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UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

**AD HOC WORKING GROUP ON FURTHER COMMITMENTS
FOR ANNEX I PARTIES UNDER THE KYOTO PROTOCOL**

Sixth session

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Item 3 (a) of the provisional agenda

Analysis of means to reach emission reduction targets and identification

of ways to enhance their effectiveness and contribution to sustainable development

Emissions trading and the project-based mechanisms

**Further input in relation to possible improvements to emissions trading and
the project-based mechanisms under the Kyoto Protocol**

Submissions from Parties

Addendum

1. In addition to the five submissions contained in document FCCC/KP/AWG/2008/MISC.7, two further submissions have been received.
2. In accordance with the procedure for miscellaneous documents, these submissions are attached and reproduced* in the language in which they were received and without formal editing.

* These submissions have been electronically imported in order to make them available on electronic systems, including the World Wide Web. The secretariat has made every effort to ensure the correct reproduction of the texts as submitted.

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PAPER NO. 1: AUSTRALIA

AUSTRALIA

Emissions Trading and the Project-based Mechanisms

Submission to the AWG-KP and the AWG-LCA

Australia welcomes the opportunity to submit further views to the AWG-KP and AWG-LCA on possible improvements to the flexibility mechanisms.

Carbon markets are an important means of achieving large-scale emissions abatement in a cost-effective and flexible way. A comprehensive and well-functioning carbon market will assist countries to commit to, and achieve, ambitious mitigation objectives. The expansion and improvement of the flexibility mechanisms are therefore a critical component of an effective post-2012 framework.

Australia submits that the flexibility mechanisms should be developed in line with the following core principles to ensure that they operate as effectively as possible. Specific comments on the proposals contained in annexes I and II of FCCC/KP/AWG/2008/5 are included in the attached paper.

Supportive of ambitious, differentiated mitigation actions

The flexibility mechanisms should be developed to accord with the more ambitious mitigation objectives of the post-2012 framework. To be effective, the post-2012 framework will need to reflect a range of differentiated responses from Parties according to their national circumstances and respective capabilities. The mechanisms will need to support these new commitment structures and provide incentives for enhanced mitigation action by all major economies. Approaches which facilitate national contributions to mitigation projects by host Parties may be one way of progressing such an outcome.

Comprehensive coverage

An effective response to climate change will require all countries and all sectors to be engaged in the task of emissions reduction. It is therefore important that the full range of abatement opportunities are available to the market through the flexibility mechanisms. Technological and methodological improvements since the adoption of the Kyoto Protocol mean there is now much greater scope for measurable, reportable and verifiable abatement through carbon capture and storage and reduced emissions from deforestation and forest degradation (REDD). There is also an opportunity to promote the uptake of land use, land-use change and forestry (LULUCF) activities through improving the rules and procedures associated with them.

Environmental effectiveness

If the flexibility mechanisms are to effectively support mitigation efforts, they must be environmentally effective. It will therefore be important to ensure the emissions reductions associated with them are genuine. This suggests avoiding multiplication factors on Kyoto units.

Not only could multiplication factors distort the market, they could jeopardise the ultimate objective of the Convention.

Care must be taken to avoid perverse outcomes. In this regard, the merit of HFC-23 incineration projects under the CDM is a particular issue. If implemented properly, HFC-23 incineration projects deliver emissions abatement. However, there is some evidence that these projects have resulted in adverse climate and ozone impacts. The AWGs should remain conscious of the potential interaction of these projects with the Montreal Protocol.

Sound governance

Sound governance and institutional arrangements are critical to ensuring that the objectives of the flexibility mechanisms are delivered in an efficient, transparent and accountable way. In the interests of economic efficiency, the governance arrangements should provide as much certainty and predictability for the market as practicable, balanced with the flexibility to respond to changing circumstances and new technologies. In addition, every effort should be made to minimise administrative costs.

Market integrity

In considering improvements to the flexibility mechanisms, the AWGs should be mindful of preserving market integrity. A properly functioning market will facilitate abatement at a lower cost to the global economy because abatement will occur where and when it is most cost-effective. The broader the scope of the market, the more opportunities for emissions reduction will be available. This means that limitations regarding abatement sources and location should be avoided. In addition, increasing banking by eliminating carry-over restrictions on Kyoto units will increase the intertemporal flexibility of the carbon market, which is likely to improve its efficiency.

The flexibility mechanisms are a means of achieving our climate change mitigation objectives. It is essential that they are developed in a way that supports and promotes the broader post-2012 framework. Consideration of improvements to the post-2012 operation of the flexibility mechanisms should therefore not be carried out in isolation from the work being done in other work-streams and, in particular, the AWG-LCA.

