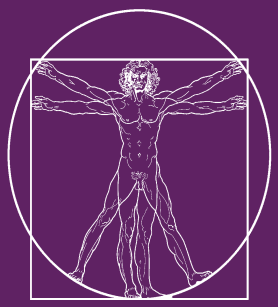

2020 UPDATE

Negotiating cooperation under Article 6 of the Paris Agreement

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ABBREVIATIONS

A6.4ER	Article 6.4 Emission Reduction
A6.4M	Article 6.4 mechanism
A6TER	Article 6 Technical Expert Review
BAU	Business-as-usual
BTR	Biennial Transparency Report
CA	Corresponding adjustment
CARP	Centralised Accounting and Recording Platform
CER	Certified Emission Reduction
CDM	Clean Development Mechanism
CMA	COP serving as Meeting of the Parties to the Paris Agreement
CMP	COP serving as Meeting of the Parties to the Kyoto Protocol
COP	Conference of the Parties
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
DOE	Designated Operational Entity
ETF	Enhanced Transparency Framework
EU	European Union
GHG	Greenhouse gas
IPCC	International Panel on Climate Change
ITMO	Internationally transferred mitigation outcome
LDC	Least Developed Country
MPG	Modalities, procedures and guidelines
NIR	National Inventory Report
NDC	Nationally Determined Contribution
NMA	Non-market based approach
OMGE	Overall mitigation in global emissions
PA	Paris Agreement
REDD+	Reducing Emissions from Deforestation and Forest Degradation and the role of conservation, sustainable management of forests and enhancement of forest carbon stocks in developing countries
SB	Subsidiary Bodies
SBI	Subsidiary Body for Implementation
SBSTA	Subsidiary Body for Scientific and Technological Advice
SIDS	Small Island Developing States
SoP	Share of proceeds
TER	Technical Expert Review
UNFCCC	United Nations Framework Convention on Climate Change

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EXECUTIVE SUMMARY

Agreement on the specific rules for the two market approaches and the non-market approaches defined in Article 6 of the Paris Agreement is still outstanding. Negotiations failed to result in agreement twice in a row, and the COVID-19 pandemic has led to the postponement of further negotiations from 2020 to November 2021. As a result, Article 6 negotiations cannot be finalised before countries revise their first Nationally Determined Contributions (NDCs) and begin implementation.

The last round of negotiations at the UN Climate Change Conference in December 2019 made some progress, and retained three different texts as a basis for future negotiations on Article 6, while a clean text on non-market approaches under Article 6.8 was developed. There was agreement, to a large extent, on accounting of internationally transferred mitigation outcomes (ITMOs) through 'corresponding adjustments' (CAs) to national emissions balance and reporting (Article 6.2); review of cooperative approaches (Article 6.2); the governance of the Article 6.4 mechanism; and procedures for the transition of Clean Development Mechanism (CDM) activities and methodologies (but not credits) under Article 6.4. This progress is significant and should not be underrated.

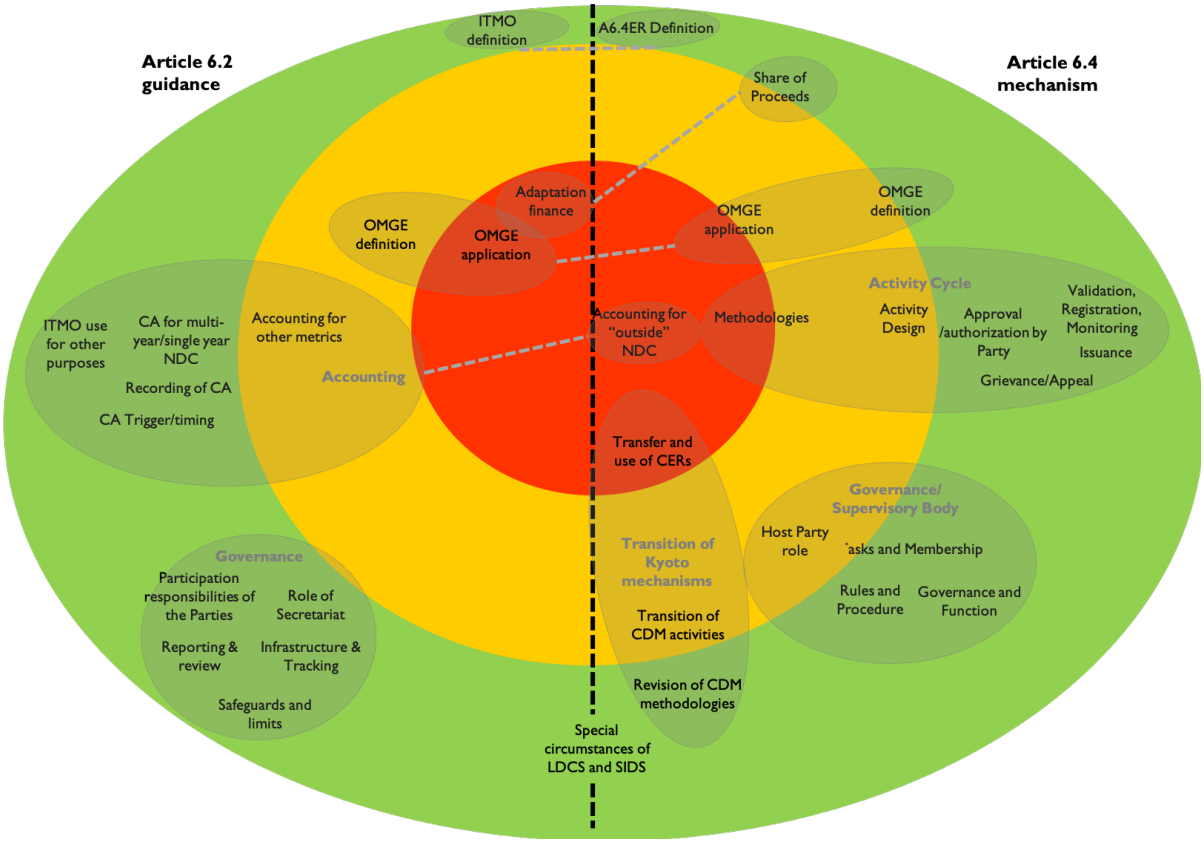
Five 'crunch issues' still remain to be decided on a political level:

- **Whether and how to account for mitigation that is not covered by an NDC:** The question of what is meant by 'outside an NDC' can be approached in different ways. It could either refer to 'outside of the sectoral scope' or 'beyond the mitigation action specified by the NDC'. It is contested whether activities outside the NDC can generate ITMOs and whether CAs need to be undertaken. A compromise proposal is to exempt Article 6.4 activities 'outside' the NDC from CAs until 2030, which would prevent a perverse incentive to keep NDCs narrow in the subsequent period.
- **Ways to generate adaptation financing through Article 6.2 cooperative approaches:** The compromise proposal to 'strongly encourage to commit' to contribute to adaptation finance under Article 6.2 cooperative approaches would need a clearer degree of operationalisation to be palatable to those Parties who want similar treatment for Article 6.2 cooperative approaches and the Article 6.4 mechanism, especially after the entry into force of the Doha Amendment to the Kyoto Protocol which mandates adaptation finance from all three Kyoto market mechanisms.
- **Whether and how to transition pre-2020 CDM units:** Cut-off dates for registration of activities generating eligible Certified Emissions Reductions (CERs) and for the use of CERs in the context of the first NDC implementation period have been proposed as a compromise. Progress at COP25 was hampered by a lack of understanding of the impacts of different possible cut-off dates on the volume of CERs. A quantification of these impacts is currently being undertaken through various international research efforts.
- **How to operationalise the concept of 'overall mitigation in global emissions' (OMGE):** Two interpretations have been brought forward: a share of mitigation outcomes is not claimed by anyone; or crediting baselines are set so strictly that only a small share of the achieved mitigation is actually credited. The latter would allow the host country to do less mitigation elsewhere and still reach its NDC target. Only the former interpretation is contained in the negotiation texts, but with a voluntary and a mandatory option.
- **How to approach baseline setting and additionality determination under the Article 6.4 mechanism:** Disagreement relates to the stringency of the baseline approaches. Some Parties want to continue to apply the approaches used under the CDM, while others want to go beyond business as usual (BAU)-derived baselines, or at least ensure that NDCs and Low Emissions Development Strategies (LEDs) define what is BAU. The question of how baselines can be aligned with the long-term target of the Paris Agreement is still hardly understood.

Various other issues could become contested in the run-up to COP26. For instance, the role of emissions 'avoidance' is unclear. Often this term is understood to refer to reducing emissions from deforestation and forest degradation in developing countries, and the role of conservation, sustainable management of forests, and enhancement of forest carbon stocks in developing countries (REDD+), or as not exploiting fossil fuel deposits. The issue of accounting for use of Article 6 units in voluntary carbon markets, and whether this should require CAs, also needs clarification. This issue has seen the emergence of two schools of thoughts in recent months: one that sees voluntary carbon markets as key approaches to harness private action toward the long-term target of the Paris Agreement; and another that sees governments in the driving seat of ambition through an array of mitigation policy instruments that leave limited room for voluntary carbon market action.

Overall, most crunch issues are linked to different views how to transition from the Kyoto Protocol era to the Paris Agreement. The former was characterised by top-down processes and relatively short time horizons. The latter is based on bottom-up approaches aiming to raise ambition over time in the context of long-term targets. Some governments want to make a 'clean cut' from the Kyoto world to make the market approaches under Article 6 commensurate with the long-term ambition of the Paris world. Others want to apply the approaches that have worked in international carbon markets in the past, to have functioning markets up and running to support NDC implementation in coming years. Essentially this boils down to the question of whether the market approaches under Article 6 should directly work to enhance ambition, or whether they facilitate achievement of the NDCs through lowering of mitigation costs, thereby making it politically easier to strengthen future NDCs. It will not be easy to reconcile these two world views.

Figure 1: Status of Article 6 negotiations after COP25 in Madrid



Note: Issues in the green area are not contentious. Those listed in the yellow area have some agreement among Parties on potential landing zones. The issues placed in the red circle are the most contentious. Non-market based approaches are not considered in this Figure, as there is general agreement on the way ahead.

INTRODUCTION

2020 is an unusual year. For the first time since the entry into force of the UN Framework Convention on Climate Change (UNFCCC), neither the annual Climate Change Conference nor the annual meetings of the UNFCCC Subsidiary Bodies could take place because of the COVID-19 pandemic. As a result, decisions on key issues that will influence the implementation of the Paris Agreement have remained in limbo. This includes decisions on the 'rulebook' for implementing the Article 6 mechanisms. Since agreement on the Article 6 rules will now not be possible until late 2021, countries will not be in a position to decide the role of Article 6 mechanisms in their Nationally Determined Contributions (NDCs), either when they update these NDCs in 2020 or begin NDC implementation at the start of 2021. Existing market-based cooperation, for instance under the Kyoto Protocol's Clean Development Mechanism (CDM) or under voluntary carbon markets, also face uncertainty.

ecbi published a general guide to the Article 6 negotiations before the last UN Climate Change Conference, held in Madrid in December 2019. This policy brief provides an update of where Article 6 negotiations stand after the Madrid Conference. It outlines progress in Madrid, and areas where consensus is still lacking. We hope that the 2019 brief and this update will be useful 'travel companions' for negotiators, political leaders, and other stakeholders on the route to the next round of negotiations in 2021.

