPL text (this provision sent to the 2019 work programme for the KTL, like all other non-CO2e metrics-related provisions).

With respect to the inclusion of mitigation co-benefits from adaptation and economic diversification, there is a provision to report on them, while at the same time, there is a further provision to elaborate on them.

3.9 Review

The provisions in the KTP and KTL are the same: The Article 6 technical expert review shall review the initial report, and the regular information, and forward it to technical expert review under Article 13 paragraph 11. The Article 6 technical expert review elaboration, is, as discussed, included in the 2019 work programme (KTL).

3.10 Recording of adjustments

The provisions in KTL and KTP are very similar. Provisions in KTSB, being at an earlier stage, show more in the format of options.

Since this section is on Recording of Corresponding Adjustments, the one discussion that needs to be signaled as critical to take place is on an integrated view on how the flow of ***corresponding adjustments - tracking of ITMOs – recording – reporting -*** take place, for CO2e and non CO2e metrics.

It needs to be clear on how this takes place, and if it possible to have both at the same time for different times, etc.

3.11 Safeguards and limits

Provisions on safeguards and limits were strong asks by some Parties, but they are not elaborated in any detail in any of documents that we are examining, which then also indicates strong resistance by some Parties. A landing zone for this issue will be a difficult one, even if the perception may be that it does not signal that this issue can bring the whole Article 6 rulebook to a halt. Some of these issues may inadvertently be resolved if issues already mentioned are resolved (e.g. I/O)

Some details can be glimpsed from the KTL work programme for 2019, where some of these issues were placed:

- *"Transfer limits;*
- *Minimum holding requirements;*
- *Use of internationally transferred mitigation outcomes towards a Party's nationally determined contributions being supplemental to domestic action such that domestic action constitutes a significant element of the effort made by each Party towards its nationally determined contribution;*
- *Maximum limits on the use of internationally transferred mitigation outcomes towards a nationally determined contribution;*
- *Requirements relating to carry-over of internationally transferred mitigation outcomes*

from one nationally determined contribution period to the next;

- *Limits relating to the use by a Party of internationally transferred mitigation outcomes from emissions and removals not covered by the sectors and gases included in its nationally determined contribution towards its own nationally determined contribution;*
- *Avoiding significant fluctuations in the international market for internationally transferred mitigation outcomes;*
- *Addressing internationally transferred mitigation outcomes from sectors that have a high degree of uncertainty in emissions estimates."*

While it is quite clear that in the COP 24 context these issues were going to be pushed to the work programme, they will, in some way, need to be addressed as part of the package at COP 25. It is unlikely to be a desire to push things to a 2020 work programme.

3.12 Share of proceeds for adaptation

This is an issue that is simply not mentioned in Article 6.2 while clearly present in Article 6.4. Financing for adaptation was an important issue at COP 24 and will continue to be in any climate change discussions.

Both "overall mitigation" as well as "share of proceeds (SOP) for adaptation" are present in the KTSB text, but only SOP remains in the KTP text as a stand-alone chapter. Overall mitigation in Article 6.2 is discussed in previous sections.

SOP is not present in the KTL text, but is referred to in the work programme, in a voluntary way, using "could" as an operative word as a way to have it implemented for baseline-and-credit generated ITMOs.

Again, difficult issues to resolve, especially as it is linked to the overarching challenge of balance between 6.4 and 6.2.

4. Article 6.4

On the face of it appears that Article 6.4 is seen as more "familiar territory" by many negotiators, while Article 6.2 is seen as the novelty, where new things have to be defined and discovered. This may simply be due the initial reference to it as CDM+ or as the sustainable development mechanism, as well as the fact that many features seem at first blush more familiar. At the same time, there is much at stake, as how much Parties will make use of Article 6.2, and how much they will use Article 6.4, and what are the deciding factors, is still not well understood.

