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SB50 Side Event Report

Article 6 negotiations: technical analysis of key issues for markets

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This is a report of a side event held at 50th Session of the Subsidiary Body for Scientific and Technological Advice and the Subsidiary Body (SB 50) for Implementation organized by UNFCCC from 17th to 24th June 2019, in Bonn, Germany.

- Title: Article 6 negotiations: technical analysis of key issues for markets
- Date: 19 June 2019, Wednesday, 15:00–16:00
- Organizers: Organisation for Economic Co-operation and Development (OECD)
- Venue: Room Bonn
- Panel: Ms. Manasvini Vaidyula (OECD); Ms. Stephanie La Hoz Theuer (ICAP/Adelphi); Mr. Luca Lo Re (IEA); Mr. Dirk Forrister (IETA)
- Moderator: Helen Plume (New Zealand; CCXG Chair)

■ Abstract

Analysis on key issues in markets negotiations was presented from a recent paper “Markets negotiations under the Paris Agreement: a technical analysis of two unresolved issues” by the OECD/IEA Climate Change Expert Group. Presentation focused on Article 6.2 accounting, use of ITMOs from outside of NDCs and the potential transition of activities and units from the CDM to the Article 6.4 mechanism. Also, a representative of IETA provided private sector perspective on market mechanisms development.

■ Session summary

1. Ms. Manasvini Vaidyula: How to ensure environmental integrity for single-year NDCs? Environmental integrity and single year NDCs – Examining options of possible accounting methods for single-year NDCs and their implications

[Different accounting methods and their implications on environmental integrity]

- If Parties with single year NDCs engage in transaction of ITMOs, following environmental integrity risks can arise. It is important for any accounting methods being considered for use by single-year NDCs to limit such risks.
 - ITMOs transferred out are generated from emission reductions in non-target years and are not accounted for against the target.

- ITMOs acquired over multiple years of the NDC period are used to meet emission reduction targets in one year only.
- There are five accounting methods currently under discussion: 1) Multi-year method, 2) Yearly method, 3) Averaging method, 4) Cumulative method, 5) Target year only.
- (OECD paper treats all five methods but three methods were covered in this event)
- 5) “Target year only”: Corresponding adjustment for ITMOs transfers and acquisitions that relate to target year only. This method would reduce the risk that ITMOs being transferred from non-target years not being accounted against the target.
- 3) “Averaging”: Corresponding Adjustment that equals the annual average of ITMOs transacted throughout the NDC period. (E.g. If 100 tCO₂ of ITMOs transferred, across the NDC period of 10 years, then adjustment to be applied would be $10/100= 10$ tCO₂ against its target emissions)
- 4) “Cumulative”: Corresponding adjustment that equals the cumulative sum of ITMOs transacted throughout the NDC period.
- 3) and 4) ensures that any ITMOs being transacted are accounted against the target year emissions. But 4) raises the risk that Parties can meet the target by applying a single large adjustment by acquiring enough ITMOs while emissions in another year potentially not reduced.

[Possible scenarios for how Parties trade and associated implications]

- Parties are currently considering if it’s possible to stipulate that two Parties use a same accounting method when they transact ITMOs.
- Under the same method rule: It could limit the number of potential partner for transacting ITMOs.
- Without the same method rule: Environmental integrity risks depends on combination of accounting methods used by both Parties. (e.g. A Party with multi-year targets using “accumulative method” acquires ITMOs from a Party with single-year target using “averaging method”, it’s not necessarily going to raise the risk. On the other hand, a Party with single-year target had better to trade with another Party uses same/similar method.)

2. Ms. Stephanie La Hoz Theuer: Using outside-scope mitigation outcomes towards NDCs

- This Presentation is preliminary results of a journal article which Stephanie La Hoz Theuer, Andrew Howard, Kelly Kizzier and Martina Cames are working on.

[Issues]

- 12-14% of emissions lie outside scope of NDCs. This comes from no less than 2/3 of NDCs meaning they are not economy-wide. It is not so big in terms of volume but in

terms of the number of countries effected is significant.

- Question is should Mitigation Outcomes (MOs) generated outside the scope of NDCs be used towards NDCs? and how shall we account it?

[Pros and Cons]

- Pros: 1) Identification of mitigation potential, and 2) reduction of mitigation cost. Using MOs from outside of NDCs brings mitigation incentives to outside scope.
- Cons: 1) Disincentives to enhancing the scope of NDCs, 2) Fairness towards countries with economy-wide NDCs, 3) Lack of incentives for ensuring quality, and 4) Double counting risks.
- As for 1), there could be an incentive to keep sectors which can be source of credits outside of NDC scope. As for 3), If you generate credits outside of accounting, there would be limited incentives to ensure the quality. As for 4), especially when a country has both GHG target and non-GHG target, there would be risks of double counting.

[Two key options for addressing concerns]

- (Five methods were identified in the paper but two options were explained in this event)
- Progression in scope: MOs from outside scope of NDC can be used but host country is required to bring area / sector / gas / source within scope of next NDC.
 - Pros: could address perverse incentives on increasing the NDC scope.
 - Cons: does not address other concerns (fairness, quality, double counting). Technically challenging (what should be included in the scope). Difficult to enforce.
- Accounting: require that corresponding adjustment be made.
 - Pros: avoids having to clarify what is inside and what is outside. Addresses all concerns (perverse incentives on scope, fairness, quality, double counting). It is often difficult to clearly distinguish outside or inside of NDC.
 - Cons: fewer incentives for pursuing outside scope mitigation options because countries would have to further reduce within scope of NDCs.
- (Responding to a reaction from Mr. Michael (Zurich Uni.)) Only allowing mitigation outcome only inside scope of NDC is another option (which is not discussed in this event).

