

Ad Hoc Working Group on Long-term Cooperative Action to enhance implementation of the Convention (AWG-LCA)

Submission by the Republic of Nauru on behalf of the Alliance of Small Island States (AOSIS)

Views on matters referred to in paragraphs 79 and 80 of decision [-/CP.17]: work programme on standards and approaches to ensure real, permanent, additional and verified mitigation outcomes, avoid double counting of effort and achieve a net decrease and/or avoidance of GHG emissions

AOSIS welcomes the opportunity to present its views on matters referred to in paragraphs 79-80 of decision -/CP.17 (Outcomes of the AWG-LCA). This submission builds on AOSIS's earlier submissions on the establishment of one or more market-based mechanisms to enhance the cost-effectiveness of, and to promote, mitigation actions (FCCC/AWGLCA/2011/MISC.2 at 40-47) and AOSIS's submission on possible non-market based mechanisms (FCCC/AWGLCA/2011/ MISC.3 at 6-8) and should be read in conjunction with these earlier submissions.

1. Introduction

COP17 in Durban emphasized that *various approaches*, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries, ***must meet standards that deliver real, permanent, additional and verified mitigation outcomes, avoid double counting of effort, and achieve a net decrease and/or avoidance of greenhouse gas emissions*** (see decision -/CP.17, paras.79-80). The COP requested the AWG-LCA to conduct a work programme to consider a framework for such approaches, with a view to recommending a decision to the Conference of the Parties at its eighteenth session. The COP invited Parties to submit views on these matters, including their experiences, positive and negative, with existing approaches and mechanisms as well as lessons learned (para. 81).

2. The climate regime already has an internationally-agreed framework for standards and approaches to deliver real, permanent, additional and verified mitigation outcomes for mitigation, established under the Kyoto Protocol

Any framework for standards and approaches to deliver real, permanent, additional and verified mitigation outcomes for mitigation actions must begin with the Kyoto framework, reinforce its international and centralized approach, continue to apply internationally-agreed common accounting rules, ensure use of UNFCCC institutions, and be even more stringent with respect to environmental integrity.

Emissions inventories: The international community must be able to determine the emissions that the atmosphere sees from each individual Party's economy-wide emission reduction commitment or targets. It must also be able to assess the emission reductions to be delivered by all commitments, targets and actions in aggregate, to assess progress toward global goals.

The most direct way to assess the achievement of emission reductions is through regular GHG inventories from all Parties that apply a common set of accounting rules, that are reviewed by technical experts for transparency, consistency, comparability, completeness and accuracy, that are subjected to adjustments where common methodologies have not been applied, leading to a

possible over-estimation or underestimation of emissions, and that are reviewed for compliance with legally-binding emission reduction commitments and targets.

Any deviation from straight-forward national inventory accounting must be narrowly circumscribed and closely overseen at the international level to ensure the environmental integrity of the commitments and actions pledged and taken, and the ability of the international regime to track emissions, is not undermined.

Market mechanisms and eligibility: The Kyoto Protocol's flexible mechanisms allow Annex I Parties to generate and acquire units that may be applied against their emission reduction commitments – but only in certain narrowly-prescribed circumstances. However, to access this flexibility, Annex I Parties must satisfy a series of reporting and eligibility requirements, which are established, operated, enforced and overseen at the international level. Emission reduction projects undertaken by Annex I Parties in developing country Parties or in other developed country Parties may only produce units for use toward quantified economy-wide emission reduction or limitation commitments where projects have first been proposed for review at the international level, evaluated by the CDM Executive Board or Joint Implementation Supervisory Committee against a series of agreed rules and baseline methodologies, and the resulting emission reductions verified using agreed monitoring and verification methodologies and standards.

