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Items 4 (f) and 5 (a) (ii)-(iv) of the provisional agenda

MATTERS RELATED TO DECISION 1/CP.3 PARAGRAPH 5

Article 6 of the Kyoto Protocol

Article 12 of the Kyoto Protocol (clean development mechanism)

Article 17 of the Kyoto Protocol (international emissions trading)

ACTIVITIES IMPLEMENTED JOINTLY

Compilation of submissions by Parties

1. At their eighth sessions, the Subsidiary Body for Scientific and Technological Advice (SBSTA) and the Subsidiary Body for Implementation (SBI) "invited Parties to submit views on the mechanisms referred to in decision 1/CP.3, paragraph 5 (b), (c) and (e)" (see FCCC/SBSTA/1998/6, para. 63 (e) and FCCC/SBI/1998/6, para. 49 (e)). Some Parties also submitted views on the pilot phase of activities implemented jointly.

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

3. Any further submissions received will be issued in an addendum to this document, to be made available at the fourth Conference of the Parties.

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* Including the ninth sessions of the Subsidiary Body for Scientific and Technological Advice and the Subsidiary Body for Implementation.

** In order to make these submissions available on electronic systems, including the World Wide Web, some of these contributions have been electronically scanned and/or retyped. The secretariat has made every effort to ensure the correct reproduction of the texts as submitted.

FCCC/CP/1998/MISC.7

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PAPER NO. 1: AUSTRIA

(on behalf of the European Community and its member States
and Bulgaria, Croatia, Czech Republic, Estonia, Hungary,
Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Switzerland)

NON-PAPER ON THE CLEAN DEVELOPMENT MECHANISM (CDM)

Decision 1/CP.3 sets one specific task for CoP 4 in relation to the CDM, which is to consider the implications of early crediting. This is important, but should be seen in the wider context of making the CDM truly effective and operational in promoting long term reductions of greenhouse gas emissions and sustainable development. Therefore, modalities and procedures should be established as soon as possible, be developed in parallel and be consistent for all flexible mechanisms. In this context, the principle of supplementarity as described in the Non-papers on emissions trading (FCCC/SB/1998/MISC.1/Add.3/Rev.1) and Joint Implementation (FCCC/SB/1998/MISC.1/Add.6) is also relevant for the CDM.

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 and Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Switzerland on these modalities, procedures and guidance.

The European Community, Austria, Germany, Finland, Portugal, France, Sweden, Belgium, Spain, Denmark, Greece, Italy, Ireland, The Netherlands, Luxembourg, United Kingdom and Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Switzerland are looking forward to hear other Parties' views, and especially those of non-Annex I Parties, on these issues and expect a fruitful dialogue. This paper includes some elements that can already be presented as potential principles, modalities and procedures and others which are also necessary for an environmentally effective and efficient CDM but have to be further developed.

The European Community, Austria, Germany, Finland, Portugal, France, Sweden, Belgium, Spain, Denmark, Greece, Italy, Ireland, The Netherlands, Luxembourg, United Kingdom and Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Switzerland propose that COP 4 should agree on key principles and should agree terms of reference and a timetable for further work by the COP, the Subsidiary Bodies and the UNFCCC Secretariat.

I. Principles and eligibility

1. The operation of the CDM should be guided by the following principles:

a) The CDM shall assist developing countries in achieving sustainable development and in contributing to the ultimate objective of the Convention and shall assist

Parties included in Annex I in achieving compliance with their quantified emission limitation and reduction commitments.

b) In accordance with Art. 12.3 (b) only a part of emission limitation and reduction commitments under Art. 3 can be met through certified emission reductions accruing from CDM projects. This provision is necessary because emission reductions achieved under the CDM lead to an expansion of the overall assigned amount of Annex I Parties. The part shall be determined in a way which ensures that Annex I Parties overall still achieve a significant reduction in their emissions domestically.

c) CDM project investment should be distinct from and not compete with ODA and GEF funding.