The UNFCCC negotiations proceed on the basis of draft texts that are revised based on interventions and proposals by Parties. Every iteration of a draft text tries to consolidate the current options until there is a final version all Parties can agree to. The draft text usually encompasses a decision text on the context, overarching principles of the issue in discussion, operational steps to be taken, and an annex with detailed regulatory content. In the context of the Article 6 negotiations, the Conference of the Parties serving as Meeting of the Parties to the Paris Agreement (CMA) is planning to:

- Adopt guidance on cooperative approaches under Article 6.2.
- Adopt the rules, modalities, and procedures for the Article 6.4 mechanism.
- Define a work programme under the framework for non-market approaches under Articles 6.8 and 6.9.

As Parties were unable to reach agreement during the 2019 UN Climate Change Conference in Madrid, the three last iterations of the negotiation text, prepared under the Chilean Presidency, were forwarded to the Subsidiary Body on Technological and Scientific Advice (SBSTA) for further consideration. While the unresolved issues are not many, they are of "high political weight", as SBSTA Chair Tosi Mpanu Mpanu said during an ecbi Webinar to discuss an earlier draft of this update.

Figure 1 in the Executive Summary provides an overview of where Article 6 negotiations currently stand.

EMERGING FEATURES OF ARTICLE 6 COOPERATION

Despite lack of a final agreement at COP25, negotiators had progressed well on technical issues and produced a largely coherent and clean text. This chapter summarises the current status of the draft Article 6 rulebook with regard to aspects where negotiation text seems consolidated and positions have converged to a certain extent. This chapter aims to describe what the final rulebook may look like, while recognising that 'nothing is agreed until everything is agreed'.

Article 6.2: Accounting framework for ITMOs

While there is no centralised governance body to supervise multilateral or bilateral 'cooperative approaches' described in Article 6.2, the CMA is mandated to adopt robust accounting guidance for all Internationally Transferred Mitigation Outcomes (ITMOs) to ensure, among other things, that double counting is avoided on the basis of a so-called 'corresponding adjustments'.

Definition of ITMOs and scope of guidance

As the name indicates, ITMOs are mitigation outcomes that are transferred internationally. The guidance does not prescribe whether these mitigation outcomes are expressed as credits, allowances, or other types of units. The draft text defines ITMOs, and thereby the scope of the guidance based on criteria that relate to their date of creation and institutional origin:

- ITMOs represent mitigation from 2021 onwards.
- ITMOs are mitigation outcomes from a cooperative approach.
- ITMOs are mitigation outcomes authorised by a participating Party for use for international mitigation purposes other than achievement of its NDC (for instance, under the Carbon Offsetting and Reduction Scheme for International Aviation, or CORSIA) or for other purposes (for instance, voluntary carbon markets).
- ITMOs are emission reductions generated by the Article 6.4 mechanism (A6.4M) when they are internationally transferred. This clarifies the link between the Article 6.2 guidance and the A6.4M.

In addition, the definition establishes key quality criteria of ITMOs:

- ITMOs must be real, verified and additional.
- ITMOs represent emission reductions and removals when internationally transferred.
- ITMOs are measured in tCO_2e or another metric determined by participating Parties which is consistent with the NDCs of the participating Parties.

The mitigation activities underlying ITMOs must respect the Article 6.2 guidance or be set up in the context of the A6.4M (see below). The definition of the term 'cooperative approach' however remains unclear. Can ITMOs be generated exclusively by bilateral or multilateral cooperation among states (which may include authorisation of private actors to participate) or also by other forms of private or public-private international cooperation? The latter may include voluntary markets and sectoral cooperation outside of the Paris Agreement (such as CORSIA). Defining 'cooperative approach' is particularly important in the context of reporting requirements, as their scope remains unclear, particularly on whether the voluntary carbon markets will be covered by the Article 6.2 guidance.

The Article 6.2 guidance establishes key guardrails to ensure that ITMOs represent quantified reductions or removals and are not pure 'accounting units': they must have a clear link to a concrete mitigation action and they must be reported using a unique 'identifier' (such as a serial number). However, mitigation outcomes are only subject to this international guidance from the moment of their authorisation for international transfer.

Participation requirements

Countries that engage in cooperative approaches must be a Party to the Paris Agreement and be implementing an NDC; have arrangements in place to authorise and track ITMOs, in accordance with the requirements of the guidance; and provide the most recent National Inventory Report (NIR) required under the Enhanced

Transparency Framework (ETF). With their participation in cooperative approaches, Parties must comply with the reporting requirements that are discussed below.

Environmental integrity principles

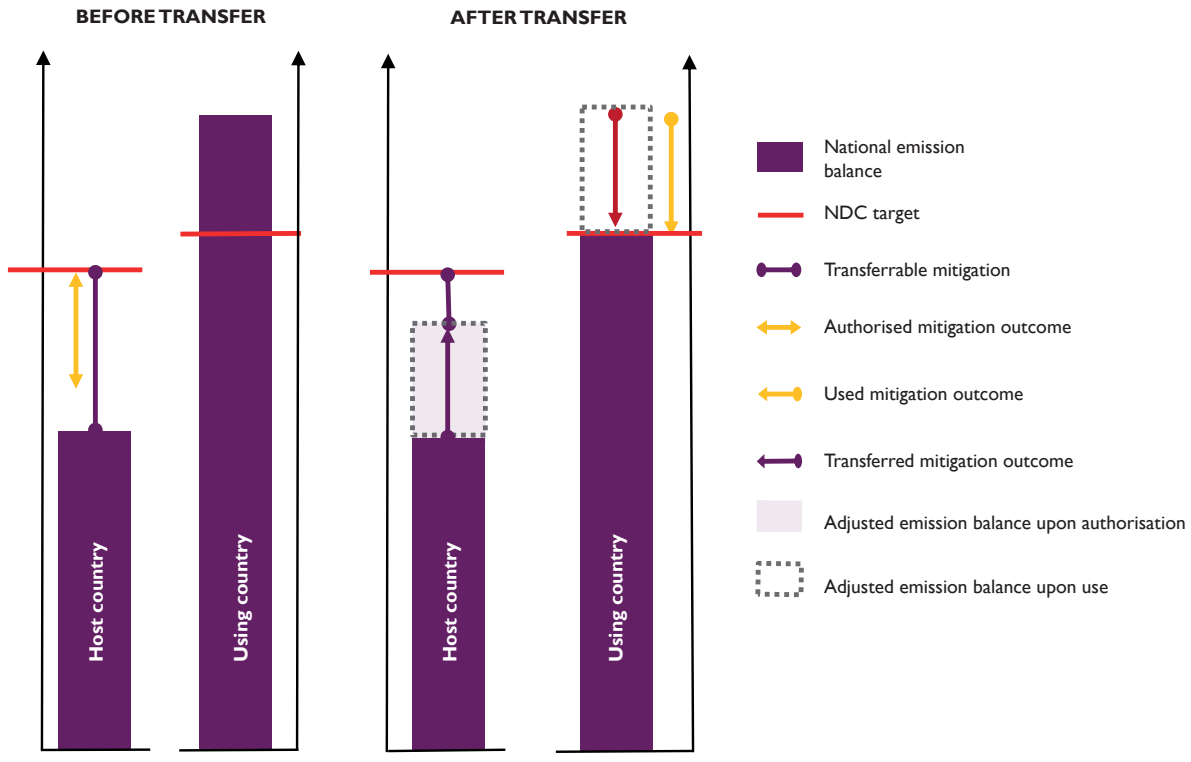
The Article 6.2 has introduced safeguards for the environmental integrity of the underlying mitigation through regular reporting requirements for participating Parties. They must report that they have:

- Ensured that their participation in cooperative approaches does not lead to a net increase in global emissions, but contributes to mitigation and the implementation of the host Parties' NDC.
- Established robust and transparent governance processes.
- Ensured the quality of the mitigation outcomes through stringent reference levels, conservative baselines, and below BAU emission projections. These reference levels, baselines, and projections must take into account all existing policies and address potential leakage.
- Minimised the risk of non-permanence of mitigation and addressed in full any reversal of emission removals, if they occur.

Accounting

Corresponding adjustments: To avoid double counting, 'corresponding adjustments' (CAs) must be made to the emission balance of NDCs on both ends of a transaction. The transferring Party 'un-counts' the mitigation outcome (that is, adds the respective amount of emissions to the annual emissions level of sources and gases related to its NDC); while the using Party 'counts' the mitigation outcome (deducts the respective amounts of emissions from its emission level as reported) (see **Figure 2**).

Figure 2: Corresponding adjustments



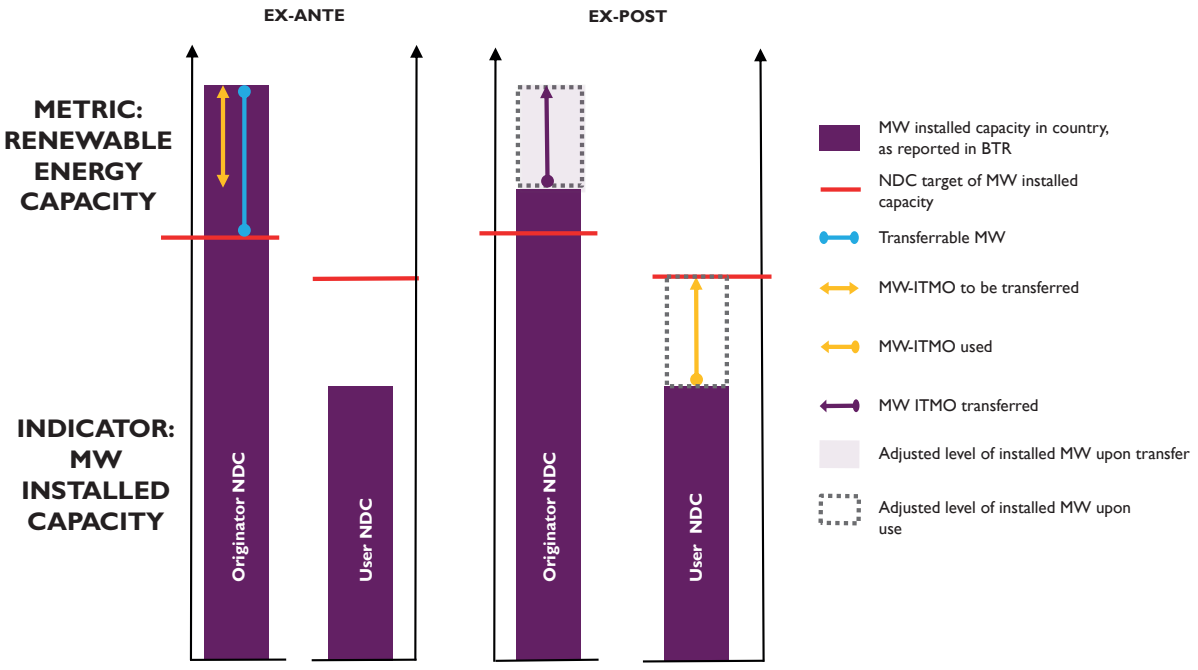
If ITMOs are expressed in tCO_2e, the process is very straightforward:

- The participating Party takes the annual balance of emissions and removals covered by its NDC. It would make most sense if the emission balance would be calculated based on the NIR for the respective year. However, this link would need to be established in the negotiations on the operationalisation of the ETF.
- The transferring Party adjusts its respective annual emissions balance through 'adding' the amount of transferred emissions to the balance and reports this balance in its regular report.
- The using Party adjusts its respective annual emissions balance through 'subtracting' the amount of used mitigation outcomes to the balance and reports this balance in its regular report.

