



VCS Submission on Operationalizing Article 6

29 September 2017

Overview

The specific requirements related to Article 6 need to facilitate the cost-effective trading of robust emission reductions that are not double counted or claimed. In order to have a mechanism that effectively achieves these objectives, it will be important to break these requirements into two components, as follows:

- **Credibility of International Trading.** Article 6 will need to ensure that all emission reductions traded internationally are not double counted and are tracked as they move across borders. Presumably, this means all such units will need to be tracked and corresponding adjustments made to the corresponding national accounts. To achieve this, it will be necessary to have a universal set of rules on how double counting is to be avoided, particularly in the context of differentiated Nationally Determined Contributions, or NDCs (i.e., single-year target, absolute cap vs. BAU, etc). Ideally, the UNFCCC would develop such requirements as only an international body with official standing can establish a set rules for all to follow. In addition, either the UNFCCC, or some other international body, would set up an international registry that enables the tracking of all of the units that are traded across borders. Requirements to avoid double counting and double claiming should apply to all trading, whether done under Articles 6.2 or 6.4.
- **Environmental Integrity of Individual Units.** All emission reduction units eligible for international trading will need to have environmental integrity, which means they will need to represent real emission reductions. There is already broad agreement on what environmental integrity means in terms of emission reduction units, which include, at a minimum, that emission reductions be additional, independently verified, permanent, and listed on a registry. Such requirements must be required under Article 6.4, although parties trading under Article 6.2 should be encouraged to borrow from these principles.

In the sections below we outline how we would envision governance and oversight would take place in respect of Articles 6.2 and 6.4.

Article 6.2 - Focus on the Credibility of International Trading

Because trading of Internationally Transferred Mitigation Outcomes (ITMOs) under Article 6.2 will be done on a case-by-case basis based on bilateral agreements, there cannot be any requirements in respect of the units that are traded. In other words, the environmental integrity of the units traded under Article 6.2 cannot be guaranteed. Consequently, it will be up to trading partners to either ensure the environmental integrity of any transacted units, or suffer the consequences of trading units that do not represent real reductions.

Assuming rules on double counting are in place and are enforced, it will be up to each country to ensure that any ITMO trading reflects the transfer of real emission reductions. If the ITMOs being traded do not have environmental integrity (e.g., are not really additional), then the host country would have made a corresponding adjustment to its national accounts on the back of those units and would be undermining its ability to meet its NDC because its inventory will not reflect any reductions and it will therefore need to find extra reductions in its economy. Thus, while Article 6.2 cannot prescribe the specifications of ITMOs, robust rules to prevent double counting that are enforced will encourage trading partners to rely on units that have environmental integrity. Otherwise, the host country will be “left holding the bag.” Robust rules and enforcement of these will thus serve as a way to encourage parties to trade units that have environmental integrity. To achieve this, we would encourage reliance on existing GHG crediting programs in order to leverage the considerable expertise residing in various organizations around the world that manage such programs. This would also prevent parties from reinventing the wheel.

The main governance body in respect of Article 6.2 therefore needs to be in respect of enforcing rules to ensure the integrity of international trading, which in large part depend on preventing double counting. This is no small task, and will require the active participation of an international body with official standing and which can oversee the implementation of the requirements on double counting. Ideally, it is the UNFCCC that both develops such requirements and enforces them.

To conclude, as long as there are clear consequences to trading bogus ITMO, countries should be left to trade whatever they want, from whichever sectors they want. In order to avoid putting host countries at a disadvantage by trading units that do not represent real emission reductions, we would recommend parties adhere to the principles that have already been tried and tested to ensure the environmental integrity of the units, including reliance on the expertise and infrastructure already present both in compliance and voluntary carbon markets worldwide.

Article 6.4 - Focus on Environmental Integrity of Individual Units

Like Article 6.2, Article 6.4 will require will require robust rules to maintain the integrity of international trading (i.e., prevent double counting/claiming). In our view, the requirements described above in respect of preventing double counting/claiming under Article 6.2 ought to be the exact same ones that are used to oversee trading under Article 6.4. Otherwise, there will be a patchwork of requirements that would undermine trading of emission reductions.

Additional Requirements (beyond those for Article 6.2)

Because the focus of Article 6.4 is to create units with environmental integrity, it will require additional governance elements beyond what Article 6.2 will require. Specifically, Article 6.4 will require detailed specifications in respect of the units that are created for trading. This means that provisions of Article 6.4 will need to specify the criteria that all units need to meet, as well as outline how the criteria can be met. For example, if the requirements under Article 6.4 specify that all emission reductions be additional and permanent, it will need to also specify how those requirements can or should be met (e.g., developing positive list approaches for projects that are *a priori* additional, reliance on a buffer account to ensure permanence).