To promote consistency and effectiveness, the post-2012 flexibility mechanisms should be available to the widest range of Parties, including those which are Parties to the Convention but not the Kyoto Protocol. Consideration of flexibility mechanisms by the AWG-LCA will facilitate contribution by any such Parties.

The attached paper sets out initial Australian views regarding the policy merit of specific proposals. It does not purport to discuss any potential legal implications of any of the proposals. Discussion of any such implications should be addressed in 2009, in accordance with the AWG-KP work program. In the meantime, it is important that the AWGs consider the policy merits of all proposals for improving the flexibility mechanisms, regardless of their eventual legal form. Prematurely limiting options will impact adversely on the effectiveness of the final post-2012 framework.

ATTACHMENT

Comments on the proposals in annexes I and II of FCCC/KP/AWG/2008/5

ANNEX I

I. A. Include other land use, land-use change and forestry activities

Australia draws attention to its submission to the AWGs on LULUCF. There is an opportunity to promote the uptake of LULUCF activities in the flexibility mechanisms by improving the rules and procedures associated with them. The use of robust, spatially-explicit estimation methodologies would deliver greater confidence in the measurability and verifiability of reductions from the LULUCF sector and, in turn, allow for greater equivalence of units generated from LULUCF activities. Australia recognises that transitioning to such robust methodologies will represent a significant challenge and is ready to assist countries with capacity building and technology transfer to reach this standard of estimation.

Reducing emissions from deforestation and forest degradation in developing countries (REDD) is included under proposal I.A (include land use, land-use change and forestry activities). Australia submits that REDD should be a separate item on the CDM list under Annex I. While related to LULUCF, REDD is a separate issue and is at a different stage of development. A market-based approach to REDD would award credits for avoided deforestation and forest degradation in non-Annex I Party countries, whereas LULUCF rules assign debits for emissions from deforestation in Annex I Parties. Conflating REDD and LULUCF may obfuscate the issues pertinent to each. Australia therefore proposes removing the - “reducing emissions from deforestation and degradation” dot point from the LULUCF note and replacing it with:

“A1. Include reducing emissions from deforestation and forest degradation in developing countries

Note: The following issues, inter alia, may be relevant to consideration of this element:

- *resolution of methodological issues;*
- *resolution of policy issues;*
- *modalities for the inclusion of REDD;*
- *environmental integrity.*

The AWG-KP should also take account of work being done in other processes on this issue, including the AWG-LCA.”

I.B. Introduce a cap for newly eligible land use, land-use change and forestry activities

Australia does not support a cap on eligible LULUCF activities under the CDM. All genuine abatement activities should be included in the flexibility mechanisms without restriction. Placing undue limitations on particular activities will increase the cost of abatement to the global economy.

I.C. Include carbon dioxide capture and storage

Carbon dioxide capture and storage (CCS) is a key technology for reducing greenhouse gas emissions and should not be excluded from the flexibility mechanisms. Fossil fuels, especially coal, will remain major sources of the world’s energy in the coming decades. All major models of how the world can achieve lower greenhouse gas emissions expect a significant part of the reduction to be achieved through the use of CCS. Australia supports discussing this item under both the SBSTA and the AWG-KP.

Australia has recently announced a proposal to establish a Global Carbon Capture and Storage Initiative which includes a Global Carbon Capture and Storage Institute. The Institute will aim to accelerate the development and commercialisation of CCS technology by facilitating demonstration projects, leveraging and sharing experiences, and supporting necessary research. This Initiative will accelerate collective learning on CCS and help in the effort to realise commercial scale CCS plants as soon as possible.

Australia draws attention to its submission to the SBSTA (FCCC/KP/2006/MISC.2) regarding approaches to including CCS in the flexibility mechanisms.

I.E, I.F & I.G Sectoral and NAMAs: proposals

Moving beyond the project-based approach and considering approaches that enable sectoral activities to benefit from private sector investment may be a way of delivering broader technology benefits, as well as larger cuts in emissions. Sectoral approaches may also open up abatement opportunities in sectors which have not been readily accessible using a project-based approach.

Sectoral approaches have the potential to build capacity around national and sectoral inventory capabilities within host countries.

I.H & I.I Environmental integrity and additionality proposals

The requirement to demonstrate additionality has been identified as one of the most resource-intensive steps in the CDM process. Methods to assess additionality through the development of standardised, multi-project baselines and positive lists which grant automatic in-principle approval for technical aspects of well-recognised technologies may assist in improving the efficiency of the approvals process.