In some ways, the issues that are up for debate for Article 6.4 are different, but at the same time, strongly connected to those in Article 6.2. The main difference will emerge from the governance of the two articles. The connection results from the

obvious reasoning that having two different and separate regulatory systems for secondary transfers (that is beyond the initial issuance) for 6.2 and 6.4 sound inefficient and somewhat illogical. Therefore Article 6.4 units will need to behave as ITMOs, or be regulated under the same framework at some point – hence the issue, at what point does an Article 6.4 unit transfer is governed by the ITMO framework?

4.1 Definitions

In KTSB, KTP and KTL, there are extensive definitions of ITMOs. There is no reference to avoidance and removal, which seem to eliminate whole classes of assets, and make the participation by many Parties, including those interested in REDD+, questionable. The reference to non-CO2e metrics is there, but different from that in Article6.2 in that the use of other metrics is to be proposed by Parties to the CMA, for its consideration and approval.

The one condition which is surprisingly missing is the one that would make any Article6.4 activity dependent on mitigation actions being outside/beyond the NDC, which was one of the main asks of some Parties.

The KTSB also includes a definition of overall mitigation as a fixed percentage not used – this definition is absent from the KTP and the KTL.

Including non-CO2e as an option, to be dealt with after the approval of the rulebook, will certainly ensure an uphill struggle to get these metrics approved. This will make the Article 6.4 mechanism closer to being a successor to the CDM.

4.2 Participation

Interesting to note are the references in KTP to unilateral measures, probably a scar from the KP (but missing from the KTL text where it was pushed in the work programme), as well as a strong reference to the special circumstances of the LDC and AOSIS, which will be defined. This may provide, beyond the recognition of these special circumstances, the opportunity to provide for some compromises that will unlock current problems in the Article 6 rulebook.

An important question, for Article 6.4, as it was in Article 6.2, is whether such provisions would then contravene the national determined nature of the NDCs, by forcing Parties to accept vintages and technologies in ITMOs that they feel is inappropriate for their circumstances.

4.3 Activity Cycle

In the activity cycle, there are some changes that need to be mentioned between the

KTP and KTL texts, which are a simplification from the optionality in the KTSB. These changes are significant, as they again signal issues that need to be regarded as "difficult".

The KTL text, as opposed to the KTP text, does not include a reference to removals and avoidance, for which the discussion was moved to WP, together with a reference to co-benefits from adaptation and economic diversification.

The KTL text also does not include a reference to the I/O NDC (also in the WP), as well as no reference to human rights (also in the WP). It must also be noted the specific bracketed exclusion of Article5 (REDD+) in the KTSB text, which was not repeated in the other two texts, but may be implicit in having a discussion in the work programme on removals (KTL text).

Other things that need to be mentioned is the reference in the KTP and KTL texts of the need for national and subnational consultation. This may be somewhat surprising given that most Parties already have such processes embedded in the national legislation for project approval, and the "decentralized ethos" of the Paris Agreement, that should still apply to Article 6.4.

Finally, and by no means a minor issue, is the demonstration of additionality. Article 6.4 is seen as a successor to the CDM and a baseline-and-credit approach and therefore additionality, mentioned in 1CP.21, is a critical aspect. The two approaches mentioned are (both KTP and KTL, therefore seem to be believed as acceptable):

- *Emission reductions achieved by the activity are additional to any that would otherwise occur, taking into account all relevant national policies, including legislation;*
- *Emission reductions are complementary to the policies and measures implemented to achieve the NDC of the host Party.*

What is unclear if these are OR conditions or AND conditions.

The one approach that is not mentioned in the text is the one that would make additionality dependent on mitigation actions being outside/beyond the NDC, which was one of the main asks of some Parties.

4.4 Appeals process

Both the KTP and the KTL texts contain provisions for an appeals process. This is an issue that has confounded the CDM for many years, without ever reaching a conclusion. The gridlock was driven by the dispute over who had standing to launch an appeal process for CDM – it was feared by some Parties that anyone could launch an appeal at any time for any reason, essentially blocking internal projects and

overriding domestic approval processes.

