

**Views of the Edison Electric Institute (EEI)  
on New Market-based Mechanisms  
As Contained in**

**Decision \_\_\_/CP.17 on “Outcome of the work of the Ad Hoc Working Group on Long-term  
Cooperative Action under the Convention”**

**March 5, 2012**

In response to the invitation for stakeholder views on using markets to enhance the cost-effectiveness of, and to promote, mitigation actions – contained in section II.E of the draft decision (\_\_\_/CP.17) on “Outcomes of the work of the Ad Hoc Working Group on Long-term Cooperative Action (AWG-LCA) under the Framework Convention on Climate Change (FCCC),” which was adopted by the Conference of the Parties at its 17<sup>th</sup> session (COP-17) – the Edison Electric Institute (EEI) welcomes the opportunity to submit these comments. In particular, section II.E of the AWG-LCA Outcomes Decision addresses various approaches for “Enhanced Action on Mitigation,” including opportunities for using markets in furtherance of such action.

Specifically, paragraph 81<sup>1</sup> of the above-referenced AWG-LCA Outcomes Decision invites Party and non-governmental organization (NGO) views on the matters referred to in preceding paragraphs 79 and 80, including positive and negative experiences with “existing approaches and mechanisms as well as lessons learned,” while paragraph 85 invites such views on paragraphs 83 and 84 of that decision. See Attachment. The stated objective of this section of the decision is

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<sup>1</sup> Paragraph numbers referred to in this paper are taken from the advanced unedited version of the draft decision on the “Outcome of the work of the [AWG-LCA],” posted as of February 17, 2012, at <http://unfccc.int>.

for the AWG-LCA to recommend to COP-18 decisions on a framework for such approaches and on a work program to elaborate modalities and procedures for the new market-based mechanism referred to in paragraph 83.

EEI is the trade association of U.S. shareholder-owned electric companies and has international affiliate and industry associate members worldwide. Our U.S. members serve 95 percent of the ultimate customers in the share-owned segment of the industry and represent about 70 percent of the electric power industry in the U.S. EEI is also a credentialed NGO to the FCCC whose representatives attended COP-17 at Durban, South Africa.

## **I. Background**

One of the key decisions adopted at COP-17 – the AWG-LCA Outcomes Decision – builds on the adoption at COP-16 of the Cancun Agreements (1/CP.16), including section III.D of that decision on use of market-based mechanisms.<sup>2</sup> The AWG-LCA Outcomes Decision also extends the term of the AWG-LCA through 2012 in order to complete its work “and reach agreed outcomes pursuant to Decision 1/CP.13 (Bali Action Plan).”

We understand from the AWG-LCA chair’s conclusions at COP-17 that the LCA work to be completed includes, in the case of market-based mechanisms, the unfinished implementation

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<sup>2</sup> Both the heading of section III.D of 1/CP.16 and the heading of section II.E of the COP-17 decision are identical, both referring to “Various approaches, including opportunities for using markets,” regarding “mitigation actions.” However, in the case of paragraphs 80-85 of the COP-16 decision, there is no reference to the words “various approaches,” although these words do appear in paragraphs 79-80 of the COP-17 Outcomes Decision. The word “approaches,” coupled with the word “including,” suggests that the section is focused, at least in part, on more than just market-based mechanisms. EEI’s comments focus on the development and use of market-based mechanisms.

tasks and issues of section II.E.<sup>3</sup> The preamble to section II.E of the AWG-LCA Outcomes Decision provides that the “existing flexible mechanisms established under the Kyoto Protocol” (KP) are to be maintained and any new mechanisms would “build upon” – but not necessarily replace – the KP mechanisms. The preamble also notes that the Parties may, individually or jointly, develop and implement various approaches to enhance mitigation actions “in accordance with their national circumstances.”