However, as mentioned earlier, ITMOs can also be expressed in "*other metrics determined by the participating Parties and consistent with the participating Parties*' NDC" – for instance, for renewable energy credits transferred internationally. For these – as yet unknown – "*other metrics*", an equivalent to a NIR, elaborated on the basis of guidance from the International Panel on Climate Change (IPCC), does not exist. The current draft text therefore sketches out the following process to take place in a 'buffer registry':

- The participating Parties need to have an NDC measured in the same "*other metric*" as the ITMO. They need to report an annual level of the relevant indicator for this metric. The relevant indicator must be used by the Parties to track progress of NDC implementation in their Biennial Transparency Reports (BTRs).
- If the ITMO metric and the NDC metric does not correspond, participating Parties must only apply a corresponding adjustment to the relevant 'portion' of the NDC (that must be then quantified in the same metric as the ITMO).
- This reported annual 'level' of the indicator is then correspondingly adjusted for (see **Figure 3**).

Figure 3: Example of CA in non-GHG metrics for non-GHG NDC targets

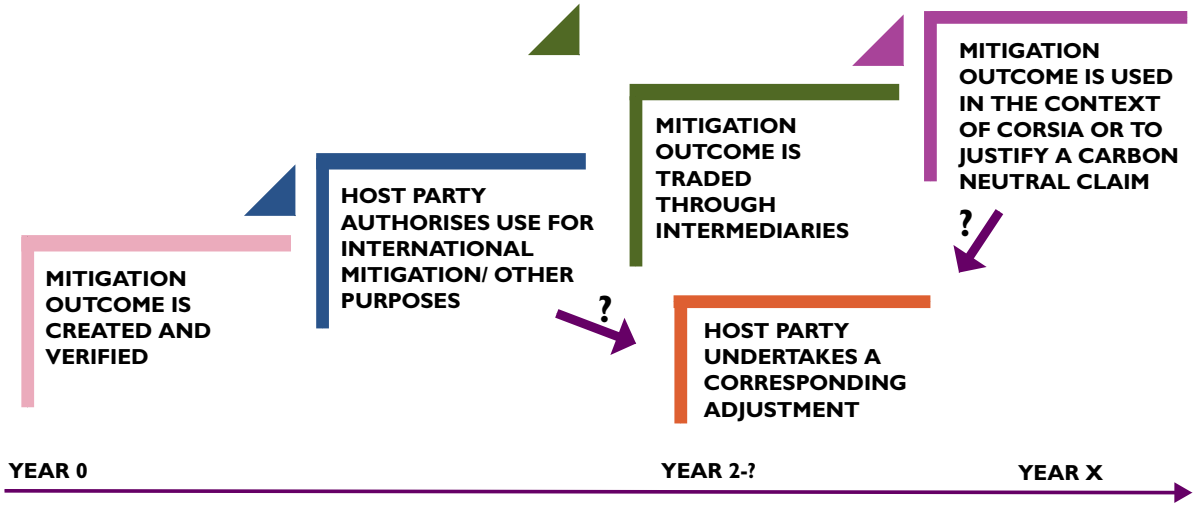


While the application of CAs for ITMOs in non-greenhouse gas (GHG) metrics must also be consistent with the guidance, how this works in practice remains rather vague and the functions of the 'buffer registry' are not detailed. Therefore, the draft texts foresee that further guidance is developed in this regard, in particular with regard to method of 'conversion' between metrics. As it stands now, the current draft text does not yet offer a solution to the environmental integrity risks of trading ITMOs in non-GHG metrics that can have different mitigation impacts in different national contexts (see the 2019 ecbi policy brief for details). In addition, Parties will have to make the link to the ongoing negotiations on reporting formats under the ETF and see what information will be needed in BTRs to have similar rules on "*other metrics*" as for ITMOs expressed in GHG metrics.

Triggers of corresponding adjustments: The transferring Party must apply a CA upon 'first transfer' of an ITMO that will be used towards another Party's NDC. For ITMOs that are authorised for other international mitigation purposes or other purposes, Parties could not yet decide whether the host needs to apply a CA upon authorisation or upon use by the non-Party.

Some Parties prefer a CA at the point of authorisation, as it gives greater legal assurance to non-State, private buyers that the accounting rule will be applied, and avoids problems if the mitigation outcome is only used after the NDC implementation period (and therefore accounting period) of the Party is over. Other Parties envisage blanket ex-ante authorisations for ITMOs, for instance for mitigation outcomes generated in a specific sector. They would therefore prefer only to account for the portion of mitigation outcomes actually exported/ used elsewhere. An authorisation of transfer would always imply the acknowledgement of the host Party that it has to undertake CAs according to the Article 6 rules.

Figure 4: Different triggers for accounting for use of ITMOs for 'other purposes'



The acquiring Party applies a CA upon use, meaning that if the Party only 'holds' the ITMO with the intention to further transfer it, it does not have to undertake a CA.

Multi/single year accounting: Apart from reporting adjusted emission balances on a regular basis, Parties must account for their engagement in international market mechanisms when they report on their progress in implementation and achievement of their NDC. The NDC target can either be defined as a single-year target (to

be achieved in the end year of the NDC implementation period), or as a multi-year target (to be achieved over the period of NDC implementation).

Accounting for market transfers in the context of multi-year targets is quite simple. The multi-year target is converted or expressed in one economy-wide trajectory, in sectoral trajectories, or in an emissions budget. The annual adjusted emissions balance is then compared to the target level of the respective year as indicated by the NDC and/or cumulatively to the overall emissions budget at the end of the NDC implementation period.

Accounting for ITMO transfers towards single-year targets is more complex. As the target only relates to a single year, Parties can only account for NDC achievement in this final year. If a Party does not relate its accounting to the whole NDC implementation period preceding the target year, then ITMOs transacted prior to this year would not be accounted for. In that case, accounting for achievement of the NDC would not be representative of the implementation of the NDC through the NDC implementation period. If the acquiring Party at the same time reduces its mitigation effort by the acquired amount, this could potentially lead to an increase in global emissions. Some Parties therefore argue that in order to participate in market-based cooperation, all participating Parties should have to formulate a clear basis for accounting that is harmonised internationally, and also considers NDC implementation over time. Other Parties fear an interference in the national choices of formulating NDCs through accounting rules.

Parties were able to reach the two following compromise options, available for Parties with a single year target (approximately 80%). Both technical options enshrine technical safeguards to make accounting 'representative' of the Parties' engagement in international markets in the entire NDC implementation period.

1. **The Party provides a multi-year emissions trajectory, trajectories, or budget for the NDC implementation period that is consistent with implementation and achievement of the NDC**. Then, annual adjustments can be applied in the same manner they are applied to multi-year NDCs. The advantage is that such a trajectory or budget gives all implicated stakeholders certainty with regard to the amount of ITMOs a Party can transfer or must purchase over the course of the NDC implementation period. However, translating a (distant) NDC target in a concrete trajectory may be technically and/or politically challenging for many Parties. A numerical example for a five-year NDC period is shown in **Table 1**.

Table 1: Accounting against multi-year trajectory for single year targets (host Party perspective)

	2015	2020	2021	2022	2023	2024	2025 (target year)
Accounting trajectory (pre-defined)	20	20	19	18	17	16	15
NIR reported emission balance	20	22	21	17	15	14	13
Accumulated surplus emissions (pre-adjustment)		2	4	3	1	-1	-3
ITMO transfer					1	1	
Corresponding Adjustment					1	1	
Adjusted emission balance					16	15	
Accounting surplus/ deficit after adjustment		2	4	3	2	1	-1 (NDC is achieved)

2. **The Party calculates a 'rolling average' of the ITMOs it transfers and acquires throughout the NDC implementation period**. Every year, the Party takes the cumulative amount of ITMOs transferred (additions) and acquired (subtractions) since the beginning of the NDC implementation period and divides this amount by the number of elapsed years in the NDC implementation period. This allows the Party to undertake annual 'indicative' adjustments equal to this average amount and a 'final'

CA in the NDC single target year. Averaging could increase the volume of transfers, as the buying Party would need to buy more ITMOs than needed to achieve its NDC in the target year. Compared to the trajectory(ies) approach, it is also a rather simple approach that leaves no room for 'gaming'. However, averaging could lead to delayed engagement of governments in carbon markets as it only becomes clear at the end how much is needed to achieve the NDC. Also, how much a country needs to buy (or can sell) over the entire period depends on the mitigation gap or overachievement of a single year. This is very uncertain, as emissions in the future target year may be impacted by temporary occurrences such as weather patterns or other external shocks like the COVID-19 pandemic. A numerical example for a five-year NDC period is shown in **Table 2**.

Table 2: Rolling average accounting for single year targets (host Party perspective)

	2015	2020	2021	2022	2023	2024	2025 (target year)
Accounting trajectory (pre-defined)	20	20	19	18	17	16	15
NIR reported emission balance	20	22	21	17	15	14	13
Accumulated surplus emissions (pre-adjustment)		2	4	3	1	-1	-3
ITMO transfer					1	1	
Rolling average ITMO transaction	0	0	0	0	0.25	0.4	0.333333333
Corresponding Adjustment					0.25	0.4	0.333333333
Adjusted emission balance					15.25	14.4	13.33333333
Accounting surplus/ deficit after adjustment		2	4	3	1.25	-1.4	-3.4 (NDC is achieved)

In the future, further accounting approaches could be approved by the CMA, if Parties propose them.

Reporting and review process

The modalities, procedures, and guidelines (MPGs) of the ETF under Article 13 of the Paris Agreement (Decision 18/CMA.1, Annex) call on Parties to report on information related to ITMOs and Article 6 cooperative approaches in the context of the structured summary on NDC implementation and achievement. There are some reporting requirements defined in §77.d of these MPGs. As this paragraph states it is to be operationalised consistent with Article 6 rules, some Parties insist that the paragraph has no validity on its own, but can only be operationalised once the Article 6 rulebook is agreed. They argue that this paragraph does not consider accounting for ITMOs in non-GHG metrics, which is part of the draft Article 6.2 rules.