The current formulation does not address these concerns, as the process is loosely defined, with further work in the work programme:

> *"Activity participants may request the mechanism registry administrator to cancel the specified amount of A6.4ERs in accordance with their instructions".*

4.5 Overall mitigation in global emissions

Overall mitigation in global emissions is a provision present in Article6.4 and that needs to be operationalized. The Paris Agreement text refers to:

> *"shall aim: … (d) To deliver an overall mitigation in global emissions"*

The wording of "shall aim", not the "shall" which implies an obligation in UNFCCC language, was maintained in both the KTP and KTL texts, but the methods to reach this aim are presented as either voluntary in nature or through less than precise means, such as "conservative baselines". Reference is made to a 10% cancellation, which is the closest to a benchmark that Parties may be prodded to observe.

4.6 Avoiding the use of emissions reductions by more than one Party

The KTP text contains a plethora of options as this was, on the face of it, the issue that pushed the Article6 rulebook to COP 25. This issue, which essentially is the avoidance of double counting under Article 6.4 issuance, was supposed to have been hermetically sealed in Article6.5 of the Paris Agreement:

> *"Emission reductions resulting from the mechanism referred to in paragraph 4 of this Article shall not be used to demonstrate achievement of the host Party's nationally determined contribution if used by another Party to demonstrate achievement of its nationally determined contribution."*

Except that no one seems to have anticipated that one could claim that if Article 6.4 units are issued from outside/beyond the NDC, then they are double counted. The provision that would tighten this up is to say that A6.4U issued by a Party from outside the NDC/beyond the NDC cannot be used by the host Party – that is, it cannot purchase, directly, or through a long transaction and transfer chain, its own A6.4U coming from outside the DC, and use then towards its own NDC. Long and convoluted, but such a provision would close the loop.

One other issue that is a derivative: is there a differentiation needed or not between the issuance and first transfer?

The KTP text provides number of options to tighten Article6.5 – and they are all sent to the 2019 work programme in the KTL text.

Option A

62. [Pursuant to Article 6, paragraph 5, a Party hosting Article 6, paragraph 4, activities shall make a corresponding adjustment consistent with the guidance for cooperative approaches referred to in Article 6, paragraph 2 of the Paris Agreement for all emission reductions[, if those emission reductions are transferred internationally][from [X date]].]

Option B

63. [Pursuant to Article 6, paragraph 5, a Party hosting Article 6, paragraph 4, activities shall make a corresponding adjustment consistent with the guidance for cooperative approaches referred to in Article 6, paragraph 2, only to emission reductions that are included in the sectors and greenhouse gases covered by its NDC[, if those emission reductions are transferred internationally] [from [X date]].]

Option C

64. [A Party hosting Article 6, paragraph 4, activities shall not be required to make a corresponding adjustment consistent with the guidance for cooperative approaches referred to in Article 6, paragraph 2 for the first transfer of A6.4ERs from the mechanism registry. Pursuant to Article 6, paragraph 5, a Party transferring after the first transfer or acquiring emission reductions from the mechanism shall make a corresponding adjustment consistent with the guidance for cooperative approaches referred to in Article 6, paragraph 2.]

It is interesting to note that the KTP text refers to the need for CA for emissions reduction in the sectors covered by the NDC; it also refers, as another option, to the need NOT to make any CA for the first transfer, as a blanket statement, without referring to where they originate. This must be seen as a confirmation that the language of "outside NDC" or "beyond NDC, which was difficult to operationalize, seems to have been largely abandoned, at least for the moment.