The Kyoto Protocol's common accounting rules, and the framework for their implementation, has taken two decades to develop. This effort has truly been a multilateral one, with all Parties to the Convention negotiating the rules that would eventually be applied under the Kyoto Protocol. This rulebook adopted through the Marrakech Accords and subsequent decisions provides assurances to all Parties that units representing emission reductions represent real, permanent, additional and verified emission reductions. It is designed to ensure that the commitments of Annex I Parties will not be watered down through reliance on units that have not been subjected to rigorous international scrutiny and do not comply with multilaterally-agreed stringent and transparent accounting rules.

For Annex I Parties, these rules require, among others:

- legally-binding economy-wide emission reduction or limitation commitments
- annual GHG inventory accounting
- establishment of initial assigned amounts for accounting periods
- national registries that meet agreed standards
- centralized registries to track all traded units
- technical reviews by expert review teams of national inventories, satisfaction of eligibility requirements and reporting obligations
- adjustments to inventories where methodologies used may lead to overestimation or underestimation of emissions
- reporting of supplementary information on how commitments will be met
- compliance assessments
- international oversight by the Compliance Committee

Where tradable units are involved, these rules also require:

- uniform treatment of proposed projects
- uniform crediting periods

- internationally-agreed validation standards, standards for accreditation of DOEs and verification standards
- baseline methodologies and monitoring standards agreed at the international level
- oversight by the CDM EB, JISC and/or Compliance Committee, staffed by representatives from regional groupings, developed and developing countries, to ensure transparency and ensure application of internationally-agreed rules
- the power to suspend trades at the international level where trades would violate multilaterally agreed rules
- provisions to ensure environmental integrity (e.g., carryover restrictions, commitment period reserves, caps on credit use, supplementarity, eligibility requirements)
- the ability to adjust rules at the international level as necessary where difficulties arise
- uniform methods to address non-permanence issues around LULUCF-related units in a uniform and predictable way

These are all valuable elements that must be retained.

Any criticisms of the flexible mechanisms with respect to environmental integrity, additionality, scope and scalability are best addressed by making the international rule set **more uniform, more stringent, and more centralized**, rather than less uniform, less stringent and decentralized. This is a lesson learned from the EU ETS and it is a lesson equally relevant for the international climate change regime. Systems are needed to provide still greater environmental integrity and assurances of additionality at the international level.

The Kyoto Protocol has moved in this direction by endorsing use of sector-specific standardized baselines for demonstrating additionality. Any new mechanism must build on such approaches and explore other options that will enable full participation by all Parties, especially SIDS.

3. Moving beyond offsets to substantial net emission reductions

Over 100 Parties to the UNFCCC have expressed their support for a temperature limitation to **well below 1.5 degrees Celsius** above pre-industrial levels, and long-term stabilization of greenhouse gas concentrations in the atmosphere at **well below 350 parts per million of carbon dioxide equivalent**. To achieve these goals, **more than an 85% reduction** in global emissions is needed below 1990 levels by 2050. According to the IPCC's Fourth Assessment Report, a **25-40%** reduction in Annex I Party emissions is needed by 2020, together with a substantial reduction in business as usual emissions (estimated at **15-30% below BAU**) from developing countries even to limit temperature increases to 2.0 to 2.4 degrees above pre-industrial levels, together with a peaking of global emissions by 2015.

To keep warming to below a 1.5 degree increase, it has been said that annual global emissions need to drop to roughly **44 billion tonnes** of CO₂-equivalent emissions per year by 2020 from business as usual emission levels.¹ If the pledges that have now been presented are aggregated, with their associated accounting provisions taken into consideration, expected global emissions leave a **gap of approximately 11 billion tonnes**² of emission reductions to be closed in 2020.³

¹ See "Bridging the Emissions Gap", UNEP, November 2011, available online at: www.unep.org/publications/ebooks/bridgingemissionsgap/

² Id. According to "Bridging the Emissions Gap", even if all higher "conditional" pledges were implemented and all loopholes available to Annex I Parties were eliminated (such as use of surplus AAUs and lenient LULUCF accounting rules), in the most optimistic scenario a mitigation gap of 6 billion tonnes of CO₂-equivalent emission reductions

The greater the reliance on offsets, the lower the effective emission reductions the atmosphere will actually see from mitigation pledges of all Parties. Moreover, if Parties rely on offsets that do not guarantee environmental integrity, additionality and permanent emission reductions, global mitigation ambition will be eroded even further. The Kyoto Protocol flexible mechanisms generate units that may be traded among Parties toward emission limitation or reduction commitments; they do not, by design, deliver net emission reductions.