Assessment of additionality through negative lists of project activity types should be approached with caution. As noted above, in order to best achieve large-scale emissions reduction at least cost, the flexibility mechanisms should cover as many abatement sources as possible. In cases where the operation of the flexibility mechanisms give rise to perverse incentives, for example where HFC-23 incineration projects prolong the operation of existing HCFC-22 plants or lead to the construction of new HCFC-22 plants, which may affect other international environmental activities, it may be preferable to address these issues directly.

I.J Differentiate the eligibility of Parties through the use of indicators

The mechanisms will need to support new and differentiated commitment structures and provide incentives for enhanced mitigation action by all major economies. Consequently, it may be that purely offsetting approaches will remain most appropriate for certain developing countries and consideration should be given to approaches which facilitate national contributions by more advanced developing economies.

I.K Improve access to clean development mechanism project activities by specified host Parties

It is to be expected that CDM and JI projects will be concentrated in those countries where there is high potential for cost-effective mitigation. However, creating the right enabling environments (legal, social and economic policy frameworks) to promote private investment is of critical importance. It would be valuable for the AWGs to consider lessons learnt from successful host Parties, that could be adopted in other Parties. In addition, Parties may also

wish to consider ways to reduce market barriers to the uptake of project-based activities in certain locations.

Expanding the scope of the flexibility mechanisms to include additional sectors, in particular those relating to LULUCF and REDD, may facilitate a wider geographical distribution of projects.

Mandating where project activities should occur would impede the efficiency of the market and raise the cost of abatement to the global economy.

I.L Include co-benefits as criteria for the registration of project activities

In line with the objective of the Convention, the flexibility mechanisms should remain tightly focused on emissions reduction. While projects should be allowed scope to contribute towards sustainable development and other co-benefits, the introduction of additional mandatory criteria may inadvertently detract from the emissions reduction objective. Host Parties are best placed to determine what constitutes sustainable development and which co-benefits are most appropriate to their circumstances.

I.M Introduce multiplication factors to increase or decrease the certified emission reductions issued for specific project activity types

Market-based approaches deliver least-cost abatement by providing incentives to reduce emissions where this is most cost-effective. It is therefore preferable to allow the market to determine which types of project activity to pursue.

The introduction of multiplication factors also risks undermining the environmental integrity of the mechanisms. It is important that each Kyoto unit accurately represent one tonne of CO₂-e reduced or, given the offset nature of the CDM, emissions will rise.

IV.A Relax or eliminate carry-over (banking) restrictions on Kyoto units

Facilitating increased banking by relaxing carry-over restrictions on Kyoto units will improve intertemporal flexibility and therefore improve the economic efficiency of the market.

IV.B Change the limit on the retirement of temporary certified emission reductions and long-term certified emission reductions

It is important that the post-2012 agreement maximises the LULUCF sector's capacity to reduce emissions and increase removals. The rules regarding credits generated from LULUCF activities has discouraged projects in this sector. The use of robust, spatially-explicit estimation methodologies would deliver greater confidence in the measuring, verifying and monitoring of emissions reductions and potentially allow for greater equivalence among Kyoto unit types.

IV.C Introduce borrowing of assigned amount from future commitment periods

Like banking, borrowing would also improve intertemporal flexibility and therefore improve the economic efficiency of the market. However, long-term borrowing could lead to significant and potentially detrimental delays in the global abatement effort. Australia assesses that this risk outweighs the potential flexibility benefits of any form of long-term or unlimited borrowing. Depending on the eventual form of the post-2012 framework, there may be scope to consider some form of short-term, limited borrowing between commitment periods.

IV.D. Share of proceeds

The flexibility mechanisms are a key mitigation tool. Applying a share of proceeds to the flexibility mechanisms may distort international market price signals and reduce incentives to invest in mitigation projects, negatively affecting the role of the mechanisms in reducing greenhouse gas emissions.

It is important that the international community identify additional means to finance adaptation that are efficient, effective and equitable. However, a discussion on share of proceeds as a means of assisting developing countries to meet the costs of adaptation should not be considered in isolation from the broader discussion on financing adaptation which is to be taken up in the AWG-LCA.

ANNEX II

I.A Introduce a different supervisory structure and institutional arrangement in case of modification to the clean development mechanism

Significant amendments to the clean development mechanism or the introduction of additional mechanisms will require appropriate, and potentially different, supervisory structures and institutional arrangements. These structures and arrangements should be designed in light of the new mechanisms and detailed consideration should be deferred until the precise structure of the reformed flexibility mechanisms is settled.