## **II. EEI Views**

### **A. General Views**

Market-based mechanisms are an important policy tool often used in national programs to help maximize the cost-effectiveness of the programs and minimize the economic impacts of reducing greenhouse gas (GHG) emissions. Parties should be equally capable of applying such mechanisms in the case of international multilateral action. Thus, in general, EEI supports the development of new flexible, technologically neutral, market-based mechanisms in such a fashion that allows each Party to adopt the use of such mechanisms in accordance with its national governance and priorities. Further, all countries should have the opportunity to embrace one or more of them, consistent with national or regional circumstances, such as the level of capacity for implementation, country preference, economic sector and technology, and their fit with national policies and programs.

The most efficient way to reduce (GHG) emissions nationally, regionally and globally is through economy-wide approaches. If there are exemptions and only one or a few sectors are covered,

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<sup>3</sup> The AWG-LCA thus far has only one scheduled session in May 2012 in which to carry out its mandate.

the odds of achieving environmental success would decline and the costs of action would climb significantly. New market-based mechanisms, in general, should be available to all sectors of the economy and to play a significant part in reducing emissions in countries and regions that choose to employ them in creating market signals and actions to stimulate technology development and deployment. In short, market mechanisms have the potential to enhance the cost-effectiveness of mitigation actions, and should be encouraged.

The U.S. electric power sector has experience with the use of emissions trading. In particular, the introduction of the U.S. sulfur dioxide (SO<sub>2</sub>) allowance trading program in 1990 to address the acid rain issue is seen by many as a significant development in environmental regulation. Lessons learned from that program could help inform the creation of new market-based mechanisms under the FCCC. The program is generally regarded as a success, though not without flaws, which helped demonstrate that, when properly designed, emissions trading can be used to achieve significant emissions reductions at a much lower cost than would be incurred under a traditional regulatory approach. This view of the SO<sub>2</sub> allowance trading program is supported by numerous analyses, including a recent study by Resources for the Future, which concludes that emissions trading “seems especially well suited to addressing the problem of climate change.”<sup>4</sup>

B. Paragraphs 79-81

Regarding the AWG-LCA’s work on market-based mechanisms at COP-17, we understand that the provisions of section II.E of Decision \_\_\_/CP-17 largely stem from paragraphs 80 and 81 of

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<sup>4</sup> G. Chan et al., The SO<sub>2</sub> Allowance Trading System and the Clean Air Act Amendments of 1990: Reflections on Twenty Years of Policy Innovation, at 32, Harvard Environmental Economics Program, Cambridge, MA (Jan. 2012).

the Cancun Agreements. Those paragraphs mandated the AWG-LCA to consider and elaborate on the establishment of one or more market-based mechanisms regarding mitigation actions with the objective of recommending a decision thereon at COP-17.<sup>5</sup>

However, the COP-17 decision no longer calls for either the consideration or elaboration of the “establishment” of any market-based mechanism. This is a welcome change, particularly in light of the decisions adopted at COP-17 launching a process for the development of a protocol, another legal instrument or a legal outcome under the FCCC for 2015 through the creation of a new subsidiary body (SB). Efforts towards immediately establishing market-based mechanisms on a separate track from the new negotiating process would tend to presuppose some of the outcomes of that process, possibly even before the new SB has an opportunity to plan its work. Clearly there should be interest in exploring various options regarding such new market-based mechanisms. They could be accomplished through the request in paragraph 80 for a program to consider a framework for such mechanisms.

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<sup>5</sup> Paragraph 80 of the Cancun Agreements, which is referred to in paragraph 83 of the Durban Outcomes Decision, adds that such consideration “should take into account the following:

- (a) Ensuring voluntary participation of Parties, supported by the promotion of fair and equitable access for all Parties;
- (b) Complementing other means of support for nationally appropriate mitigation actions by developing country Parties;
- (c) Stimulating mitigation across broad segments of the economy;
- (d) Safeguarding environmental integrity;
- (e) Ensuring a net decrease and/or avoidance of global greenhouse gas emissions;
- (f) Assisting developed country Parties to meet part of their mitigation targets, while ensuring that the use of such a mechanism or mechanisms is supplemental to domestic mitigation efforts;
- (g) Ensuring good governance and robust market functioning and regulation;”

That framework, too, should afford broad flexibility for developed and developing country Parties to design new such mechanisms that account for the Parties' national circumstances, including their regulatory and policy requirements, while ensuring that they are consistent with the several listed characteristics of paragraph 80 of the Cancun Agreements.