d) The CDM should work in an effective, efficient, transparent, accessible, non-discriminatory and accountable manner and should not lead to distortion of competition.

e) The CDM should encourage investment, in particular private sector investment in emission reductions in non-Annex I countries and become an incentive for capacity building, as well as development and transfer of environmentally sound technologies and practices.

f) Further work on the CDM should:

- be carried out in parallel and be consistent with work on JI and emissions trading
- take full account of work and experience of relevant bodies, such as the IPCC, the UNFCCC Secretariat, the GEF and its Implementing Agencies, and of the experience gained under the AIJ pilot phase.

2. Project Eligibility

a) CDM projects should be consistent with the sustainable development needs and priorities of the host country.

b) CDM projects shall provide emission reductions that are additional to any that would otherwise occur (Art. 12.5). CDM projects should lead to real, measurable and long-term benefits related to the mitigation of climate change while minimizing adverse environmental, social, public health and economic effects. Therefore the CoP needs to decide on criteria for certification. These need to include project baselines against which environmental benefits can be accurately accounted or estimated in order to assess additionality. Further studies are needed on different options for determining baselines (e.g. whether baselines should be standardized for project categories and/or whether adequate technologies could provide default baselines and/or whether baselines should be developed on a case by case basis.)

c) Article 12 does not provide for projects for the enhancement of removals by sinks to assist Annex I Parties in achieving compliance with their commitments under Article 3, although the CoP/MoP could decide otherwise. There are considerable issues of complexity involved in the inclusion of sinks such as links with biodiversity, forest and desertification issues, consistency with sustainable development and the verification and certification of reductions from sequestration projects. The IPCC Special Report is expected to contribute to consideration of these issues.

d) CoP 4 should agree on terms of reference for SBSTA and SBI to develop modalities and procedures on CDM project criteria and operational modalities for adoption by CoP/moP1. These should be based on the above principles and criteria and be consistent with the framework to be developed for other flexible mechanisms.

3. Participation of Parties

a) Participation is voluntary. Each CDM project should be approved by the Parties involved (Art. 12.5 (a)).

b) It is the aim of the European Community, Austria, Germany, Finland, Portugal, France, Sweden, Belgium, Spain, Denmark, Greece, Italy, Ireland, The Netherlands, Luxembourg, United Kingdom and Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Switzerland that only Parties that

- (i) have ratified the Kyoto Protocol,
- (ii) have submitted their inventories and their national communications in accordance with Art. 12 of the FCCC and information pursuant to Art. 7 and Art. 10 of the Protocol, and that
- (iii) have ratified the compliance regime to be developed and adopted under Art. 18 of the Protocol shall participate in CDM projects.

c) Participating Annex I Parties have to be in compliance with Art. 5 and Art. 7 of the Protocol. Parties' implementation of the requirements of the modalities and procedures for the CDM should be subject of expert review under Art. 8.

d) Private and public entities should be able to participate in the CDM under the authority and responsibility of the Parties involved and subject to the guidance provided by the executive board of the CDM.

II. Process (incl. methodological issues)

4. Project Identification and Implementation

a) In order to ensure that CDM projects are compatible with and supportive of national sustainable development needs and priorities, host countries in addition to approving

the project in accordance with Art. 12.5 (a) should be involved in project identification, development and implementation.

b) CDM investment should flow directly between the partners involved in the project. The CDM should work efficiently, minimize transaction cost and avoid the creation of a new bureaucracy.

5. Certification, Auditing and Verification

a) One Certified Emission Reduction (CER) unit should be equal to one metric ton of CO₂ equivalent emissions calculated using the global warming potentials defined by Decision 2/CP. 3 or as subsequently revised in accordance with Art. 5.3 of the Protocol.

b) CER units should have a unique serial number that reflects the country of origin and the year of certification and a project reference.

c) Independent auditing and verification of CDM project activities, including certified emission reduction units have to be ensured. Guidelines and methodologies for independent auditing and verification have to be decided upon by the COP/moP.

d) The operational entities for the certification of emission reductions could be intergovernmental and/or public and/or private entities. In order to avoid conflict of interest such entities must not be involved in project identification and implementation. Operational entities should be under the supervision of an institution that is able to ensure independent and effective functioning of such entities. These entities shall be designated by the COP/moP.