3. Mr. Luca Lo Re (IEA): Implications of potential transition of units from the CDM to the Article 6.4 mechanism

[What do we mean by transition of units?]

- Transition of KP mechanisms in to Article 6.4 is being discussed under SBSTA, even though the PA does not explicitly call for such transition.
- Three levels: 1) Transition of activities: how to re-register existing activities in new mechanism, 2) Transition of units: Pre-2020 units can be potentially converted into Art.

6.4 emissions reduction, 3) Transition of methodologies and rules: CDM and JI methodologies can be allowed for new projects.

- Options being discussed for transition of units (CERs) are 1) Full transition, 2) Limited transition, 3) No transition.

[Quantifying supply and demand implications of transition options]

- Currently available CERs can be estimated by applying following formula:
 - Total CERs issued = [CERs in holding accounts + CERs in cancellation accounts] in CDM Registry + [CERs in holding accounts + CERs in cancellation accounts + CERs in retirement accounts + CERs in replacement accounts] in Annex 1 registries
 - Currently available CERs = CERs holding accounts in CDM Registry + CERs in holding accounts in Annex 1 registries
- 1.9 billion CERs were issued and 1.1 was used so far. Total amount of available CERs is 0.8 billion. Also, potential CERs demand to 2020 was estimated as 0.3 billion. With only currently available CERs, the supply would be more than 2.5 times higher than the estimated demand in 2020.
- We also need to take into account another potential effect by potential supply from “dormant” projects. Potential CERs supply to 2020 could be maximum 4.7 billion CERs.
- Current CDM rules says If projects continue to monitor GHG abatement then they can request retroactive issuance of CERs at any time within their crediting period. These “dormant” projects could restart issuance retroactively in response to an agreement on transitioning CERs together with a market signal on demand.
- This potential supply could imply large carry-over of units, with pre-2020 CERs potentially used for post-2020 mitigation targets. It could put at risk the environmental gains of the Art.6.4 mechanism and reduce the incentive to invest in new activities.

[Example of options to limit transition of units]

- The report examined several limitation options could be applied such as geographic restriction, vulnerability restriction, vintage restriction, etc. Different options would have different implications; combination of these restrictions also possible.

4. Mr. Dirk Forrister (IETA): (Private sector perspective)

- (Reactions to Luca’s presentation) From the perspective of IETA, everybody inactive in the past carbon market believes that they would like to be active in the future.
- IETA members expect that the negotiation would make further progress on the area of transition of methodologies/system and its process, possibly in next year.
- IETA has a strong view on the issue of transition of activities. Issuance from projects with extended crediting period into 2020s should be eligible under the new regime. This could

be a signal of continuity from the past.

- There are more concerns on transition of units. When we talk to people in the market, they don't believe these "dormant" projects would restart. However, some projects particularly in Africa which have never had a chance to issue might still exist.
- IETA has much more focus on future such as CORSIA, new market development, carbon pricing in Colombia and South Korea etc.

■ Q&A session

Q1. Axel Michaelowa (Univ. Zurich/Perspective): To Vaidyula: With regard to the option of "averaging" and "accumulative", don't you think that "averaging" should be differentiated toward an option of taking into account of likely shape of emission curve? Emissions doesn't always continue to rise during NDC period, emissions can go down towards the NDC target by implementing mitigation policies.

A1. Ms. Manasvini Vaidyula: Single year target is such a black box and difficult to design possible emission curve and "Averaging" would be a better method. There is a concept of NDC representativeness that tries to ask Parties to engage in Art.6 transaction how they plan to achieve the NDCs. This maybe could manage that concern better. But It would be difficult to actually implement this concept because of political issue or lack of capacity in countries.

Q2. Axel Michaelowa (Univ. Zurich/Perspective): To Stephanie: Don't you think we should differentiate depending on countries? Especially LDCs in Africa would have difficulties to cover certain sectors because of lack of capacity and data. Transition period for those countries should be longer.

A2. Stephanie: Yes. We need to consider certain exemptions. But currently I don't have ready-made answer on these options.

Q3-1. Axel Michaelowa (Univ. Zurich/Perspective): To Luca: 4.7 billion is overestimated because of serious methodological issues of the study.

Q3-2. Aki Kachi (NewClimate Institute): To Dirk: What If price of CERs will be high because of demand?

A3. Dirk: When we show those estimates (4.7 billion tCO₂) to people actually in the market, they will laugh. There is no way that those projects still alive. I don't believe that scare tactic number out there. Another important issue is that particularly projects in energy sector potentially will have difficulties to re-register because they may be in part of baseline covered by NDC.

A.4 Lambert (NewClimate Institute (Co-author of the OECD report)): The estimate is a

potential and doesn't mean all the projects necessarily come to the market. However, I think data is quite solid. NewClimate Institute did a survey using random sampling on 1,300 projects. One thing need to be considered is the survey conducted in 2013-2014, so the situation may have changed slightly.

A.5 Luca: We looked at difference resources and other estimates. Other estimates always range from 2 billion tCO₂ up to 5 billion tCO₂ in any case. There is an accordance among authors in the magnitude of billions. One questions is about timing and speed, how fast projects developers request issuance will affect the estimate. Also, there is a significant amount of carry-over CERs which is estimated 0.8 billion tCO₂ by latest report by IGES. We should also think about this issue for functioning of the new market.

Q4. Aki Kachi (NewClimate Institute): To Stephanie: How do you do corresponding adjustment for MOs from outside scope of NDC?

A5. I don't see particular difference between corresponding adjustment.