The new structures should be designed to facilitate the core principles of market integrity, environmental integrity and economic effectiveness. There should be appropriate lines of accountability and processes should be as transparent as possible.

Given the ongoing and increasing importance of the flexibility mechanisms, there may be value in considering revising the governance and institutional arrangements to provide for full-time, professional appointments to the relevant supervisory bodies. Consideration should also be given to strengthening the eligibility criteria for members.

Australia also draws attention to its submission to the Article 9 review on how the current institutional arrangements, governance and rules of procedures of the CDM and joint implementation may be improved in the first commitment period.

I.I Introduce alternative accounting rules for afforestation and deforestation project activities in order to increase demand

Australia suggests this should read "Introduce alternative accounting rules for afforestation and reforestation project activities in order to increase demand". This was the wording from the proposal in the annex II list attached to the Report of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol on its resumed fifth session, held in Bonn from 2 to 12 June 2008.

III.B Enhance equivalence among Kyoto unit types

Australia notes its comments under I.A and IV.A and IV.B of the proposals in Annex II. Reducing unnecessary differences between the rules for carry-over and longevity of different types of Kyoto units would simplify accounting and improve market efficiency.

PAPER NO. 2: JAPAN

Japan's Submission for the AWG-KP
Emission Trading and Project-Based Mechanisms

1. General view

- In the post-2012 international framework, the operation of flexible mechanisms should be more efficient and effective in order to encourage cost-effective mitigation actions. In addition, the current CDM needs significant improvement to reflect differences in the economic development levels among developing countries, and to provide appropriate incentives to their efforts matched with each country's situation, while supporting their sustainable development.
- The annexes to the conclusion of the Accra session contain important elements to achieve such improvements and we should further crystallize the discussion on this basis. For the discussion, a group should be set up to allow both the AWG-KP and the AWG-LCA to jointly discuss flexible mechanisms (e.g. a joint contact or informal group), as they affect all Parties' actions, including those of developing countries.
- Recalling the conclusion of the Bonn session, stating that flexible mechanisms "should be supplemental to the implementation of domestic actions at the disposal of Annex I Parties," the AWG-KP should first identify the domestic measures as means to reach emission reduction targets for Annex I countries, and discuss the mitigation potentials that can be achieved with those measures, giving due consideration of the marginal or total abatement costs. Subsequently, the potential supplemental role of flexible mechanisms should be considered.

2. Views on specific items on the annexes

Annex I

I. CDM

C. Include carbon dioxide capture and storage (CCS)

D. Include nuclear activities

(Basic ideas)

The scope of the flexible mechanisms should be open to any available technology. In this regard, nuclear energy and CCS technologies should be added to the mechanisms. Judgments on actual use of those technologies should be left to the market, and should not be prejudged by pre-established rules. We consider that technology transfer and efficient emissions reduction of global greenhouse gases through the use of the flexible mechanisms are our common goal.

In the *Note* of section I.D of Annex I, 3S (nuclear non-proliferation/safeguards, safety and security) are specified as issue which may be relevant to consideration of the CDM. As ensuring 3S is a prerequisite for the introduction of nuclear power, the following points need to be addressed when nuclear energy becomes eligible for the CDM:

- how a country which considers introducing nuclear power should make efforts to ensure 3S; and
- how advanced countries with peaceful use of nuclear energy should support such efforts.

E. Introduce sectoral clean development mechanisms for emissions reductions below a baseline defined at a sectoral level

F. Introduce sectoral crediting of emission reductions below a previously established no-lose target

(Basic ideas)

Introduction of sectoral CDM and sectoral crediting mechanisms should be further considered as means to urge further efforts of emission reductions by developing countries on a sectoral basis. The section I.F. of Annex I of the Accra conclusion contains a description of financial incentives and nature of targets (as no-lose targets), but Parties may have different views on the design of these matters and should not make prejudgments at this stage. Therefore, we request that the description be deleted and instead add the relevant items to *Note (items to be considered further)*. Further consideration is needed for means to set emission reduction targets. The mechanisms may cause adverse effects such as low level of credibility of credits and environmental integrity, and lack of international fairness within a certain sector, depending on eligible sectors and facilities, measures of setting baselines or targets, measures of assessing the validity of targets, means for measurement, report and verification of actual emissions, etc. These problems should be firmly addressed in designing the mechanisms.

(Additional input to the section I.E. and I.F. of Annex I)

Delete: "The Party may receive upfront financing, technology and credits for verified emission reductions below the target. There shall be no consequences for a party that does not meet its approved target."