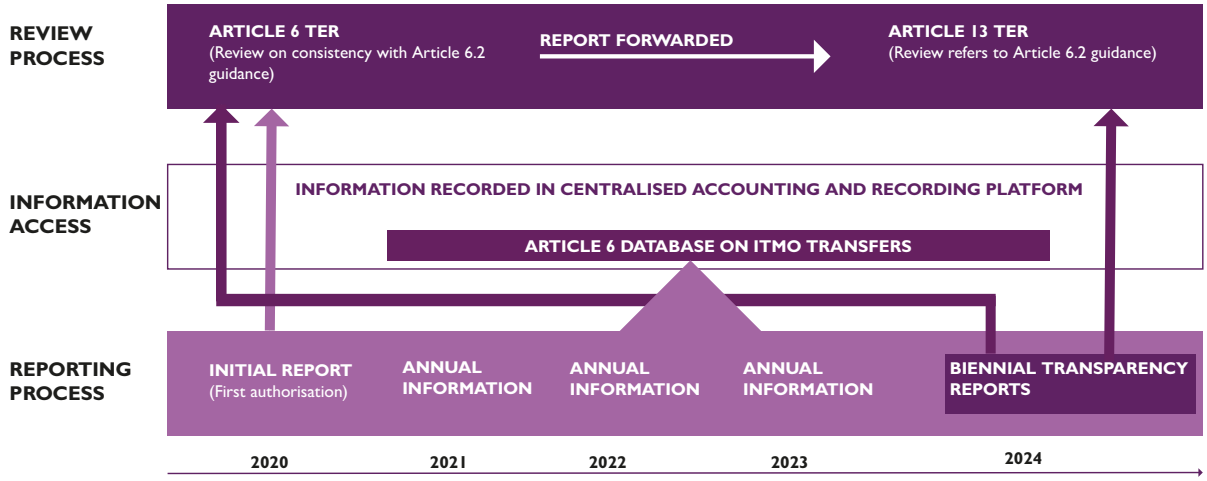
Other Parties insist that the paragraph is part of a binding decision and therefore valid. Some Parties acknowledge the importance of developing additional rules under Article 6. Others consider §77.d as sufficient to operationalise the principle of avoidance of double counting, even in the absence of a decision on the Article 6.2 guidance.

Parties eventually agreed to focus on adopting the Article 6 guidance that can then inform the operationalisation of the reporting requirements under the ETF. Given the renewed deferral of a decision on Article 6, this means now that the Article 6 reporting requirements and the reporting formats under the ETF will have to be negotiated in parallel at COP26.

Reporting requirements for Parties: According to the draft texts, Parties must submit an initial report, annual information, and regular reports. The initial report must be submitted upon first authorisation for transfer in an NDC implementation period by the participating Parties. The report can be provided in conjunction with the country's next due BTR, where practical. In the initial report, Parties demonstrate that they meet the participation requirements, detail their accounting approach for the NDC implementation

period (including related information on their NDCs) and describe the cooperative approaches they participate in. While the information on NDCs and accounting must only be submitted once per NDC implementation period, the description of a cooperative approach must be provided every time an ITMO from a new approach is being authorised.

Figure 6: Reporting and review process under draft Article 6.2 guidance



As soon as Parties engage in cooperative approaches, they must submit annual information in an agreed electronic format. This annual information is not tied to any reporting obligation under the ETF and only relates to information necessary to track the international flow of ITMO transfers.

In the context of the BTRs, Parties must submit regular information. Here, Parties must submit information relating to three different categories:

- Reporting on a Party's participation in cooperative approaches.
- Reporting on how each cooperative approach meets the requirements of the Article 6.2 guidance.
- Reporting of CAs undertaken following the authorisation, first transfer or use of ITMOs, in line with the guidance.

The information submitted by Parties in their reports will be reviewed by an Article 6 technical expert review (A6TER) for consistency with the guidance, in accordance with MPGs to be developed as part of a future work programme. The review team will then provide recommendations on how to provide consistency with the guidance and forward its result to the Article 13 technical expert review. The Secretariat is requested to periodically prepare a compilation and synthesis of the results of the A6TER process.

The UNFCCC Secretariat will provide access to non-confidential information through a 'Centralised Accounting and Recording Platform' (CARP) that will include:

- A description of each cooperative approach, the expected mitigation and the participating Parties involved.
- Public information on ITMOs.
- All non-confidential information submitted by Parties in the context of the reporting obligations.

The CARP will also contain an Article 6 database with:

- Information on cooperative approaches.

- CAs, annual emission balances and information on ITMOs first transferred, transferred, acquired, held, cancelled and/or used by participating Parties.

In addition, the UNFCCC Secretariat will offer an international registry for Parties that do not want to set up their own registry for tracking of ITMOs. It will perform all the functions that national registries need to perform as well, i.e. allow the tracking of ITMO movements through unique identifiers.

Article 6.4: UNFCCC-governed crediting mechanism

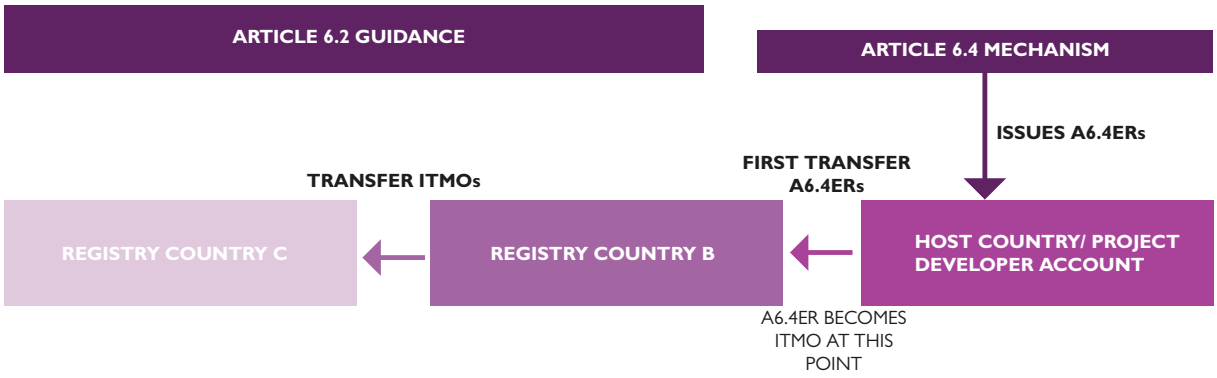
Governance of the mechanism

The A6.4M will be governed by a Supervisory Body and is placed under the authority of the CMA. The Supervisory Body will:

- Define the detailed rules of operation of the A6.4M, based on decisions of the CMA.
- Approve methodologies that can be applied to Article 6.4 activities to calculate the crediting baseline, determine the 'additionality' of the activity and monitor the mitigation achieved.
- Register activities under the mechanism.
- Issue Article 6.4 Emission Reductions (A6.4ERs) into the mechanisms registry, which will be administered by the UNFCCC Secretariat.

The mechanism will differentiate between A6.4ERs that were not authorised for (first) transfer or use by other (international) purposes and those that have received this authorisation. A6.4ERs authorised for transfer towards another Party or for other (international) mitigation purposes will be considered ITMOs and participating Parties must respect the Article 6.2 guidance.

Figure 7: Link between the Article 6.2 guidance and the A6.4M



The host country will have certain responsibilities in the context of the activities (see below) and may also choose to exercise further overview functions, in order to make sure that the country's engagement with the A6.4M is in the benefit of the host country and contributes to the implementation of its NDC (see below). However, Parties have agreed that the oversight on the mechanism will be placed entirely in the hands of the Supervisory Body.

Activities and activity cycle

Under the A6.4M, activities that reduce emissions or increase removals of GHGs from the atmosphere can be registered. Activities include projects or programmes, but can also take the form of further 'upscaled' activities (such as sectoral programmes or crediting of policy instruments), if approved by the Supervisory Body.

To be registered under the A6.4M, an activity must undergo stakeholder consultations and obtain the host Party's approval. In this approval, the host Party must elaborate how the activity fosters sustainable development and contributes to emission reductions in the host country and other purposes. In contrast to the CDM, there will be a grievance mechanism implemented by the Supervisory Body.

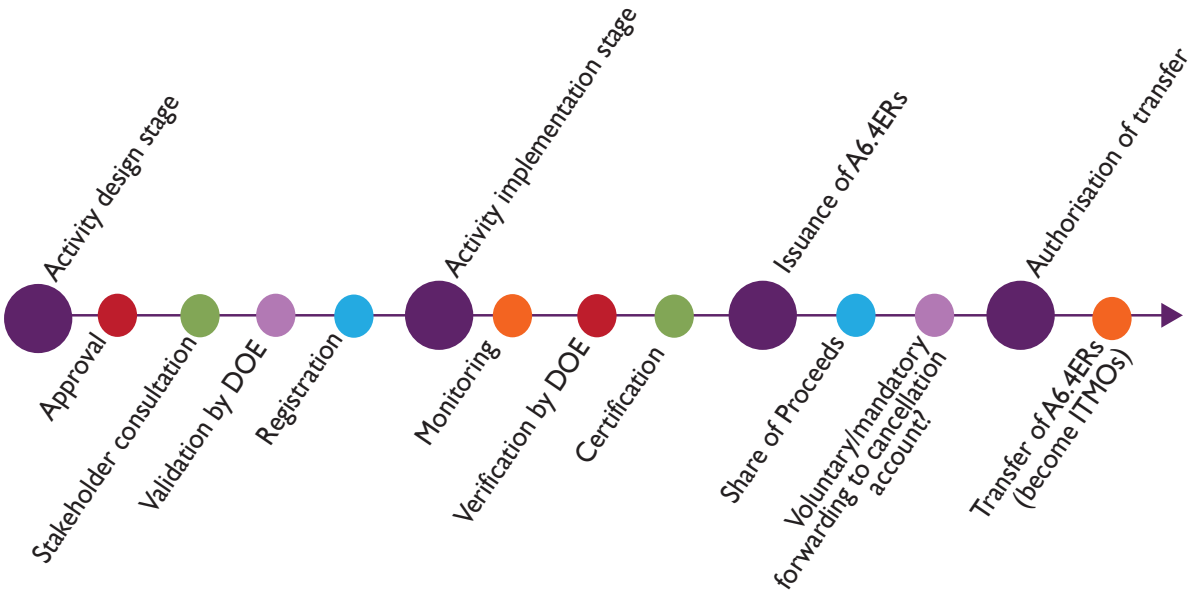
In addition, Article 6.4 activities must respect key environmental integrity safeguards, in particular deliver real, measurable and long-term climate benefits; minimise the risk of non-permanence and ensure that reversals are addressed in full; and avoid negative environmental and social impacts.

As per the current draft text, methodologies that are used in the A6.4M must follow a transparent and conservative approach, take into account relevant policies and be consistent with the NDC of the host Party. The methodology should promote the reduction of emission levels in the host county as well as contribute to any long-term low emission development strategy and the long-term goals of the Paris Agreement. In addition, the methodology should encourage an increase in ambition over time. While Parties agree on these principles *per se*, the related mandate of 'shall' or 'should' is still contested, with some Parties calling for stronger language on these principles.