Today there is a lot of experience, both in the regulated/compliance and the voluntary carbon markets, in respect of how to ensure the environmental integrity of traded units. For instance, while the Clean Development Mechanism (CDM) demonstrated many of the structures carbon markets now rely on (e.g., proper accreditation of third-party auditors), the Climate Action Reserve (CAR) drove innovation in respect of relying on positive list approaches to determine additionality. For its part, the VCS Program addressed key challenges facing land-based projects, including addressing leaking and non-permanence risk, which has resulted in numerous projects around the world reducing emissions through the protection of forests. As a result, there are now several different GHG crediting programs that issue units with environmental integrity and which are driving investment towards mitigation projects around the world in a variety of sectors.

‘Open Architecture’ Approach

While the default assumption has been that the UNFCCC would establish a new GHG crediting program along the lines of the CDM, Article 6.4 will be more successful if it leverages the broad expertise that is currently residing in many organizations that manage GHG crediting programs. In addition to the CDM, this includes the American Carbon Registry (ACR), the Climate Action Reserve (CAR), the Gold Standard and the VCS Program, all of which are managed by non-profit organizations and are thus insulated from commercial interests. All of these GHG crediting programs ensure environmental integrity by requiring that projects have, at a minimum, strong requirements around key elements of emission reductions/removals (e.g., additionality, independent auditing, permanence, transparent registry) and that they have the programmatic capacity to operationalize those requirements. The diagram below illustrates the types of requirements and programmatic elements that could be required of participating GHG crediting programs as part of the ‘open architecture’ approach.



This means that the focus of Article 6.4 ought not to be the design and management a singular GHG crediting program, but rather the establishment of high-level criteria that all GHG crediting programs will have to meet in order to issue units that can be traded under Article 6.4. As such, the governance of Article 6.4 will need to ensure oversight of the creation of units eligible for trading, meaning that a body (ideally the UNFCCC) would oversee both the process through which individual GHG crediting programs apply and are accepted to become part of the Article 6.4 architecture, as well as the performance of the organizations against the criteria (e.g., through regular audits).

The above approach, also referred to as an ‘open architecture’ approach, is precisely what is being proposed under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), where a base set of requirements is established and then various GHG crediting programs are allowed to operate within that context, with appropriate oversight by an oversight body. The [AILAC submission](#) on proposed architecture for Articles 6.2 and 6.4 on this topic also mirrors this open source approach. Indeed, this is very similar to what was proposed as the Framework for Various Approaches (FVA) which was discussed in the past under the climate negotiations years ago.

There are many benefits to the ‘open architecture’ approach. For example, it will:

- 1) **Drive Innovation.** Competition among the crediting programs will drive innovation. As mentioned above, it was the Climate Action Reserve that pioneered the use of positive list approaches for the determination of additionality, and it was the VCS Program’s innovations addressing leakage and permanence that enabled carbon finance to flow to land-based projects.
- 2) **Reduce Transaction Costs.** Having multiple programs operating in the ecosystem will encourage competition and ensure accountability, thereby keeping transaction costs low, another key ingredient in fostering investment in climate change projects.
- 3) **Achieve Scale.** One of the key lessons from the CDM/JI was that a single body is not likely to be able to deliver the architecture and platforms needed to incentivize investment across a wide range of sectors and at the scale that is needed to effectively address climate change.

- 4) **Ensure Geographic Diversity.** Having a wide set of options in terms of crediting GHG emission reductions will allow for carbon finance to flow to countries that have traditionally not benefited from this source of financing, thereby ensuring geographic diversity. For instance, CDM investment largely bypassed Africa, and yet the voluntary market has provided important options for African countries (as well as other LDCs) through projects that provide efficient cookstoves, and both restore and protect forests.

The biggest risk to the ‘open architecture’ approach is that one or more of the participating GHG crediting programs may generate units that lack environmental integrity. To address this, a robust set of criteria needs to be established and rigorous application and oversight processes need to be in place. The State of California was the first to experiment with such a system when it opened up the application process for third-party GHG crediting programs to provide registry services for the offset component of the state’s cap-and-trade system. ICAO is currently sorting out how such a process will work in respect of the CORSIA. The UNFCCC would do well to learn from these efforts and build upon them to ensure that participating GHG crediting programs are complying with the requirements.

Governance

In our view, it will be important to separate the establishment of the criteria for Article 6.4 units and the oversight of the entire system, on the one hand, from the day-to-day management of GHG crediting programs on the other. Such a division of labor would enable the body governing the entire system to focus on big-picture items (e.g., uptake of standardized methodologies, preventing double counting) while at the same time enabling the various GHG crediting programs participating in the mechanism to issue units for trading under Article 6.4 and evolve to meet the needs of the market. Importantly, such a set up would mean the oversight body would have no conflicts of interest in respect of setting the high-level rules and running the day-to-day operations of a crediting program (as it did in the CDM), which would result in greater independence in respect of ensuring overall environmental integrity.