Given the need to increase global mitigation ambition, there is now a need to identify ways to generate a **substantial net decrease** in GHG emissions through the KP mechanisms and the new market-based mechanism under the Convention. A range of modalities might be envisaged to ensure a net decrease in global emissions through participation in the new market-based mechanism. See AOSIS submission on paragraphs 83 and 84 of decision -/CP.17 (new market mechanism). These include, among others:

- **Conservative baselines**, set at a fixed percentage below verified BAU projections (e.g., 20% or 30% below BAU projections)
- **Sectoral baselines set below absolute emissions**, averaged over a fixed time period preceding the trading/crediting period (e.g., average 2008-2010 emissions) for emission reductions to be delivered over a fixed timeframe (e.g., 2013-2017)
- **Discounting of units generated or traded**, at a rate that will ensure that the units generated lead to, or the units traded reflect, a substantial net benefit to the environment
- **Setting aside a portion of units generated for the benefit of the environment** through the international transactions log (e.g., W% set aside for the environment; X% available for acquisition through the international transactions log; Y% credited to host Party emission reduction goals; Z% contributed to the Adaptation Fund). The cancellation of set aside units would ensure that the environment sees a net decrease in GHG emissions.

Any of these approaches, to be effective, requires a uniform and centralized approach at the international level under the Convention, or under the Protocol in the context of improvements to the existing project-based mechanisms (CDM and Joint Implementation).

4. Units created under bilateral offset programmes, national offset programmes and voluntary carbon reduction schemes should not be given international recognition for purposes of offsetting international commitments under the UNFCCC and KP

It is essential that any units that are accepted for use toward quantified emission commitments of Annex I Parties be established at the international level, and validated, monitored and verified at the international level to ensure additionality, permanence, environmental integrity and supplementarity, and tracked and traded through UNFCCC

would still remain. See also Climate Action Tracker Briefing Paper, 10 January 2011, "Cancun Climate Talks - Keeping Options Open", C. Chen, B. Hare, M. Hagemann, N. Höhne, S. Moltmann, M. Schaeffer (Climate Analytics, PIK, Ecofys), available at http://www.climateactiontracker.org/briefing_paper_cancun.pdf.

³ This abatement potential exists. According to a 2010 McKinsey study, in 2020 technical measures costing below €80 per tonne produce an abatement potential of 19 gigatonnes of CO₂-equivalent. More than 10 GT could be achieved at negative cost by 2030. See Impact of the financial crisis on carbon economics, Version 2.1 of the Global Greenhouse Gas Marginal Abatement Cost Curve (McKinsey & Company, August 2010) http://www.mckinsey.com/client-service/sustainability/pdf/Impact_Financial_Crisis_Carbon_Economics_GHGcostcurveV2.1.pdf

institutions, to avoid double counting and enable an ongoing assessment of global emission reductions and progress toward global goals.

Over the last few years, a number of programmes have been initiated by Annex I Parties to support emission reduction efforts in developing country Parties. Some are national, some are bilateral, some are regional or multilateral. Certain Annex I Parties have now indicated their interest in having the emission reductions achieved under these programmes count toward their own quantified economy-wide emission reduction limitation commitments or targets established at the international level under the Kyoto Protocol or Convention.