The A6.4M draft texts recognise the special circumstances of Least Developed Countries (LDCs) and Small Island Developing States (SIDS). Thus, there may be differences in rules applicable to them, in particular with regard to NDCs or to the application of methodologies (such as baseline setting and additionality determination).

The activity cycle resembles the CDM activity cycle. Designated operational entities (DOEs) – accredited auditors – will validate the design of the activities prior to registration and verify the monitoring and calculation of the achieved mitigation prior to the issuance of A6.4ERs.

Figure 8: Activity cycle under the A6.4M



The crediting period under Article 6.4 will start earliest in 2020 and likely cover a period of a maximum of 5 years, renewable twice or 10 years with no option of renewal. Different crediting periods may be adopted for forestry and land-use related activities. The host Party decides if the crediting period shall be renewed.

Host Party responsibilities

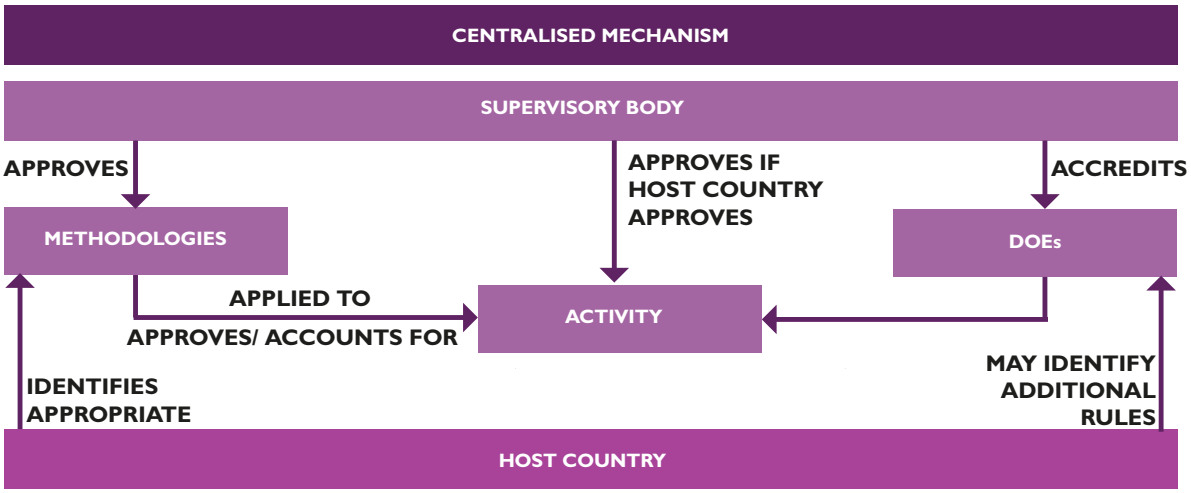
Before an A6.4M activity from a specific host country can be registered, the according host Party must have designated a national authority to the mechanism. In addition, the host Party must indicate publicly how the participation in the mechanism contributes to sustainable development and which types of activities it would consider approving and how such types would contribute to mitigation and NDC achievement in the host Party.

Some Parties wanted to expand the host Parties' responsibilities (and rights) that are known from the CDM in the context of the A6.4M to ensure host Parties actively ensure benefits from market-based cooperation. However, other Parties feared that a system of 'dual governance' might lead to a fragmented and heterogeneous implementation of the mechanism in different countries. Now, a more nuanced approach is proposed to enlarge the options at the host countries' disposal, if they wish to exercise a higher degree of influence over the implementation of A6.4M activities. (It should be noted here that even in the absence of such provisions, any host Party can formulate their own conditions to issuing a Letter of Approval, the precondition to the registration of an activity). These proposals include:

- The option for the host Party to specify upfront which baseline approaches or other methodological approaches that are approved under the A6.4M it considers to be applicable to its national context.
- The option for the host Party to determine shorter crediting periods (apart from having to confirm the renewal of a crediting period).
- The options for the host Party to exercise further functions of the mechanism under supervision of the Supervisory Body.

They are, however, still partly contested by Parties that favour a more centralised approach to the implementation of the mechanism.

Figure 9: Governance of the A6.4M



Transition of CDM activities

Parties did progress significantly in Madrid on the question of the transition of registered CDM activities to the CDM's successor, the A6.4M (while there was no progress made with regard to the use of pre-2020 credits, see below). Many Parties agreed on the need for a well-organised process that ensures there is no regulatory 'gap' for activities on the ground. However, due to the deferral of a decision both with regard to the A6.4M

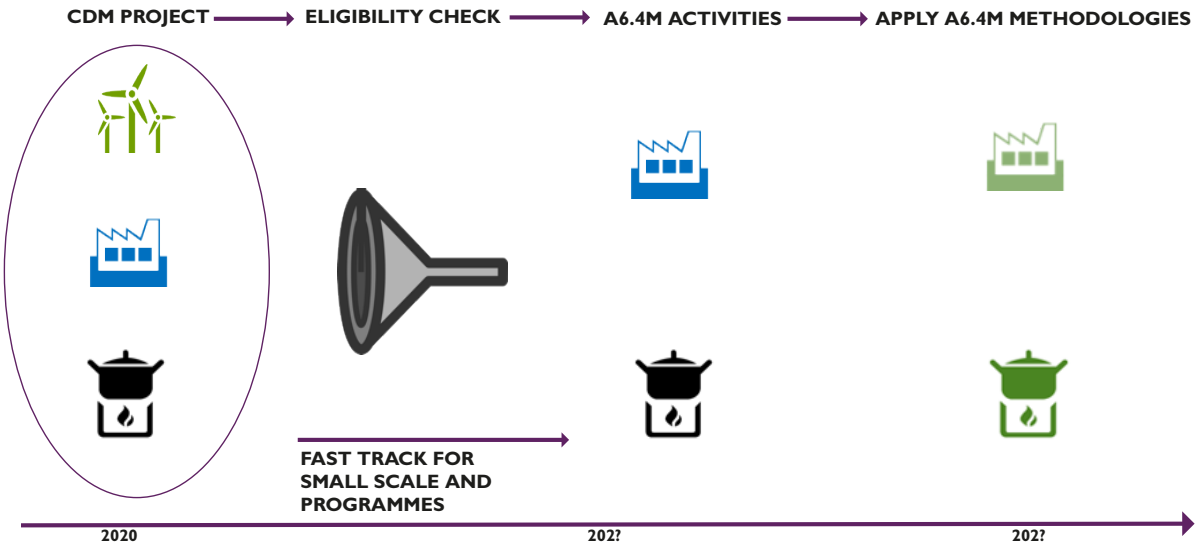
under the CMA and a failure to agree on guidance for the CDM Executive Board for operation of the CDM after 2020 under the Conference of the Parties serving as meeting of the Parties to the Kyoto Protocol (CMP), a regulatory gap has now materialised. Some Parties say that Certified Emissions Reductions (CERs) can no longer be issued after 2020 and crediting periods cannot be renewed, whereas other Parties want to continue the CDM without any time limit. Project owners with activities registered under the CDM have no indication with regard to their future operation either under the CDM or the prospects of transitioning to the A6.4M.

This impact on project owners is in contrast to Parties' positions at COP25, where most agreed on the need to preserve the trust of private sector actors in the UN crediting mechanisms while putting in place environmental integrity safeguards. However, Parties have different understandings on how to build trust with the private sector and what environmental integrity safeguards will be needed in order for CDM activities to become A6.4M activities.

The draft texts sketch out a transition period between 2020 and 2023 that follows the following steps:

- In order to transition, a CDM activity must receive the approval of the host Party and pass an eligibility check. The scope and criteria of this eligibility check remain to be determined. Small-scale activities and Programme of Activities qualify for an expedited transition process.
- The transitioned activity can continue to apply the CDM methodology until the end of its crediting period or until 2023 (when the transition process is to be completed), whichever date is earlier.
- From 2020 onwards, A6.4ERs will be issued for transitioned activities.

Figure 10: Process for transition of CDM projects and programmes into the A6.4M



The details of the procedure are to be developed by SBSTA in the next session. However, given the deferral of an agreement on Article 6, the timeline as sketched out in the draft texts would also need to be revisited in the following round of negotiations.

Review of existing (CDM) methodologies

Under the CDM, there are approximately 250 approved baseline and monitoring methodologies, used to determine emission reductions. However, only 10% of these methodologies have been used frequently (in more than 50 projects). For the continuation of mitigation activities, in particular of those widely applied in

different country contexts, the question of the continued validity of the methodologies in the A6.4M is of great importance. Developing new methodologies from scratch is a costly and time-consuming exercise. If CDM methodologies are not transitioned, it will take a number of years to develop A6.4M-specific methodologies from scratch.

The current draft negotiation texts propose that the Supervisory Body shall review the methodologies that are in use for the CDM and other existing market-based mechanisms "*when they are used in the context of a proposed activity*". The Supervisory Body shall then decide whether the methodology can be applied, with revisions as appropriate.

From 2023 onwards, activities will need to apply A6.4M methodologies (see above). As with the transition of activities, this timeline seems unrealistic now with the one-year delay in Article 6 negotiations. It is also questionable whether the case-by-case assessment of methodologies applied is faster or more robust than a dedicated and focused review of specific bodies of methodologies, identified as relevant beforehand.

Article 6.8: Framework for non-market approaches

SBSTA has been tasked to undertake a work programme under the Article 6.9 framework on non-market based approaches (NMAs) referred to in Article 6.8. NMAs can take various forms and refer to mitigation, adaptation, finance, technology transfer and capacity-building approaches. The key questions negotiators had to resolve were:

- What are or could be NMAs that should be promoted under the Article 6.9 framework?
- How should the work programme on Article 6.8 NMAs under the Article 6.9 framework be implemented? What would be the process and the adequate governance structure, in the short, medium and long term?
- What should be the modalities and instruments the work programme should apply to reach its objective of promoting NMAs?

The negotiations progressed well and in the last days of negotiations, the draft text was no longer subject to significant changes.

NMAs to be promoted under the framework

In the current draft text, NMAs must match the following characteristics to be promoted under the framework:

- **Formal characteristics:** NMAs should involve more than one Party (involve international cooperation); and be identified as an NMA by participating Parties.
- **Link to the NDC:** NMAs should not include the transfer of mitigation outcomes outside of the host Party (the resulting mitigation benefits must therefore remain in the host country); and they should contribute to NDC implementation in a holistic and integrated manner.
- **Content characteristics:** NMAs should aim to increase ambition in mitigation and adaptation; enhance public and private sector participation; and enable coordination across instruments and institutional arrangements.