6. Reporting to the COP/MOP

a) There should be annual reporting on individual CDM projects. They should also be included in the national communications of the Parties involved.

b) Guidelines for reporting of CDM projects need to be developed. They should be based on the uniform reporting format of the AIJ pilot phase, taking into account any recommendations on improvements to the format that may arise from the review of the AIJ pilot phase to improve information and transparent reporting.

7. Acquisition of CER units

a) The acquisition of CER units can only take place once modalities and procedures have been adopted by the CoP/moP including the determination of "part" as provided for in Article 12.3. The mechanism for accounting, certification, reporting and verification has to be defined and in place before emission reductions under the CDM can be used to count towards the fulfilment of Annex I Parties' commitments.

b) Given that Art 12.10 permits pre-commitment period banking of CER units

generated from 2000 work on detailed criteria and guidance should proceed urgently. If the modalities and procedures on the CDM have not yet been adopted by the CoP/moP in 2000, emission reduction units within the CDM that arise between 2000 and that adoption can be added to the assigned amount ex post only if they comply with the subsequently agreed modalities and procedures.

c) In accordance with Art. 12.3 (b) and 3.12 of the Protocol CER units from a CDM project should be added to the assigned amount of the acquiring Annex I Party.

d) Non-Annex I Parties will benefit from the development, transfer and application of climate friendly technology through project activities resulting in certified emission reductions (Art. 12.3 (a)).

e) The use of CER units in an emissions trading system needs to be further discussed.

8. Share of Proceeds

a) CoP/moP should agree on how the share of the proceeds from certified project activities should be generated and allocated. In ensuring that a share of the proceeds is used for adaptation and administration, the COP/moP should take account of the need to minimize possible disincentives for potential investors to carry out CDM projects.

b) There are various ways to calculate the share of proceeds which need further consideration, e.g. calculation on the basis of the return of the project activity that is the part of the project leading to real certified emission reductions.

c) The funds from the share of proceeds for adaptation should be allocated on a project basis and be managed by existing multilateral entity/entities with adequate experience and expertise.

d) Criteria for the eligibility of adaptation projects should be clearly defined building on the three stage approach defined in Decision 11/CP.1.

III. Institutional issues

The roles of the CoP/MoP, the executive board and operational entities need to be defined. Using existing bodies that have the relevant experience and expertise is generally preferable to creating new bodies. CoP needs to define the tasks of the CDM more closely before deciding which institutions should perform these functions. We need to fully build on the work and experience of relevant bodies, such as the IPCC, the UNFCCC Secretariat and the GEF and its Implementing Agencies.

PAPER NO. 2: EGYPT

FOLLOW-UP TO THE SESSIONS OF THE SUBSIDIARY BODIES OF UNFCCC

The following are some comments on cooperative mechanisms.

1. A share of the CDM allocations should be used to assist developing countries that are particularly vulnerable to adverse impacts of climate change, meet the costs of adaptation measures.
2. A minimum percentage of GHG reductions limits of Annex-I countries should be achieved due to domestic actions, at home, and the rest could be achieved through emission trading and CDM. These percentages should be determined through negotiations and approval of COP/MOP.
3. Failure to achieve the determined domestic reductions percentage, would make the non-complying party non-eligible for emission trading or CDM.
4. Building the capacity of Non-Annex I countries in emission trading and other cooperative mechanisms is essential to activate such mechanisms.