C. Paragraphs 83-85

Paragraph 83 apparently is intended to define a new market-based mechanism as operating under COP guidance and authority to enhance cost-effectiveness of, and promote, mitigation actions, considering the different circumstances of developed and developing countries. This new market-based mechanism is also to be guided by paragraph 80 of the Cancun Agreements and, subject to conditions to be elaborated, may assist developed countries in meeting part of their FCCC mitigation targets or commitments. The apparent call for both guidance and conditions is vague and uncertain. One presumably would be advisory in nature, while the other would likely be mandatory. It is unclear why both are needed in the context of such a mechanism. COP guidance should be sufficient.

Most importantly, the paragraph's reference to developed country mitigation targets or commitments under the FCCC is inconsistent with the COP-17 decision referred to above to launch a process for the development of a new protocol, another legal instrument or a legal outcome under the FCCC, which does not refer to targets or commitments under the FCCC for either developed or developing country Parties. The terms used in that decision are "mitigation," "actions," "range of actions" and "level of ambition."

Paragraph 84 requests the AWG-LCA to conduct a work program to elaborate modalities and procedures for the mechanisms referred to in paragraph 83. While such a program might elaborate on some modalities and procedures on new market mechanisms, such elaboration should be general in outline, practical and reflective of the lessons learned from the application of such mechanisms (under the FCCC and KP), not prescriptive or inhibiting of options. Prescriptive or inhibiting modalities and procedures are likely to limit Party flexibility in designing and implementing mechanisms that may be the most efficient, effective and innovative, while suitable to their national regimes. In this vein, Parties should build a system that allows for maximum flexibility in achieving reductions, and limit the use of standards or fees in conjunction with the use of different approaches, including new market-based mechanisms. Furthermore, the use of standards or fees may not work together with the use of market-based approaches. Parties should also look to lessons learned from the clean development mechanism (CDM), including the impacts of limiting project types, complementarity requirements and other restrictions on the use of market-based mechanisms.

The role of such approaches should be to encourage the entrepreneurial innovation of the private sector and encourage its engagement and participation, not from a compulsory regulatory standpoint, but because it is in the interest and benefit of that sector, both at the national and international levels.

Any modalities and procedures, and any framework, should also be technology neutral and recognize that Parties may have their own technology objectives fashioned by such matters as

their knowledge, expertise, geographic and natural circumstances, natural resources, and historic and economic circumstances.

D. Paragraph 79 Standards

Paragraph 79 emphasizes that the various “approaches, including using markets,” must meet specific standards, namely, that they deliver real, permanent, additional and verified mitigation outcomes, avoid double counting of effort, and achieve a net decrease or avoidance of GHG emissions. While it is reasonable to expect that emissions reductions are real, permanent and verifiable, it would be better not to require, in advance of their development, that new mechanisms meet an overly prescriptive list of standards, particularly ones that may not be well defined. Such standards may be appropriate for the KP’s CDM, but it does not necessarily follow that they would be appropriate or necessary for all new mechanisms, particularly in light of the characteristics in paragraph 80 of the Cancun Agreements.

Attachment



**Excerpt from Draft Decision on the Outcome of the Work of the AWG-LCA**  
*(Advanced unedited version)*

79. *Emphasizes* 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;

80. *Requests* the Ad Hoc Working Group on Long-term Cooperative Action under the Convention 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. . . .

83. *Defines* a new market-based mechanism, operating under the guidance and authority of the Conference of the Parties, to enhance the cost-effectiveness of, and to promote, mitigation actions, bearing in mind different circumstances of developed and developing countries, which is guided by decision 1/CP.16, paragraph 80, and which, subject to conditions to be elaborated, may assist developed countries to meet part of their mitigation targets or commitments under the Convention;

84. *Requests* the Ad Hoc Working Group on Long-term Cooperative Action under the Convention to conduct a work programme to elaborate modalities and procedures for the mechanism referred to in paragraph 77 above, with a view to recommending a decision to the Conference of the Parties at its eighteenth session. . .

(Emphasis added.)