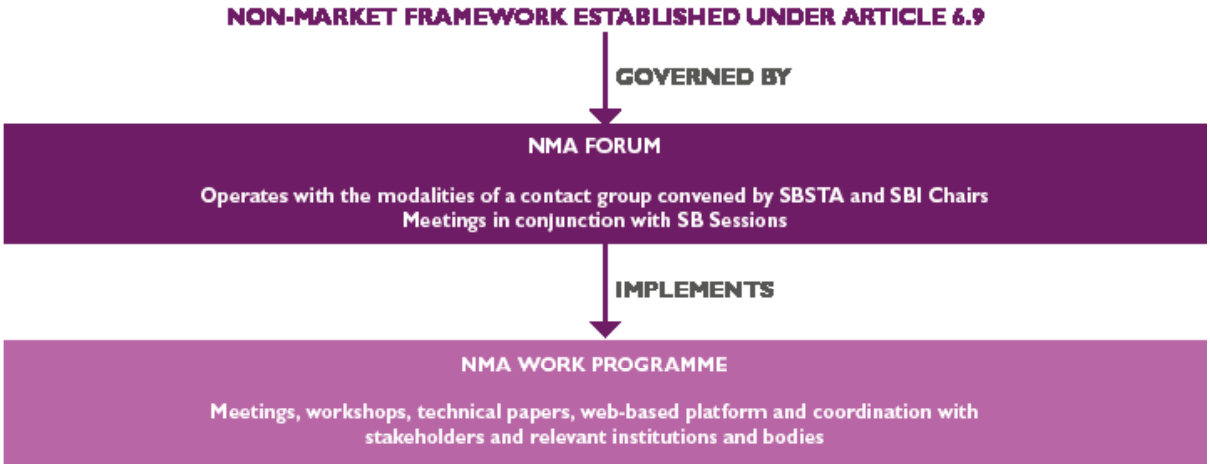
The work programme will focus on NMAs that belong to specific focus areas. These focus areas will be determined at a later stage and based on submissions by Parties and observers.

Implementation of the work programme

The draft text envisages that the work programme will be implemented by an 'NMA forum' that will also govern the Article 6.9 framework. The forum will be convened by the Chairs of SBSTA and the Subsidiary Body for Implementation (SBI), and operate according to the modalities of a contact group. The forum will meet twice a year in conjunction with the SB sessions.

The NMA forum will develop a schedule and define specific deliverables for the implementation of the work programme. Parties and observers will be invited to make submissions. After four years of implementation, the NMA forum will be reviewed by SBSTA and SBI. The review will inform a decision on whether new or different institutional arrangements will be needed to implement the work programme.

Figure 11: Relationship between NMA framework, forum, and work programme



Modalities and instruments of the work programme

The work programme will be implemented through workshops and meetings with stakeholders and experts. In addition, the work programme will be informed by submissions from Parties and stakeholders as well as technical papers by the Secretariat. Where needed, the NMA forum might coordinate with relevant existing bodies and processes under the Convention, Kyoto Protocol, and Paris Agreement.

One concrete tool proposed in the current text is the development of an UNFCCC web-based platform for recording and exchanging information on NMAs, to support the identification of opportunities to develop and implement NMAs, including through supporting the matching of NMAs with the opportunities identified.

REMAINING CRUNCH ISSUES IN ARTICLE 6 NEGOTIATIONS

Accounting for mitigation not covered by the NDC

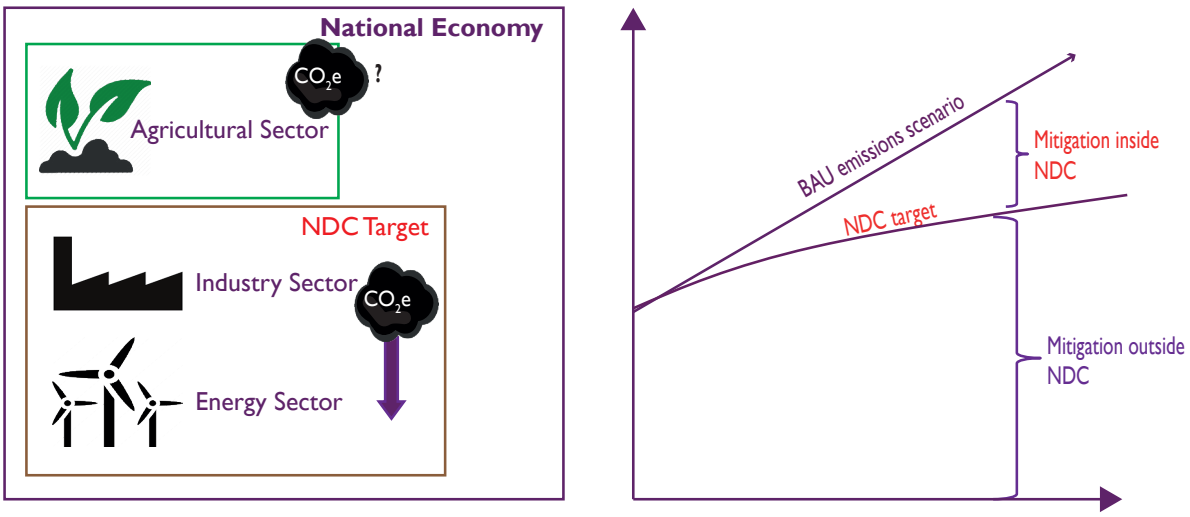
Differences in positions

A crunch issue in Article 6 negotiations is whether mitigation achieved in sectors or regarding gases not covered by / 'outside' of the NDC can be transferred out of the country, and whether the country then has to undertake a corresponding adjustment (CA). A first precondition to finding a common understanding on this issue is to define what or 'not covered by the NDC' or 'outside NDC' means.

'Not covered by the NDC' can refer to sectors or gases that are not considered in NDCs and related NDC targets (see **Figure 12**, on the left). This is the most common interpretation.

Some put forward another, conceptually completely different definition of 'outside NDC', as referring to any action going beyond the actions required to meet the NDC targets. This would include sectors and gases not mentioned in the NDC, but also any mitigation activities that go beyond what would happen in the context of NDC implementation (see **Figure 12**, on the right).

Figure 12: Different understandings of 'outside NDC'



With regard to the first interpretation of 'outside', Parties in favour of allowing for mitigation transfers from sectors not covered in the NDC argue that this would raise mitigation ambition as the underlying mitigation action was not foreseen in the NDC. Also, the cooperation would build the capacities of the host countries so the sector can be included in future revisions of the NDC. Moreover, it would be a logical continuation of the CDM approach.

Parties opposing this argue that allowing for crediting in non-NDC sectors would provide a disincentive to Parties to expand their NDC over time and move towards economy-wide targets. Some want to restrict Article 6 cooperation to activities within the scope of the NDC, with transfers being accounted for with CAs. Others want to allow for it, but argue that CAs are a necessary safeguard against so-called 'hot air', i.e. overstated mitigation outcomes to be traded internationally.

Many developing countries oppose the first interpretation of 'outside' and the need to apply a CA. They argue that if the transferring country would have to undertake a CA, it would be treated as if the sector was already covered by the NDC and thus it would need to enhance action in sectors covered by the NDC in order to comply with its pledges.

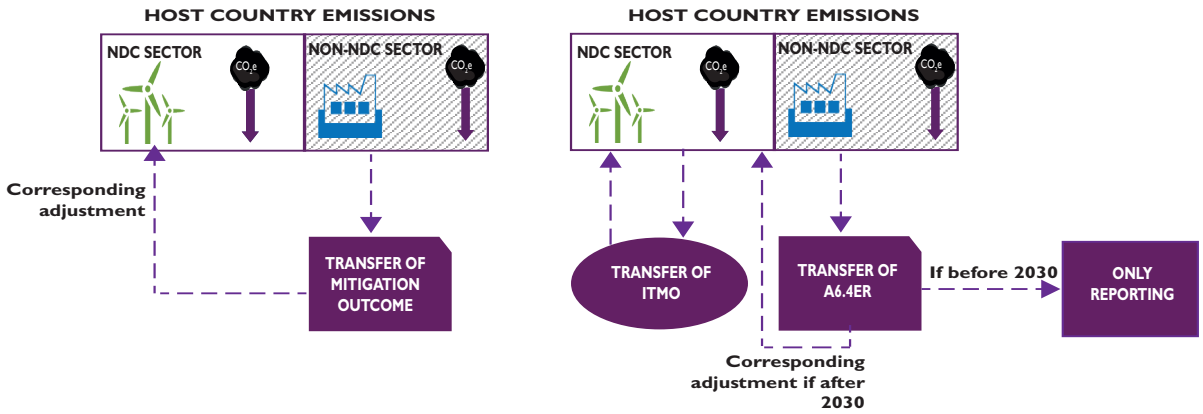
Even following this first interpretation of NDCs, it may be difficult in practice to determine if an activity and resulting mitigation outcomes are covered or not by an NDC and related measures. This will depend on the way NDCs are formulated and if there is an NDC implementation plan or further policy and strategy documents developed by the government, clearly defining the activities.

With regard to the second interpretation, opponents to the need for a CA argue that the activity 'outside' is additional and thus would not have happened under business as usual. Proponents of the need for a CA argue that additionality of an action does not rule out the possibility of double counting and therefore there is no reason to exempt additional activities from being accounted for.

The fundamental positions on this issue remained unchanged in negotiations under COP25. However, Parties narrowed down the options on how to treat this question:

- Allow for ITMO transfers from activities 'outside' the NDC, but **impose CAs** for such. (see **Figure 13**, on the left)
- Allow for ITMO transfers from sectors/gases not covered by the NDC, but impose CAs **after a transition period** (see **Figure 13**, on the right).

Figure 13: Options for accounting of sectors/gases outside of the NDC



One proposal is to have an opt-out period until 2030, where countries may choose not to apply CAs. This date is a compromise for two reasons:

- For Parties that want to avoid a perverse incentive not to include sectors in the NDC, this ensures that Parties will define their next NDC for the time after 2030 without any such perverse incentives through accounting exemptions.
- Governments that have set up their NDC in line with the ambition requested by the Paris Agreement have offered their highest possible emission reduction in their NDC. If they now need to do a CA, they risk not to achieve the NDC, given that all possible emission reductions have been pledged, a situation they could well object to as being unfair and limiting their ability to mitigate outside the NDC. The second NDC could be defined in the possession of the finished rulebook on Article 6 cooperation, better judging the opportunities of markets for NDC implementation. Therefore, they support a transition period until they have a chance to define their next NDC with the Article 6 rulebook in mind.

However, there are Parties that do not agree on any exemption from CAs, even if just temporary, as they consider it jeopardising environmental integrity.

Negotiation options with regard to the A6.4M

Parties also treated this issue differently in the context of the Article 6.2 guidance and the Article 6.4 rules, modalities, and procedures. In the context of the Article 6.2 guidance, only a reference to sectors and gases not included in the NDC was retained as reference to 'outside' NDC. Also, the draft texts clearly state that while transfers are allowed, they do trigger a corresponding adjustment to the emission balance of sources and sinks covered by the NDC.

In the context of the Article 6.4 mechanism, more Parties are pushing for a different solution. Parties in favour of exemptions argue that under the Article 6.4 mechanism, activities will have to prove their additionality and baselines for crediting will be set according to international rules. This would then limit the risk of perverse incentives not to expand the scope of the NDC.

The current draft texts list different options:

- The full coherence with the guidance on Article 6.2 (no CA exemptions).
- An opt-out period, in which Article 6.4 emissions reductions generated 'outside' of the NDC do not trigger a CA upon transfer.