PAPER NO. 3: GEORGIA

**VIEWS ON THE MECHANISMS REFERRED TO IN
DECISION 1/CP.3, PARAGRAPH 5(b), (c) AND (e)**

Georgian delegation has fixed once again its position, declared in Kyoto, at the above-mentioned session, which was reflected in the Bulletin of these sessions (June 9, 1998, vol-12, N 82, p. 2). Particularly, it is said in it that Georgia declared the readiness of a number of Annex 1 countries to take voluntary commitments on the limitation of GHG emissions, if there will be adequate aid in conformity with the 4th article of the Convention and which will be implemented within "Clean Development Mechanism". At present, Georgia can participate only in the "Clean Development Mechanism" and take commitments voluntarily within it and it has already declared about that. Just under this mechanism should be undertaken stage by stage and painless replacement of the fuel rich in Carbon by the fuel containing less carbon. Identification of GHG emission limits will be carried out within this mechanism for each large emitting enterprise, on which the introduction of new environmental friendly technologies will be possible and just by the use of these technologies and renewable power sources and with the assistance of foreign investors and international financial bodies will be implemented commitments taken, which, in fact, correspond to saved emission certified by those projects, which should be financed.

Proposal of Georgia on CDM

The only mechanism out of JI, CDM and ET mechanisms, in which Georgia is able to participate, at present is "Clean development mechanism" This mechanism widens the range of cooperation for the sides, included in the Annex I (developed countries and countries with economy in transition) creating favorable conditions for there countries to be able to develop sustainable and fulfill the commitments to the UNFCCC. In particular, CDM assists those developing countries to elaborate and implement an adaptation strategy, which have economy vulnerable to Climate Change and use the mechanism of decreased emission certification from the countries, included in the Annex I in the policy of investment of projects necessary for the sustainable development of the countries not included in the Annex I. Unfortunately, this mechanism is at present on the stage of formation. That is why it is rather vague and makes the fate of the countries, not included in the Annex I, entirely dependent on the will of developed countries situating them in rather bandaging conditions.

In spite of the considerations, mentioned above, it should be noted that numerous environmentally friendly projects have been implemented by a number of developed countries on the territories of developing countries and those with economy in transition in the experimental phase of JI, known as Activities implemented Jointly and they are to be continued till the year 2000. As a result, we hope that now and especially after improving this mechanism, projects promotion the sustainable development of the country's economy will be really implemented in Georgia.

Our considerations on the steps, accelerating the processes and promoting active participation of both developing countries and those with economy in transition in the "Clean Development Mechanism" are as follows:

1. To assist developing countries and those with economy in transition in creating their national and regional structures, which will serve clean technology transfer.
2. To establish an International Center (Similar GREENTIE), which will promote not only information collection and exchange between developed and developing countries (that is done at present by GREENTIE), but will coordinate this process.
3. Creation of more serious stimulating mechanism by local governments and international organizations for the purpose of more active participation of a private sector in these processes.
4. To carry out more assistance to developing countries and those with economy in transition while financing demonstrative and pilot projects.
5. To make target investments by international financial organizations for a local private sector.

Emission Trading

Using the Certified Emission Reduction(CER) obtained through CDM during the period from 2000 up to the beginning of the first commitment period can be used for participation non-Annex I countries in Emission Trading.

PAPER NO. 4: JAPAN

**Non-Paper on Guidelines for the Implementation of Projects
under Article 6 of the Kyoto Protocol**

With regard to Article 6 of the Kyoto Protocol, the elaboration of guidelines by the Conference of the Parties serving as the meeting of the Parties to the Protocol (COP/moP), is not necessarily prerequisite for the implementation of projects whereas Article 12 requires to elaborate, because

(3) Article 6 already provides elaborate enough guidelines to proceed the projects under Article 6.

(2) Article 6.2 specifies that "The Conference of the Parties serving as the meeting of the Parties to this Protocol may, at its first session or as soon as practicable thereafter, further elaborate guidelines for the implementation of this Article, including for verification and reporting."

