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UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

SUBSIDIARY BODY FOR SCIENTIFIC AND TECHNOLOGICAL ADVICE
Eighth session
Bonn, 2 - 12 June 1998
Agenda item 6 (b) and (c) and 8 (b) to (d)

SUBSIDIARY BODY FOR IMPLEMENTATION
Eighth session
Bonn, 2 - 12 June 1998
Agenda item 8 (b) to (d)

PREPARATORY WORK NEEDED FOR THE FOURTH SESSION OF THE CONFERENCE OF THE PARTIES ON THE ITEMS LISTED IN DECISION 1/CP.3, PARAGRAPH 5

Submissions by Parties

Addendum

1. In addition to the submissions already received and contained in documents FCCC/SB/1998/MISC.1 and Add. 1 and 2, two further submissions have been received.

2. In accordance with the procedure for miscellaneous documents, these submissions are reproduced in the language in which they were received and without formal editing.

CONTENTS

PAPER NO.1: INDONESIA
(on behalf of the Group of 77 and China)

POSITION PAPER OF THE GROUP OF 77 & CHINA ON THE MECHANISM OF THE KYOTO PROTOCOL FOR THE SECOND MEETING OF THE CONTACT GROUP ON MECHANISM

The Group of 77 & China recalls the principles of the United Nations Framework Convention on Climate Change, and affirms that any international mechanism being introduced through the Convention or the Kyoto Protocol to the Convention should be in conformity with the principles of the Convention. The rules governing the mechanisms, namely, activities implemented jointly, joint implementation, clean development mechanism and emission trading should be determined on the basis of equity, sustainable development and the other principles of the Convention. The mechanisms are off-shore measures. It has to be ensured that their design does not in any way compromise the modification of longer-term trends in anthropogenic emissions, consistent with the objective of the Convention. The mechanisms should be supplemental to domestic action. The greenhouse gas reductions achieved should be real and verifiable.

2. The new mechanisms indicated in the Kyoto Protocol are yet to be defined in terms of principles and modalities, rules and guidelines. Presently, these mechanisms are immersed in uncertainty. An important reason why this is so is because preparatory work was lacking on these mechanisms during the negotiations related to the Kyoto Protocol. With respect to the clean development mechanism and emission trading, there was no preparatory work. In any case, there are very complex and intricate methodological, technical, legal and institutional questions requiring addressal.

3. It was in this background that the Group of 77 & China had taken the position during the Kyoto negotiations that until these questions were resolved, joint implementation and emission trading should not be introduced. In respect of emission trading, the Group of 77 & China had stated that until the question of emission rights and entitlements is addressed equitably, it would not be possible to have emission trading. The question of the legal and equitable basis of entitlements continues to occupy a central position. In view of the highly complicated nature of the issues confronting the parties, the course of action should be to make due endeavour to identify the questions for the purpose of discussion and resolution. For this, preparatory work is needed.

4. The Convention secretariat can contribute to this preparatory work. It was in this light that the Chairmen of the Subsidiary Bodies were requested (Decision 1/CP.3) to give guidance to the secretariat on the preparatory work needed for consideration by the Conference of the Parties. Due thought and effort is needed to identify the issues. This cannot and should not be rushed. A significant disadvantage confronting developing countries is that they lack know-how. Discussion and debate cannot proceed if the parties lack the requisite understanding of the issues being negotiated. It is imperative that the Group of 77 & China have an understanding of the issues because the Group, which

combines the insights and perceptions of a very large body of developing economies, is, as always, keen to contribute to discussions on climate change. More preparatory work will help in this regard.

5. The preparatory work should be conducted so that the methodological questions are addressed first. The prevailing uncertainties must be removed. Without proper addressal of the methodological questions, it will not be possible to have discussions on substantive issues. The time for discussions on substantive issues will come later. The methodological questions should be addressed and responded to by the Subsidiary Body for Scientific and Technological Advice.

6. There should be no prioritisation or hierarchy assigned to the mechanisms. All the mechanisms have to be examined on the basis of the principles of equity, sustainable development, the other principles of the Convention, and in the light of the objectives of the Convention.

7. AIJ is in the pilot phase, a comprehensive review of which should take place in accordance with COP decisions, with further course of action to be decided subsequent to review by the COP.

8. The conception and design of the mechanisms should rest with the Conference of the Parties to the Convention, assisted by the SBSTA and the SBI in accordance with their division of labour in the Convention. The COP is the highest decision making body of the Convention. The COP also has valuable experience in respect of the implementation of the Convention and its requirements. Very importantly, the COP has the fuller-term insights of the parties to the Convention. The merging trend, wherein other international multilateral agencies, are also getting involved in the conduct of workshops, etc. on the mechanisms is viewed with concern by the Group of 77 & China. This trend is pre-judging the outcome of the Convention process.