The exact conditions of the 'opt-out' period are also disputed.

First, there is the question of the scope of exemptions applicable:

- 'Outside NDC' only refers to sectors and gases not covered.
- 'Outside NDC' refers to sectors and gases not covered 'among others', meaning there is room for interpretation (by the host country?) of what 'outside NDC' means.

Second, there is the question of the length of the opt-out period:

- Some Parties suggest 2023 (in line with CDM transition cut-off) or 2025 (first 5-year cycle of the Paris Agreement).
- Other Parties suggest 2030, as most NDCs contain targets in 2030.

Generating adaptation finance

Through the A6.4M

A 'share of proceeds' (SoP) will be levied in the context of the A6.4M both to cover the administrative expenses of the mechanism and to support adaptation in developing countries. SoPs were applied under the CDM: 2% of credits issued are transferred to the Adaptation Fund and a monetary fee is paid to the CDM Executive Board at the point of registration of an activity and before issuance of credits. While the application of SoP is undisputed, Parties have not yet found an agreement on the amount of SoP to be levied for adaptation and administrative purposes, and on the form of levy. Under the CDM, administrative SoP was levied as a monetary fee, whereas adaptation SoP was levied as an in-kind contribution. This means that a percentage share of the credits (2%) was transferred to an account of the Adaptation Fund for monetisation. While an in-kind contribution can yield higher revenues when market prices are high, a fee-based contribution offers more predictable income. Parties therefore have not yet agreed on whether to charge an in-kind contribution or a combination of in-kind and fee payments for adaptation purposes. Also, the level of adaptation SoP is still

disputed. Some Parties want to start with an in-kind contribution of 2%, and then review the effectiveness of leveraging resources for the Adaptation Fund after four years.

Through cooperative approaches

The question whether ITMO transfers under Article 6.2 should also generate finance for adaptation is highly contentious. In contrast to earlier negotiation rounds, Parties did agree that no equivalent SoP could be imposed, as there is no centralised 'mechanism'. Still, a number of Parties stress that levying funding for adaptation would be needed to raise ambition in both mitigation and adaptation (Article 6.1), and to avoid disadvantaging the Article 6.4 mechanism compared to 'competing' bilateral transfers. Other Parties oppose a mandatory contribution for adaptation as they assert that this would represent a disincentive for cooperative approaches, and it would not be legally or technically feasible for linking emissions trading schemes or to bilateral agreements under Article 6.2 where ITMOs transacted do not represent tradeable units. These Parties suggested a reference to 'strongly encourage Parties to commit' to contribute to adaptation finance. However, the exact manner in which Article 6.2 will generate these voluntary contributions is not described further. Here, beyond a political compromise, more technical operationalisation of a compromise would be needed.

In addition, the beneficiary of the levied funds is contested. While some Parties want an equivalent treatment of Article 6.2 and Article 6.4 and a contribution to the Adaptation Fund as a UN Fund where recipient countries have a good representation, other Parties do not want a binding beneficiary but instead the flexibility to contribute adaptation finance through their own activities to other bilateral or international funds.

So far, only the monetary contribution for adaptation purposes has been discussed in the context of the guidance on Article 6.2. However, the maintenance of the Article 6 database, the organisation of the Article 6 technical expert review, the provision of a registry to track ITMOs, and related tasks for the Secretariat will generate administration costs that are currently not considered. Host countries will also face administrative costs for the implementation of cooperative approaches.

Using pre-2020 CERs for post-2020 NDCs

Unlike the transition of methodologies and registered activities, the carry-over of issued CERs from CDM activities was at the centre of controversy in Madrid and contributed to the failure of Parties to finalise the Article 6 rules. The main question is if CERs issued before 2021 can be used in the context of post-2020 NDCs. Some Parties want to allow for the use of CERs in order to ensure project developers have a return on investments for pre-2020 action in post-2020 markets (given that a lack of demand since 2012 had limited a return on investments in the past years). Other Parties reject this as they fear that the huge overhang of CERs will limit ambition in NDCs and jeopardise environmental integrity.

The compromise is being sought between 'no transition of pre-2020 units' and 'automatic transition of all unused CERs'. At COP25 in Madrid, Parties tried to find a balanced outcome in discussions on certain cut-off dates with regard to both eligibility criteria of CERs and for the period of time in which CERs can be used. Proposals included:

- A cut-off date for registration of activities generating eligible CERs: Only CERs from activities registered after a specific date would be eligible to transition. Cut-off date proposals range from 2008 to 2016.
- A cut-off date for use of transitioned CERs: Limiting the period until when transitioned CERs may be used, with proposals ranging from 2023 (timeline of transition of CDM activities), 2025 as first 5-year cycle, or 2030 as end date of many NDC implementation periods.

In addition, some Parties suggested that CERs that do not meet the eligibility criteria for transition may go into a reserve. CERs from this reserve could then be made eligible for use by a future CMA decision.

Interestingly, a similar solution has been found in the context of the pilot phase of CORSIA, where credits from accepted standards (including CDM) can be used until 2023 if they stem from projects with crediting periods that started in January 2016 or later.

However, with the deferral of a decision by the CMA, such an 'early' cut-off date for use loses its attractiveness for Parties interested in CER transition. A further problem in negotiations is the missing clarity about the actual volume of residual CERs that would potentially be available for use according to different transition parameters. Negotiations so far were a 'numbers game', with Parties defending positions based on own assumptions on their impact, not based on a common understanding. In 2020, research and government institutions have increased efforts to understand volumes of CERs not used to date (the remaining CERs currently available), and research the future supply potential, if project developers request issuance for pre-2020 emissions reductions under the CDM not credited so far.

With the deferral of an agreement on Article 6 rules as well as no agreement under CMP with regard to the future of the CDM, the question will also arise whether potentially issued post-2020 CERs may be transitioned to the Article 6.4 mechanism and/or used towards Parties' NDCs. This depends on the decision of the CMP whether or not the CDM will be able to issue credits post-2020 in absence of an established Article 6.4 mechanism.

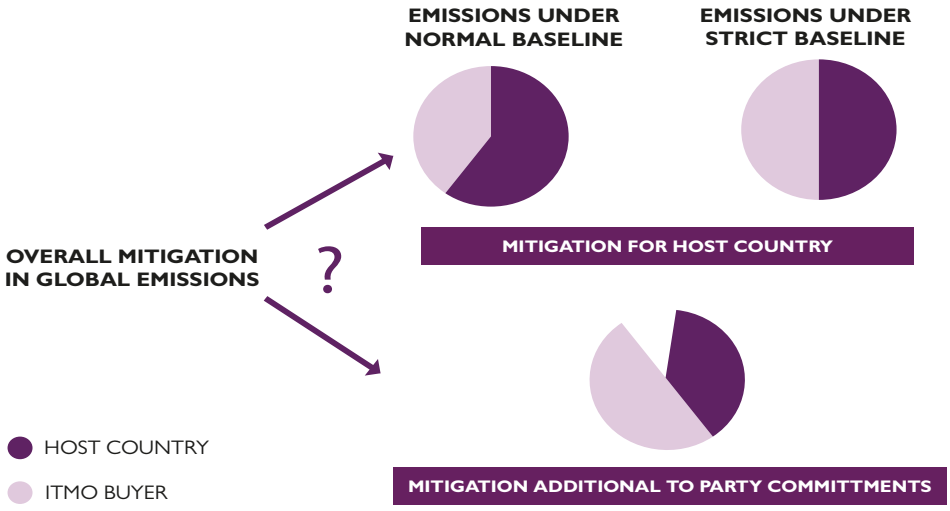
Operationalising an overall mitigation in global emissions

Article 6.4 mandates that the mechanism shall aim to deliver an overall mitigation of global emissions (OMGE). However, Parties do not share the same understanding of this principle, which challenges its operationalisation. Some see OMGE as a 'side mitigation benefit' achieved through the integrity of the mechanism. In their opinion, the fact that baselines must be set conservatively leads to an underestimation of the ITMO volume compared to the actual mitigation generated. However, the mitigation achieved but not transferred will be captured in the host country's NIR and accounted towards NDC compliance. Thus, the host country can reduce its mitigation effort elsewhere and therefore global emissions do not change. Others insist that OMGE is a principle on its own and refers to achieving mitigation that is not claimed by any participant. This would mean that a certain part of the emission reductions achieved would be cancelled, either mandatorily or voluntarily in the context of results-based climate finance.

There are also Parties who support the view that OMGE relates to both: a share of mitigation outcomes not claimed by anyone as well as the requirement of having crediting baselines that only define as 'mitigation' what goes beyond what is required in order to achieve the Paris Agreement long-term objectives. While these Parties support the operational measure of cancelling a share of A6.4ERs, they see OMGE as an overarching reference to the effectiveness of the mechanism in reducing emissions and increasing removals, which should be considered in all aspects of the design, implementation, and eventual review of the mechanism.

Supporters of mandatory cancellation argue that this alone would ensure a benefit for the atmosphere beyond Parties' targets and also benefit those Parties that are not participating in Article 6 mechanisms. Supporters of achieving OMGE through the voluntary cancellation of credits argue that this would ensure that the buying Parties carry the costs of cancellation, while the activity owner would have to carry the costs in the case of mandatory cancellation. Researchers stress that whether the seller or the buyer Party in the end would have to

Figure 14: Different understandings of OMGE and related implications



pay for the credits cancelled is dependent on the supply-demand balance on the market, with buyers paying for it if there is a demand overhang, and sellers paying if there is a supply overhang.

This leads to the following options and sub-options in the negotiation text:

- OMGE is achieved through conservative baselines or through conservative default factors in baselines (The impact of which is shown in **Figure 15**). This option is only retained in the first iteration of the draft Presidency text forwarded to SBSTA.
- According to the last two iterations of the Presidency text, OMGE is achieved through cancellation of a certain share of the issued A6.4ERs. Either this is made a voluntary provision or a mandatory provision.