Add the following items to *Note*:

- Qualification for eligible sectors, facilities and project activities
- Nature of emission reduction targets
- Promotion of improvement of sectoral efficiency
- Measure to ensure international fairness within a certain sector
- Effectiveness of facilitating actions by developing countries
- Assessment of validity of targets by a third party
- Verification of emissions by a third party

(Additional input to the section I.F. of Annex I only)

Add the following item to *Note*:

- Measures to be taken when a Party does not meet its approved target

H. Ensure environmental integrity and assess additionality through the development of standardized, multi-project baselines

(Basic ideas)

Under the current mechanism, strict and complex processes with various methodologies and methodological tools have been developed to demonstrate additionality. The principle of additionality, however, should be reviewed once again, reverting to the provision of the Kyoto Protocol. Utilizing the past experience and knowledge gained under the current mechanism, we should redesign it with due consideration of the accessibility for the project

operators. For this purpose, opportunities to reflect views of users should be provided in the process of designing the mechanism.

(Additional input to Annex I, I.H)

Add the following item to *Note*:

- Measures to reflect views of users of the mechanism

J. Differentiate the eligibility of Parties through the use of indicators

(Basic ideas)

As there are growing differences among non-Annex I Parties in the impact on climate change and the capacity to respond, non-Annex I Parties should be classified in accordance with their economic development stages etc. with the principle of equity and identify actions to be taken by each category, and measures and assistance to respond to them should be made accordingly. As the idea of “differentiation” has already been discussed in the AWG-LCA, differentiation of the eligibility of CDM should be designed consistent with the above ideas.

(Additional input to the section I.J. of Annex I)

Add the following items to *Note*:

- Process to define eligible countries
- “Graduation”

L. Include co-benefits as criteria for the registration of project activities

(Basic ideas)

In reforming the flexible mechanisms, it is important to introduce a scheme to promote measures to cope with climate change while materializing other developing countries’ needs (co-benefits approach). Including co-benefits in the criteria for the registration of project activities can provide incentives for enhancing an additional contribution to promote sustainable development for the project-based mechanisms in which many countries including developing ones are interested. Therefore, we support Option 1, which allows preferential treatments for specific co-benefits projects.

Option 2, which suggests all projects must demonstrate co-benefits and be verified by a DOE, should not be adopted, because this option may constrain flexibility in project-based mechanisms. Air pollution, water pollution, and waste management can be representative areas of co-benefits, in that many CDM projects provide co-benefits as well as GHG reduction and limitation and their direct effects are measurable. Combination of preferential treatments such as reducing financial burden and giving priority in the registration processes should be considered in order to avoid too much burden on MRV. In addition, scale thresholds should be taken into account, as relatively small co-benefits from projects possibly produce much burden on their assessment.

(Additional input to the section I.H. of Annex I)

Add the following items to *Note*:

- (“air quality” to be replaced by) Improvement of air quality, water quality and waste management
- Consideration of scale thresholds (e.g. thresholds can be set in accordance with project-types.)

Annex II.

I.CDM

I. Introduce alternative accounting rules for afforestation and deforestation project activities in order to increase demand

(Clarification)

The term 'deforestation' might be misspelt for 'reforestation'.

(Basic ideas)

Japan is concerned with the current situation where very limited number of afforestation and reforestation CDM projects have been realized. The carbon accounting and related concepts including additionality, project boundary and land-eligibility should be reviewed in order to enhance the practicability of and increase the demand of the afforestation and reforestation CDM projects.

(Additional input to the section I of Annex II)

The term 'deforestation' should be replaced with 'reforestation'.

L. Include technology transfer as a criterion for the registration of project activities.

(Basic ideas)

Preferential treatments should be considered to projects that promote technology transfer to developing countries. These treatments may include, for example, the exemption of financial burden and priority in the registration processes, etc. In this regard, the underlying activities of the technology transfer, including contributions to capacity-building, and their effects should also be subjected to project evaluation, as they contribute to future emissions reductions.

3. Legal issues

- Japan thinks that legal analysis is needed to determine which elements in Annex I to the conclusion of the Accra session would require a decision of the CMP or an amendment to the Kyoto Protocol and that discussion of issues which possibly require amendments to the Kyoto Protocol as a result of such analysis is within the mandate of the AWG-KP which considers "commitments for subsequent periods" (Article 3, paragraph 9).
- Japan is proposing to establish a legal expert group to consider legal issues arising from both the AWG-KP and the AWG-LCA, and the issue of flexible mechanisms should also be taken up by this group.

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