Nevertheless, in order to ensure smooth implementation of projects under Article 6, it would be helpful to lay down guidelines for clarifying or complementing the content of Article 6. Therefore, the Government of Japan proposes the "ELEMENTS TO BE INCLUDED IN GUIDELINES FOR THE IMPLEMENTATION OF PROJECTS UNDER ARTICLE 6." in the ANNEX.

1. Guiding Factors

(1) Efficiency and Simplicity

Guidelines for the implementation of projects under Article 6 should be simple. Projects under Article 6 could contribute to mitigating climate change through the cost-effective and efficient reduction of emissions by sources and enhancement of removals by sinks of greenhouse gases. To this end, the system should be easy to apply and minimize transaction costs.

(2) Transparency

The participating Parties should ensure transparency of the system by reporting necessary information to the COP/moP and making it public so that the system is efficient and equitable.

2. Key Issues

(1) Methodologies for Estimating Emission Reduction Units

Article 6 enables transfers and acquisitions of emission reduction units (ERUs) only among Annex I Parties, and, as a result, the combined total assigned amount for Annex I

Parties remains unchanged. With each transfer and acquisition of ERUs, an increase of an assigned amount for one Party means a decrease of an assigned amount for another Party. It follows that participating Parties are expected to determine the amount of ERUs to the appropriate level through consultation among them to protect their respective interests. Therefore calculation of ERUs could be left to the decision of the participating Parties.

Therefore, common and obligatory rules concerning methodologies for calculating ERUs, including those for establishing a baseline are considered unnecessary.

It is needless to say that the participating Parties could agree to refer to methodologies for CDM once they are elaborated by the COP/moP in accordance with Article 12.7.

(2) Supplementarity

To set a quantified ceiling for transfers and acquisitions of ERUs not only impedes the efficiency of the system, but also discourages domestic actions of a Party where a project site is located, and who carries out the project under Article 6 as its own domestic action, and reduces the extent to which the host Party could address the environmental protection. Therefore, the ceiling may not assist in the realization of the purposes of the Protocol.

(ANNEX)

ELEMENTS TO BE INCLUDED IN GUIDELINES FOR THE IMPLEMENTATION OF PROJECTS UNDER ARTICLE 6

1. Conditions for Implementation of Projects under Article 6

Any Party included in Annex I or legal entities authorized by that Party to participate may implement a project under Article 6. However, any Party that is not in compliance with its obligations under Articles 5 and 7 or that does not have a national recording system provided in section 8 below cannot acquire emission reduction units (ERUs). Any legal entity of such Parties cannot acquire them, either. (Article 6.1(c))

2. Requirements for Projects Under Article 6

Projects that satisfy the following requirements may generate ERUs as defined in Article 6:

- a) The purpose of the project is to reduce anthropogenic emissions by sources or to enhance anthropogenic removals by sinks of greenhouse gases in any sector of the economy (Chapeau of Article 6);
- b) The project shall have the approval of the Parties involved(Article 6.1(a));

c) The project shall provide a reduction in emissions by sources or an enhancement of removals by sinks of greenhouse gases, that is additional to any that would otherwise occur (Article 6.1(b)).

3. Projects Providing a Reduction in Emissions by Sources

Projects providing a reduction in emissions by sources which start before the beginning of the first commitment period may be eligible for those under Article 6.

4. Projects Providing an Enhancement of Removals by Sinks

Projects providing an enhancement of removals by sinks which enhance removals by sinks of the greenhouse gases, as defined under Article 3.3 or as added in accordance with Article 3.4, may be eligible for those under Article 6, provided that they take place after the year 1990.