If it is a voluntary provision:

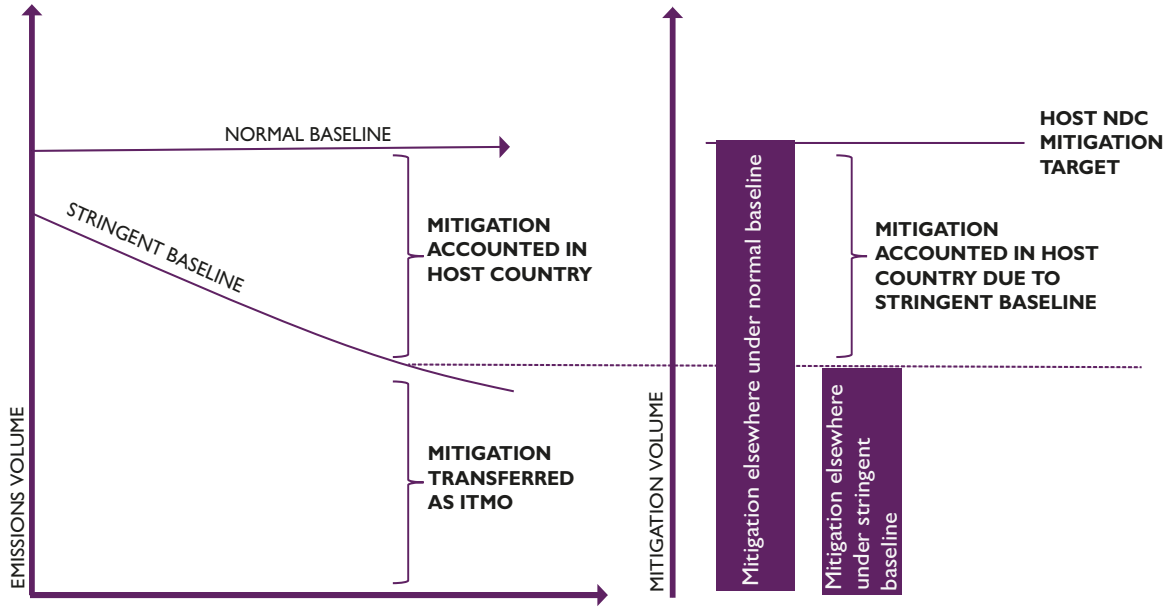
- Any cancellation by non-state actors would be seen as OMGE (even if the A6.4ER is used for carbon neutrality claims).
- The cancellation must be specifically for the purpose of OMGE and no other.

If it is a mandatory provision:

- The cancellation rate should be fixed at 2%.
- The cancellation rate should be fixed at 2% initially, but then regularly revised.

As the option of 'stringent' baselines was not considered in the last iteration of the Presidency text as an option to operationalise OMGE, many Parties consider that there is a conceptual agreement on the option of cancellation, while its exact operationalisation must still be clarified.

Figure 15: The contribution of stringent baselines to host country NDC



Baselines and additionality in the Article 6.4 mechanism

As mentioned above, the Supervisory Body will approve methodologies regarding the setting of baselines and the determination of additionality for the activity types eligible under the A6.4M. The stringency of baselines and of additionality testing is the key element to ensure the environmental integrity of the activities. Parties did agree in the last round of negotiations on some overarching key principles of methodologies (as mentioned above). However, there was no consensus with regard to:

- Specific baseline setting approaches.
- The scope of additionality testing and the link to the NDC of the host country.

Eligible baseline-setting approaches

The calculation of baselines on all levels of aggregation relies heavily on data availability. Therefore, while being key to safeguard the mechanism, complex baselines constitute barriers to participation of low income countries unless the Supervisory Body and its support structure undertake (part of) the work.

In the context of crediting baselines, three broad approaches are being discussed in the negotiations:

- The baseline scenario should reflect the application of the best available technology or of a certain performance standard. There are some variations of this general approach of determining the 'availability' of technology to also reflect on the economic or environmental costs of the technologies or to consider regional differences, like what has been done in the context of regulation in the EU (Best Available Technology Not Entailing Excessive Cost, or BATNEEC). However, this is in general a stringent approach and for many project types would already set a baseline of decreasing emissions.
- The baseline would represent a BAU scenario.
- The baseline represents the emission levels of the past of these activities (historic emissions).

Some Parties stress that there may not be a single approach suitable for all activities. Other Parties argue that different rules should apply for countries with different economic capacities. While economically stronger countries should apply a 'performance benchmark' that reflects best available technologies, developing countries with lower capacities should also be allowed to credit against BAU baselines (mostly representing an increase in emissions) or historic emission levels. Other Parties stress that the A6.4M should apply more stringent methodologies than the Kyoto mechanisms, which mostly applied BAU scenarios and historic emissions. They demand that baselines (both reference scenarios and crediting baselines) are 'consistent with Paris Agreement pathways', meaning they are calculated in a manner of ensuring the long-term mitigation targets are met. These Parties also understand a BAU scenario under Paris Agreement to already assume the implementation of NDCs and LEDS as a contribution to the agreement. Only mitigation which is going beyond these mitigation efforts would then be credited.

The text on baselines setting approaches did undergo significant changes, as Parties tried to formulate compromise proposals that strike a balance between clear principles, moving beyond the CDM requirements but also flexibility to the application in different contexts. These compromise proposals were:

- Baselines should reflect the **ambition** of the Paris Agreement to reduce emissions with proposed options being:
  - The crediting baseline must be 'below' BAU, even if the baseline was constructed based on a BAU emissions scenario.
  - Baselines must contribute to emission reductions and/or removals and be consistent with host Parties NDCs and Paris Agreement targets.
- **Flexibility** with regard to different contexts with proposed options being:
  - All baselines must take into account relevant circumstances (national, regional, local).
  - The choice of baseline must be justified.
  - Baseline setting approaches based on best available technology baselines or performance benchmarks should be the main options (or default approach), but others could be chosen if not 'economically or technologically viable'.

In the discussions, Parties are currently not distinguishing between estimation baselines (the 'reference scenarios') and crediting baselines, and which principles and characteristics apply to which aspect (or both).

Parties will need to foster common understanding on the question of whether ambition will be more likely enhanced through making the reference scenario and the crediting baselines stricter than the NDC, and thereby generating more mitigation in the host country; or through the mechanism lowering the costs of reaching the current NDC and thereby making it easier to agree on a stricter NDC in the future. Regarding the first interpretation, it should be noted that it will lead to a lower volume of ITMOs, generating a higher price and making it more costly to reach the NDCs of acquiring countries. In general, when Parties introduce guiding principles such as compatibility with the Paris Agreement, with the NDC or contributing to ambition, they will need to give guidance to the Supervisory Body on how to operationalise these principles.

Testing additionality

If the NDC of the transferring country is not ambitious (and thus generates 'hot air'), crediting of non-additional activities leads to a violation of the principle of environmental integrity. If such 'hot air' is traded, (transferred to other countries) then total global emissions increase as a result, undermining environmental integrity. When the crediting baseline overestimates the emission levels, then fictitious emission reductions will be credited, and environmental integrity is jeopardised.

Parties seem to agree that additionality rules will deviate from CDM rules and also demand that activities are only additional if they are not mandated by national policies and laws (so-called regulatory additionality). Parties have not yet agreed whether activities must also exceed mitigation from policies and measures associated with the NDC of the host Party. Here, a differentiation between policies mobilising the mitigation needed for the unconditional NDC target and those policies aiming for mitigation contributing to the conditional target seems to be required. A very stringent definition of additionality limits the number of eligible activities for crediting but supports host countries in securing domestic NDC achievement. A key question is thus whether the Supervisory Board will assess additionality only against the NDC (planned activities and binding targets); or through investment tests, or through both. These three different options are still in the negotiation text.

SMOULDERING ISSUES

The role of 'emission avoidance' in Article 6

A jurisdiction's annual GHG emissions levels can be lowered compared to emission projections by reducing its rate of deforestation (avoiding deforestation) and forest degradation. Since 2007, this has been operationalised under REDD+, which is covered by Article 5 of the Paris Agreement. However, the eligibility of REDD+ activities under Article 6, and in particular under Article 6.4, is contentious due to concerns regarding the accuracy of the monitoring of emission reductions and removals, the permanence of the emission reductions achieved, and the risk of displacement of emissions (carbon leakage).

Under the CDM, reforestation and afforestation were eligible but the limitation of deforestation was not. On the other hand, preserving and enhancing forests offers a huge mitigation potential, in particular in countries that have a very small carbon footprint with limited emissions from industry or transport sectors. Therefore, some Parties push for general eligibility, as they want to diversify the opportunities to finance the conservation and enhancement of carbon sinks. They argue that the Paris Agreement and the mandate for the Article 6.2 guidance explicitly targets both emissions and removals by sinks. Furthermore, they do not see an explicit exclusion of REDD+ activities in Article 6, solely because they are referred to in Article 5. Some also stress that if REDD+ is not excluded under Article 6.2, a level playing field should be established through eligibility under the Article 6.4 mechanism.

Another form of avoidance that has been brought into the discussion in the past is keeping fossil fuels in the ground. For instance, the government of Ecuador tried (in vain) to get financing for not exploiting the Yasuni oilfield. While this has not explicitly been mentioned in the Article 6 negotiations to date, it could resurface in the future.

According to the current draft texts, both ITMOs and A6.4ERs represent mitigation outcomes achieved through emission reductions and removals. This would include afforestation and reforestation activities, but in the past (for instance, under CDM) did not include avoided deforestation. Also, Parties did work on environmental integrity principles that accommodate the specific challenges of the forestry and land-use sector. Instead of requiring that ITMOs represent 'permanent' mitigation outcomes, the guidance now includes reporting requirements on how Parties 'minimise the risk of non-permanence' and are able to address any reversals 'in full' (see above).

However, avoidance is not explicitly mentioned either in the Article 6.2 guidance, or with regard to the A6.4M. With regard to the Article 6.2 guidance, the draft texts foresee that the eligibility of avoidance approaches

will be considered in technical follow-up work that will only be concluded at a later stage. It remains unclear whether this definition of 'avoidance' refers to both avoided deforestation and avoidance of exploitation of fossil fuels, or only to the latter. This could mean that international avoidance credits cannot be used by governments for NDC fulfilment and could only be traded on the voluntary carbon markets. The implications on accounting for such credits remain unclear as these credits will not qualify as ITMOs, whereas other credits on the voluntary carbon market will.

Accounting for voluntary carbon markets

Voluntary carbon markets have seen an upswing in the past years, linked to many private companies declaring net zero emissions targets, not only covering direct but also indirect emissions (for instance, from the use of fossil fuels produced by the companies). Therefore, some observers see voluntary carbon markets as key to harnessing private action toward the long-term target of the Paris Agreement, especially if governments are unwilling or unable to introduce strong mitigation policies. Others see governments in the driving seat of ambition as NDCs are strengthened over time. An increasingly elaborate array of mitigation policy instruments will eventually leave limited room for voluntary carbon market action.

The attractiveness of the voluntary carbon markets will be affected by the reporting and accounting obligations for international transfers of ITMOs by host countries under the Article 6.2 guidance, particularly by whether a CA by the host country is required or not. Obviously, a CA requirement will make it less likely that the host country agrees to a transfer, and will increase the transaction costs for the activity developer. Questions relate to: the definition of ITMOs and if that definition includes credits traded on the voluntary carbon markets, and; the trigger for CAs.

The draft negotiation texts do not explicitly mention voluntary carbon markets. However, they do refer to mitigation outcomes that were authorised to be used for other international mitigation purposes (for instance CORSIA) as well as 'other purposes', 'including as determined by the host country'.

The draft text clearly establishes that mitigation outcomes authorised for other international mitigation purposes and other purposes are considered ITMOs. It remains unclear however, if it is their authorisation or their use that will trigger a CA. Furthermore, it remains unclear whether the host country itself will be able to determine, whether a voluntary use of ITMOs (which it may not be able to control) is going to constitute an 'other purpose' or not.

Without doubt, carbon credits used under CORSIA will require a CA, if they stem from countries having ratified the Paris Agreement. Therefore, the two biggest voluntary standard setting organisations active in Paris Agreement host countries are preparing for the clear differentiation of credits with and without CAs.

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