These programmes provide useful learning exercises; they help developing country Parties and the private sector identify mitigation potential and can facilitate domestic emissions trading schemes. They also are valuable in directing financial flows to developing countries to support mitigation efforts, consistent with Article 4.3 of the Convention.

However, only units that are agreed through the UNFCCC and Kyoto processes, that use a common set of internationally-agreed rules, and that are generated and traded with all the transparency and international scrutiny that now attaches to the Kyoto mechanisms, are suitable for recognition at the international level to assist Annex I Parties in meeting their quantified economy-wide emission limitation or reduction commitments under the Protocol or their targets under the Convention.

It would fatally undermine the credibility of the UNFCCC regime, and the environmental integrity of the climate change regime, to endorse a fragmented and decentralized approach to the establishment of internationally-recognized offset units. This would raise unsolvable issues and concerns regarding environmental integrity, additionality, transparency, accountability, measurability and verifiability, among others.

Different programmes necessarily suffer from ***different accounting rules, different baseline methodologies, a lack of transparency at the international level and a lack of full international oversight and governance by all Parties***. There is potential for bias and pressure, as both investor and host countries in bilateral partnerships and other partnerships have an interest in ensuring that these programmes generate the greatest number of credits possible.

They also have significant differences in ***scope*** -- with some bilateral offset programmes actively cultivating project types that have not been accepted for inclusion within the CDM or JI, or that are not viewed under the climate change regime as appropriate for inclusion, or necessarily achieving additional or permanent emission reductions.

Some promote investment in ***technologies*** that the international regime has not decided are appropriate for endorsement and subsidization at the international level (nuclear, enhanced oil recovery) or technologies that have raised challenging issues at the international level with respect to additionality (nuclear, enhanced oil recovery, large hydro, super-critical coal) or permanence and leakage (certain LULUCF projects). Some may generate substantial financial benefits to investor nations – only underscoring additionality concerns. Further, some technologies or chemicals with very high Global Warming Potentials (e.g., HFC-23, N₂O) should be regulated by law rather than through market-based mechanisms.

Making matters worse, international recognition of units from disparate programmes would also run the risk of ***double counting*** in many contexts: double counting funds spent on offset

credits for the benefit of investor countries and funds spent as part of Convention obligations (fast-start finance, mobilization of 100bn); double counting of emission reductions by both investor countries and host countries; and double counting reductions from potentially overlapping projects.

Each of these elements would only undermine momentum toward a cost-effective, global carbon market by undermining the fungibility of units, fragmenting the existing market and creating unpredictable swings in market prices and market supply. Moreover, transaction costs would rise for host countries, having to deal with competing programmes with competing rules and multiple bilateral partners.

For these reasons, the only units that should be permitted for use to assist Annex I Parties in meeting their quantified economy-wide emission reduction commitments are those that are:

- ***established at the international level*** by international agreement
- apply ***an internationally-agreed common set of accounting rules***
- employ ***transparent baselines***, agreed at the international level
- operate in ***internationally-agreed sectors***
- have direct ***international oversight***
- remain within the oversight of the COP so that ***programme rules may be altered as necessary*** to ensure environmental integrity

The existing centralized system under the Kyoto Protocol facilitates a global carbon market, allows for the fungibility of units, decreases transactions costs, reduces opportunities for double counting emission reductions, and enables international scrutiny of these units in a way that cannot be achieved through disparate schemes, developed for different purposes, by different players, with different national motivations and different rule sets. There is great room for improvement in the existing mechanisms, but the answer to this is greater centralized regulation at the international level.

5. Non-market-based mechanisms offer a way to avoid double counting, and achieve a net decrease and/or avoidance of GHG emissions

Non-market-based mechanisms may be an efficient way to achieve substantial net global emission reductions in many contexts. Where low-cost or negative-cost mitigation potential exists, or concerns exist around non-permanence, non-market based mechanisms may provide a way to address concerns around environmental integrity. They also provide a means to avoid double counting emission reductions between developed and developing countries, and a means to achieve a net decrease and/or avoidance of GHG emissions.