5. Verification of Additionality and Generation of Emission Reduction Units

1. Parties involved or legal entities authorized by those Parties to participate shall decide by mutual consent the level of "any that would otherwise occur" as defined in Article 6.1(b), i.e. the amount of baseline emissions by sources or baseline removals by sinks.

b) Parties involved or legal entities authorized by those Parties to participate shall establish by mutual consent the methodologies for estimating the amount of emissions by sources or removals by sinks resulting from a project.

c) The difference between the amount of the baseline emissions by sources or baseline removals by sinks as defined in section 5. a) above and the amount of the emissions by sources or removals by sinks estimated and verified by methodologies provided in section 5. b) above constitutes the additional reduction in emissions by sources or the additional enhancement of removals by sinks as defined in Article 6.1(b).

d) Parties involved or legal entities authorized by those Parties to participate may designate by mutual consent all or a part of the additional emissions reductions by sources or the additional removals by sinks provided in section 5. c) above, as emission reduction units.

e) A Party involved where a project site is located (a host Party) has to put serial numbers on emission reduction units generated.

f) Emission reduction units are subtracted from the assigned amount of a host Party, and added to the assigned amount of the other Party involved in which the project site is not located (a guest Party).

g) Emission reduction units shall be expressed in CO₂ equivalent units. The minimum

unit is 1 ton. The GWPs used for calculating the CO₂ equivalent units are those based on the effects of the greenhouse gases over 100-year time horizon, and is fixed during a commitment period.

6. Reporting

a) Each Party shall submit to the secretariat an annual report explaining i) outline of the projects implemented by that Party or legal entities authorized by that Party to participate, ii) how to establish the baseline emissions or removals, iii) methodologies for estimation and verification, iv) estimated and verified amount of the additional reduction in emissions or the additional enhancement of removals, v) amount of emission reduction units generated and vi) amount of emission reduction units transferred or acquired.

b) The secretariat has to make the above report public.

7. Emission Reduction Unit Transfer and Acquisition

a) Emission reduction units can be transferred to third Parties.

b) If a question of implementation by a Party included in Annex I of the requirements referred to in Article 6 is identified in accordance with the relevant provisions of Article 8, transfers and acquisitions of emission reduction 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 (Article 6.4).

8. National Recording System

The national recording system is a system of Annex I Parties for recording information necessary for the implementation of Article 6, such as the information related to generation, transfer, acquisition and possession of emission reduction units of the Party, and/or its legal entities.

PAPER NO. 5: JAPAN

NON-PAPER ON DESIGN FOR THE CLEAN DEVELOPMENT MECHANISM

I. How to Proceed with Elaboration of Modalities and Procedures for the clean development mechanism (CDM)

1. Issues to be considered concerning the CDM can be broadly classified into the following categories.

(1) Substantial Issues

- (a) Methodology and Process Concerning Certification and Implementation of CDM Projects
- (b) Generation, Transfer and Acquisition of Certified Emission Reductions (CERs)
- (c) Use of a Share of the Proceeds from Certified Project Activities

(2) Institutional Issues

As a procedure, "Methodology and Process Concerning Certification and Implementation of CDM Projects" and "Use of a Share of the Proceeds from Certified Project Activities" should be considered first among these issues. It is appropriate to consider "Institutional Issues" once the above consideration has proceeded a step further.

In considering the issue "Generation, Transfer and Acquisition of CERs", attention should be paid to the interrelations and possible linkage with the designing of the emissions trading.

2. Article 12.10 of the Kyoto Protocol provides that certified emission reductions obtained from the CDM after the year 2000 can be used to assist in achieving compliance. Therefore, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (COP/moP) should agree on modalities and procedures in accordance with Article 12.7 by the year 1999, or if the Protocol does not enter into force by the year 2000, the Conference of the Parties (COP) should reach an interim agreement by the year 1999. (If the interim agreement is agreed by the COP, it is expected that later on it will be approved formally by COP/moP at its first session and applied retroactively.)

II List of Issues to be Considered and the View of the Japanese Government Regarding Such Issues

1. Substantial Issues

II Methodology and Process Concerning Certification and Implementation of CDM Projects

(a) Project Eligibility

(i) Target Projects

(i-i) Gas Coverage

CDM Projects cover six greenhouse gases listed in Annex A of the Protocol.