PAPER NO.2: UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (on behalf of the European Community and its member States and Czech Republic, Slovakia, Croatia, Latvia, Switzerland, Slovenia, Poland and Bulgaria)

NON-PAPER ON PRINCIPLES; MODALITIES; RULES AND GUIDELINES FOR AN INTERNATIONAL EMISSIONS TRADING REGIME

(as part of detailed comments on the mechanisms)

Purpose

1. This paper sets out the preliminary views of the European Community, Austria, Germany, Finland, Portugal, France, Sweden, Belgium, Spain, Denmark, Greece, Italy, Ireland, The Netherlands, Luxembourg, United Kingdom, Czech Republic, Slovakia, Croatia, Latvia, Switzerland, Slovenia, Poland and Bulgaria on the principles, modalities, rules and guidelines which should provide the framework for international emissions trading. The above Parties believe that trading, CDM and JI should be developed in parallel and the frameworks for them should be consistent with each other. However, this paper refers to international emissions trading. It is intended as a basis for the on-going discussion on the development of an open international emissions trading system.

2. This paper includes some key technical elements that can be already presented as potential rules, modalities and guidelines and others which are also necessary to provide for an effective and efficient trading system but have to be further developed.

Summary of the draft international emissions trading system

Principles

3. Recalling the principles and objectives of the United Nations Framework Convention on Climate Change, and the Kyoto Protocol, the international emissions trading system shall be designed to contribute to the achievement of real, cost-effective and verifiable environmental benefits whilst ensuring that:

(i) trading of "hot air" should not lead to overall reductions being lower than would otherwise be the case;

(ii) trading is supplemental to domestic action for the purposes of meeting commitments under Article 3* (in accordance with Article 17); and

(iii) the emissions trading system is transparent, accessible and verifiable, functions in a non-discriminatory manner, and does not lead to distortions of competition.

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* Any reference to an ‘Article’ or ‘Articles’ in this paper refers to Articles of the Kyoto Protocol unless otherwise stated.

4. The above Parties believe that the rules, modalities and guidelines need to be defined before international emissions trading can begin.

Implementation of Principles governing the international trading system

Supplementarity:

5. We believe that domestic actions should provide the main means of meeting commitments under Article 3. This is consistent with the ultimate objective of the Convention. In this context a "concrete ceiling" on the use of all the flexible mechanisms has to be defined. In addition, Article 17 states that international emissions trading "....shall be supplemental to domestic actions for the purpose of meeting quantified emission limitation and reduction commitments....". The rules governing the international emissions trading system should reflect this principle.

6. We have not yet come to a firm view on as to how the ceiling should be defined and welcomes discussion with other delegations. The ceiling could be defined in relation to a number of variables, including: the assigned amount, 1990 emission levels, or required efforts by a Party.

Environmental effectiveness:

7. The above Parties believe that international emissions trading should ensure that real emissions reductions are delivered at lower cost, and that the trading of 'hot air' should not lead to overall reductions being lower than would otherwise be the case.

This could require that:

Net transfers by a Party shall not be greater than the amount of emissions reduced by that Party as a result of domestic action.

A Party's compliance with this rule shall be the subject of expert review under Article 8.

Emissions trading market

8. We believe that there should be an open and transparent emissions trading market subject to the modalities, rules and guidelines as set out below.

Modalities, Rules and Guidelines

Eligibility

9. Parties with commitments listed in Annex B of the Kyoto Protocol shall be eligible to transfer or acquire parts of assigned amounts if they:

(a) are in compliance with Articles 5 and 7**;

(b) have adopted and ratified a compliance regime under Article 18;

(c) have a national system for tracking transfers and acquisitions of parts of assigned amount by the Party itself, and by any legal entities it may choose to authorise (consistent with paragraphs 10, 15 and 16 below);

(d) can demonstrate their compliance with the rules of the emissions trading system, as set out in the paragraphs below.

Parties' implementation of the requirements of this paragraph shall be the subject of expert review under Article 8.

Unit of transfer/acquisition

10. The tradeable unit would be parts of assigned amounts, (as defined under Article 3) which this paper will refer to as PAA units. Transfers and acquisitions of PAA units shall be denominated in metric tons of CO2 equivalent, calculated using the global warming potentials defined by decision 2/CP.3 or as subsequently revised in accordance with Article 5.3. One PAA unit would be equal to one metric tonne of CO2 equivalent emissions.