The oversight requirements for the entire system will be large and will require dedicated attention. For example, one can imagine that there will need to be oversight of the system and sanctions imposed when, for example, a participating GHG crediting program is not meeting the requirements. Certainly the same will apply to enforcing the rules on double counting. In addition, it will be incumbent upon this oversight body to consider excluding certain project types because they are no longer deemed to be additional. In summary, to effectively maintain the environmental integrity of the units traded under Article 6.4 it will be necessary for a single regulatory body to be completely independent of market stakeholders and thus have the ability to sanction those who fail to meet the requirements set out under Article 6.4, whether these be in respect of double counting/claiming or the integrity of the units created by participating GHG crediting programs.

Activities

There are two main elements to be resolved in respect of the activities that ought to be allowed under Article 6.4 – project types and the scale of intervention.

Project Types

We strongly believe that projects under Article 6.4 should be the same kinds of activities that have been developed under existing compliance and voluntary carbon markets, with perhaps some additional restrictions to ensure projects are truly additional and to encourage regulation and government action. For instance, as mentioned above, the body overseeing GHG crediting programs operating under Article 6.4 could eliminate certain project types based on its determination that they no longer are additional. This would complement action under the NDCs, where governments have in many cases specified which sectors they will be focusing on. Clearly that means projects in those sectors should not be eligible for crediting, unless emission reductions are accounted for properly in the national GHG inventory. So, the point is that Article 6.4 should allow most project types but make sure that they complement efforts under the NDCs and do not dis-incentivize government action.

It is likely that Article 6.4 activities will concentrate on the Agriculture, Forest and Other Land Use (AFOLU) sector. This is due to the fact that governments, under their NDCs, will seek to regulate their energy and transport sectors first. In addition, interventions in the AFOLU sector tend to be more complicated. As such, it will be critical for the success of Article 6.4 to embrace reductions in the AFOLU sector, especially REDD+ given its potential for reducing global emissions and drawing down atmospheric carbon.

In general, the existing project cycle makes sense and we would recommend keeping it, though the process would benefit greatly from being streamlined. For example, the validation step could be removed entirely if standardized methods for demonstrating additionality are used. California has adopted this approach and it has worked well, both because it provides a clearer and more objective way to determine additionality and it reduces transaction costs. We also know that the registration request review process can be a significant bottleneck, so finding ways to streamline that process, and make it more predictable, would be tremendously beneficial to attracting private sector investment. Indeed, having multiple GHG crediting programs (per the recommendation above) would address this concern as competition would incentivize GHG crediting programs to process requests in a timely fashion and streamline their procedures.

Scale of Activities

In order for Article 6.4 to be successful, it will need to embrace activities at all scales, from projects to governmental programs. There is a mistaken perception that Article 6.4 needs to move away from project-based mechanisms in order to achieve scale, and we strongly believe that disallowing project activities would undermine one of the elements that have worked well in the CDM and the voluntary carbon market. One of the reasons for the success of projects is that they provide very clear boundaries around which the private sector can base investment decisions on and then drive performance. So, in the first instance, Article 6.4 should embrace project-based activities. At the same time, where project-based activities are coupled with or embedded in governmental programs, they will need to reconcile their reductions with those occurring at the governmental level (to maintain environmental integrity).

One approach that marries project-based activities and sectoral approaches is the development of performance methods as set out under the VCS requirements for standardized methods (see second half of the [VCS webpage on methodologies](#)). These requirements set out how one would develop a performance benchmark that would apply across an entire sector. A key challenge with this approach,

however, is access to production information, which often is held by private companies who consider it confidential and market-sensitive. As such, all stakeholders should advocate for the sharing of such information within the context of developing these benchmarks, which would protect confidentiality (as is done under the VCS requirements) and promote these approaches.

There are also new emerging opportunities to align project-level and governmental action on climate change. For example, the development of national Forest Reference Levels (FRELs/RELS) has set the stage for enabling REDD+ project activities to link to governmental efforts by aligning their baselines with the respective FREL/REL and ensuring consistency in accounting. At the same time, the VCS Jurisdictional and Nested REDD+ framework (JNR) provides requirements for integrating project-level activities and governmental action, and allows both to be credited with the same rigor so as to ensure environmental integrity across the board.

To conclude, there are new modalities that enable project-level activities to link to broader sectoral efforts. Article 6.4 needs to promote that integration without undermining the potential of both project and sectoral efforts.