(i-ii) Sinks

CDM should include sink projects. The coverage of sink projects will be further discussed.

(i-iii) Projects commenced before the year 2000

Projects commenced before the year 2000 can be certified as CDM projects.

(ii) Additionality

(ii-i) How to Define the Concept of Additionality

Additionality of projects is the most important issue in establishing the CDM system. According to Article 12.5(c), additionality refers to "Reductions in emissions that are additional to any that would occur in the absence of the certified project activity." Comparing the emissions in the case when no CDM project took place (i.e. baseline emissions) with the emissions in the case when the project was carried out (i.e. project-based emissions), if the project-based emissions fall below the baseline emissions, the difference can be certified as being additional. (Projects concerning sinks can be considered in the same way. If project-based removals by sinks exceed baseline removals by sinks, the difference can be certified as being additional.) Thus, the following two points are the key issues.

- How to certify baseline emissions (or removals by sinks)
- How to verify project-based emissions (or removals by sinks)

(ii-ii) Establishment of Baseline Emissions. The baseline emissions may be established using the following two methods.

- Use of a standardized baseline for each project category
- When no standards have been developed, or when there are circumstances which make the use of such standard baseline inadequate, then decisions will be made on a case-by-case basis.

Standardization of a baseline for each project category would be desirable to provide simplified administrative arrangements.

Standardized baselines may also reduce transaction costs and thus promote the CDM. However, such standardization requires much experience and time. A case-by-case method would be also allowed, at least, in the meantime.

In addition, long-term projects call for further consideration of whether baselines need to be revised after a project commences, or whether other methods could be found. (For example, to use a dynamic baseline taking into account future technological advances).

(ii-iii) Monitoring, Verification and Reporting of Project-based Emissions

Project participants should be required to take responsibility for monitoring, verification and reporting of actual emissions. As in the case of establishing baseline emissions, standardized methods for monitoring, verification and reporting for each project category are preferable, but case-by-case methods should be used when appropriate.

- (iii) Are Additional Guidelines Needed for Article 12.5(a) "Voluntary participation approved by each Party involved"?

Since the approval of the project should be entrusted to the Parties involved, additional guidelines for Article 12.5(a) are not necessary.

- (iv) Are Criteria Needed for Article 12.5(b) "real, measurable, and long-term benefits"?

It is difficult to establish generalized criteria because whether a project will produce "real, measurable, and long-term benefits" depends to a great extent on various factors such as country, region, period of time and surrounding environment where the project is implemented. Thus, it is expected that any Party will judge comprehensively pursuant to each project when a Party approves.

- (v) Are Criteria needed for Article 12.2 "to assist Parties included in Annex I in achieving sustainable development"?

The host Party should judge for itself whether a CDM project is beneficial to the achievement of sustainable development. When the host Party determines that a project is not beneficial, it can reject the approval of the project. Thus, there is no need for criteria.

(b) CDM Projects Participants

As indicated in Article 12.9, participation under the CDM may involve any Party or private and/or public entities. What types of private and/or public entities are qualified to participate is to be subject to whatever guidance may be provided by the executive board of the CDM as indicated in the provision. But basically, it should be entrusted to the judgement of the Party those entities belong to.

(c) Certification Process

To minimize the risk of investors, a project should be certified as a CDM project before the project commences. On the other hand, the amount of emissions reductions cannot be made until the project is actually launched. Considering these points, the following two-step certification process is appropriate.

(i) Project Certification: Process Prior to Launching Projects

At the request of project participants, an operational entity certifies a project as a CDM project based on judging whether the applied project is appropriate to the CDM and estimating the expected emissions reductions. A project should be certified as a CDM project before launching the project. However, a project commenced before the year 2000 may also be retroactively certified as a CDM project. Specifically, the pre-project certification process is as follows.