11. All PAA units shall have a unique serial number that reflects the country of origin and the commitment period for which the assigned amount was first established. PAA units would be valid until used to offset emissions for the purposes of contributing to compliance (i.e. once used to offset emissions, PAA units would be retired from the trading system). PAA units acquired by a Party would be added to the Party's assigned amount unless the PAA units are subsequently invalidated as set out in paragraph 22 below. Similarly, PAA units transferred by a Party would be subtracted from its assigned amount.

12. A Party whose emissions are in excess of its assigned amount in any commitment period may acquire, but may not transfer, PAAs.

Entitlement to trade

13. All eligible Parties can trade.

14. The Protocol is silent on the subject of whether legal entities can participate in the international trading system under Article 17. However, the participation of legal entities has several economic advantages. If authorised legal entities are permitted to participate in international emissions trading, the Party, and not its authorised legal entities, will remain responsible for compliance with its commitments under the Protocol.

** The EU assumes that the existing accounting and reporting requirements are enhanced appropriately and that only Parties which fulfil such requirements are eligible to trade.

15. If legal entities were permitted to trade internationally, it would be essential to govern the monitoring, verification, accountability and compliance of sub-national legal entities. In addition, the manner in which Parties allocate PAA units to their legal entities should not contravene Article 3.5 of the Convention and, therefore, should avoid arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

Recording and Reporting of Trades

16. The UNFCCC Secretariat shall make information on the Parties that are eligible to participate in international trade publicly available. Each Party shall maintain a record of names and contact details of authorised legal entities within its jurisdiction that it authorises to trade, and such information shall be made available both to the UNFCCC Secretariat and to the public.

17. Parties shall track and record information on all transfers of PAA units by authorised legal entities within their jurisdiction. This information should include the amount and serial numbers of the PAA units transferred, and identify the entities and their authorising Parties between which the transaction has taken place.

18. Parties shall report, at least annually, to the UNFCCC secretariat (or an authority designated by the COP) the amount and serial numbers of the PAA units and the counterparts of all transfers and acquisitions that result in changes to their assigned amounts, including those involving legal entities. Parties shall verify to the UNFCCC Secretariat (or an authority designated by the COP) that a legal entity transferring PAA units was the registered owner of the PAA units in question.

19. The UNFCCC secretariat (or an authority designated by the COP) shall produce, on an annual basis, a tabulation of the adjustments to assigned amounts required under Articles 3.10 and 3.11 for each Party that has carried out transfers or acquisitions of PAA units.

Market mechanisms and information:

20. There are a number of ways in which the emissions trading market could be organised. The following sets out the main options (these provisions could also apply to legal entities):

(a) **Auction**. Any transfers or acquisitions by a Party shall be carried out through open, competitive bidding accessible to all Parties.

(b) **Prior notification**. Parties shall notify the UNFCCC of their intention to transfer or acquire PAA units prior to any transfer/acquisition, and the UNFCCC Secretariat shall make such information available to all other eligible Parties. This could be limited to transfers/acquisitions above a specified amount.

(c) **Use of available market mechanisms**. Transfers and acquisitions by Parties may be carried out directly or through any mechanisms to facilitate transfers such as brokers, exchanges, or auctions.

Sharing of risks of non-compliance under the international emissions trading system:

21. Rules about risk-sharing and legal liability will need to be elaborated, in order, inter alia, to provide compliance incentives and to improve the quality of Parties' monitoring systems. This section sets out the main parameters.

22. Party which is found to be in non-compliance with its obligations under Article 3 will face compliance procedures under Article 18. If such a Party has transferred PAA units to any other Party, the units transferred should be invalidated in part, or in full, for the purposes of meeting the commitments of the acquiring Parties under the Protocol. Otherwise, Parties could have no incentive not to buy PAA units from Parties they expected to be in eventual non-compliance. Modalities for invalidation of PAA units transferred under these circumstances will need to be further explored. However, if a Party finds itself in non-compliance due to the full or partial invalidation of acquired PAA units, it may be appropriate for that Party to face less stringent penalties than the seller Party.

Compliance with trading rules

23. If a question of compliance by a Party included in Annex B of the rules of the trading system as set out in the paragraphs above is identified, transfers and acquisitions of assigned emission units may continue to be made after the question has been identified, provided that any such units may not be used by a Party to meet its commitments under Article 3 until any issue of compliance is resolved.

Changes (i.e. participants, trading rules etc.):

24. Any rules, modalities and guidelines for emissions trading shall be open to review by the Parties and may be modified as appropriate by a COP.

25. Changes in trading principles, modalities, rules, and guidelines shall only take effect in commitment periods subsequent to that of their adoption. Changes in Parties' eligibility to trade or changes pertaining to new entrants that meet the eligibility criteria may occur during the current commitment period.

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