4.7 Transition from KP mechanisms

Although the PA makes reference to experience gained and lessons learned from existing mechanisms and approaches, it does not go further than that. There is no reference and no direction from the Paris Agreement to create a framework to transfer credits, activities or projects or knowledge from the KP mechanisms into the Paris Agreement, via Article 6.4, or otherwise. There is however an expectation that it is the same UNFCCC that created a GHG regulatory market under the KP, and that not providing recognition and continuity would damage the already tarnished credibility of market mechanisms issued from the UNFCCC process. The bottom fell from under the CDM market, largely through regulatory decisions, and those who invested found themselves with stranded assets.

The camps are very divided, with some feeling that at least the knowledge needs to be preserved and used "copy/paste". Others feel strongly that projects and credits need to be preserved. The opposition comes from those that question the

environmental credentials of credits from the CDM as well as are concerned about a significant surplus that could be brought into the Paris Agreements regime, leading to (again) depressed prices, and a lack of incentive for what they see as urgent action.

The options reflect all these options, for both JI and CDM. AAUs have not been directly brought into the discussion, even if JI and ERUs to cover indirectly that issue. There was an attempt to apply a temporal Band Aid in this case as well, by using 2020/2021 as the time when credits that can be grandfathered in Article 6.4 would have to be issued.

Overall, this sounds very much like a political issue, one that will be justified, but not decided on the basis of numbers.

5. Conclusions

Article 6, and carbon markets in general, will always elicit strong reactions both positive and negative. This probably arises from the current experience that some feel they had with carbon markets, which is by no means generally accepted.

Markets made a difference in the KP and the EU ETS, however, when prices dropped, this became the culprit of why things did not turn out the way some stakeholders wanted them to turn out.

Some also see carbon markets as representing an escape hatch for Parties to avoid taking domestic action which many have opposed. Or it could simply be that carbon markets really can impact the environmental integrity of the Paris Agreement, if it does not include some safeguards at least. However, there are also many stakeholders in all sectors that see carbon markets as an important tool to provide a price signal also in helping address, among others, concerns regarding competitiveness. Further carbon markets can be a significant tool in promoting cooperation and reducing costs of mitigation.

The issues are not intractable. Even the issue of CA for Article 6.4 issuance is in the end related to a vision that Parties have of their place in the climate change regime. But that place is changing, as is the world around us, including the picture of global contributions to economic growth and emissions.

While we have made progress in Katowice, it is questionable to assume that some/any issues can be seen as having been settled in Katowice. Many were

assumed closed in Paris, only to be reopened over the last three years - so we need to be prepared for that.

The best place to find the "difficult issues" is the KTL text. If we were to take this approach, then some of the issues we may need to focus include:

- How do we deal with ITMOs in metrics other than CO2e – is there a need for them, and does that lead to other outcomes, such as the need for a buffer account for CA.
- How do we do CA for issuance from "outside NDC", including first issuance under Article6.4. We may need to eliminate that option, or give it a time horizon.
- How do we articulate tracking-CA-reporting if we allow Parties choice in the basis and timing of CA.
- Is it justifiable to add provisions that were not in the Paris Agreement, even if excluding them seems unfair - and they are seen by their proponents to bring about balance seen by some as necessary.
- How do we address the single/multi-year NDC accounting? Is there a need for simplifying assumptions to make this while market work and not collapse under the weight of the branches that the diversity in NDCs bring.
- Is the continuity of KP mechanisms something that needs to weigh on the Article 6 rulebook, or this is a political decision that can be separated and send to the CMS as a stand-alone issue.

None of these are simple issues, as Parties, and negotiators have invested heavily in "their" option. Markets may be different from what UNFCCC negotiators can imagine, and if we want to harness their energy, we may need to accept that.

In the end, the answer may be that we will have to make simplifying assumptions in order to arrive at a functional market. The complexity that the Paris Agreement has introduced needs to be addressed and it can be addressed through:

- Political compromise on some issues
- Simplifications, by assuming that participation is restricted to Parties accepting certain conditions – e.g. NDC in CO2e budgets
- Centralization of functions

Are any of these solutions, or a combination thereof, palatable to Parties?