A variety of non-market-based mechanisms (funds or investments or other approaches that do not result in offsets) can assist in providing developing countries and the private sector with access to the upfront capital needed to realize cost savings and emission reductions. Such programmes may be useful in supporting mitigation efforts where it is difficult to measure emission reductions accurately, or where data may not be sufficiently reliable, as in the forestry sector, and with efforts to reduce emissions from deforestation and forest degradation (REDD+).

Non-market based mechanisms may also be beneficial where the potential exists for a large number of inexpensive emission reduction credits to flood the market if these reductions result in offset credits, decreasing the price signal needed to incentivize more expensive or longer-

term emission reductions. This is increasingly the case with low-cost abatement options for HFCs and N₂O. Use of a non-market based mechanism to address industrial gas projects, which involve high global warming potentials and low abatement costs, may succeed in preventing a glut of credits from reducing carbon market prices. AOSIS is of the view that HFC-23 and N₂O abatement should not continue to be eligible within the CDM after the first commitment period or be eligible in any other market-based offset mechanism, but should instead be subject to domestic and international regulation as nationally appropriate mitigation actions. Other industrial gases with high GWPs present the same difficulty and should also be addressed similarly, rather than through offset mechanisms.

It may be useful for the work programme on standards and approaches to consider how non-market based mechanisms can promote mitigation actions and achieve a substantial net decrease in emissions:

- where investment decisions are likely to be made for reasons other than reducing GHG emissions or generating CERs, and therefore reductions may not be additional (nuclear facilities, large hydro projects)
- where emission reductions result from export promotion schemes that provide a substantial return to the investing country, or where overseas development assistance is involved)
- where efforts are already undertaken for other purposes, demonstrating that they are already cost-effective (negative cost emission reductions, energy efficiency improvement projects or technologies, carbon injection linked to enhanced oil recovery)
- where market-based approaches have already led to perverse incentives to generate additional emissions for reduction (HFC-23 reduction projects) or may perversely lead to increased fossil fuel dependency (coal projects)
- where market-based approaches might lead to leakage (industrial gas and REDD+ projects)⁴
- where reductions may flood the market with low-cost credits, or credits that may not reflect real and additional reductions (e.g., HFC-23 and adipic acid abatement)
- where unavoidable or significant uncertainties exist in emission estimates (LULUCF and REDD+)
- where emission reductions produce a net cost savings to the investor.

Some Parties have expressed concern that the UNFCCC process at present does not operate at a larger scale, or fund certain kinds of projects (REDD+, nuclear, cleaner-coal technologies). The fact that these kinds of projects are not included under the CDM does not prevent Annex I Parties with an interest in these project types from providing substantial funding support to these initiatives if they so choose, consistent with their obligations under Article 4.3 of the Convention.

6. Work programme on standards and approaches to ensure real, permanent, additional and verified mitigation outcomes, avoid double counting of effort and achieve a net decrease and/or avoidance of GHG emissions

This work programme could:

⁴ See "Industrial N₂O Projects under the CDM, Adipic Acid: A Case of Carbon Leakage?", L. Schneider, M. Lazarus, A. Kollmuss (Stockholm Environment Institute, October 9, 2010)

- Consider methodologies and options to ensure substantial net emission reductions, in connection with the new market-based mechanism established under paragraphs 83 and 84 of decision -/CP.17
- Consider ways to use non-market based mechanisms, such as green investment funds, revolving funds, and concessional loans, to deliver measurable, additional emission reductions outside an offsetting context – to ensure no double counting of emission reductions and assist in incentivizing low cost or negative cost reductions
- Consider ways to avoid double counting between project-based mechanisms and emission reductions achieved through funded NAMAs

This work programme could be informed by technical papers from the secretariat, in-session workshops, submissions of views of Parties and other experts.