- Additionality

An operational entity establishes the baseline emissions of the project and estimates project-based emissions. Additionality is certified based on whether the estimated project-based emissions fall below baseline emissions.

- "Voluntary participation approved by each Party involved" and "real, measurable, and long-term benefits related to the mitigation of climate change"

An operational entity confirms whether participating Parties approve the project and whether these Parties recognize the project will generate these benefits.

(ii) Reductions Certification: Process After Launching the Project

An operational entity certifies emissions reductions by comparing the project-based reductions obtained from the results of actual monitoring, verification and reporting with the baseline emissions established during the project certification process.

(d) Definition of Article 12.6

Activities expected under Article 12.6 are to make a match between investors and project participants and so forth.

(2) Generation, Transfer and Acquisition of CERs

(a) Generation Process of CERs: Are CERs generated simply through certification of reductions by an operational entity or is some kind of additional procedure necessary afterwards?

(b) Owners of CERs: To whom and how much do the generated CERs belong? CERs are shared by the project participants (i.e. Parties or private and/or public entities). The allocation of CERs among multiple project participants is decided by consent of the participants themselves.

(c) How are CERs Transferred and Acquired?

(i) Characteristics of CERs: Fungibility of Assigned Amount Units (AAUs) of Emissions Trading and Emissions Reduction Units (ERUs) of Joint Implementation

(ii) Tracking of CERs

(3) Use of a Share of the Proceeds from Certified Project Activities

(a) Process for Determining a Share of the Proceeds

A share of the proceeds should be determined based on the generated amount of CERs and not the amount of investment to CDM projects.

To promote the CDM, it is appropriate to set a share of the proceeds at a comparatively modest level. If it is set at a high level, the number of CDM projects will decrease, thus the financial contributions to support developing country Parties will also decrease.

(b) Allocation of a Share of the Proceeds Between "Covering Administrative Costs" and "Assisting Developing Country Parties"

Options include the following.

- To entrust the determination of the total amount of a share of the proceeds and the allocation to the decision of the COP/moP
- (Based on the assumption that a project participant can select an operational entity from among more than one designated operational entities) Only the part of a

share of the proceeds for assisting developing country Parties could be decided by the COP/moP. The part of a share of the proceeds for covering administrative costs could be decided by an operational entity itself.

- (c) Definition of "to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the cost of adaptation"

The framework to assist developing country Parties by using a share of the proceeds should be studied among others with the view to implementing assistance efficiently and minimizing administrative expenses.

2. Institutional Issues

(1) Executive Board

- (a) The number of Board Members and Structure of the Executive Board
- (b) Secretariat of the Executive Board
- (c) Frequency of Executive Board Meetings
- (d) Budget of the Executive Board
- (e) The Role of the Executive Board: Definition of Supervision of the CDM (Article 12.4 of the Kyoto Protocol)

(2) Structure and Role of Operational Entities

- (a) Designation of Operational Entities by COP/moP
 - Are Guidelines needed for Designating Operational Entities ?
 - The Number of Operational Entities
 - Newly Established Entities or Existing Entities ?
 - Private Entities, Public Entities or International Organization ?
- (b) Role of Operational Entities: Other than Certification

- (3) Who conducts to "assist in arranging funding of certified project activities as necessary" (Article 12.8)

- (4) Who conducts "to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the cost of adaptation" (Article 12.8) (COP/moP or executive board or operational entity (or entities) or should it be entrusted the Global Environment Facility (GEF)?

PAPER NO. 6

**RESPONSES TO G-77/CHINA
QUESTIONS ON FLEXIBILITY MECHANISMS**

The following document is a set of answers, submitted by Australia, Canada, Iceland, Japan, New Zealand, Norway, Russian Federation, Ukraine and United States to questions posed by the G-77 and China in FCCC/SB/1998/MISC.1/Add.5. It represents the preliminary views of these countries, and is submitted with a view to facilitating further discussions on these important issues.

General

1. What are the points of difference and points of similarity among the three mechanisms provided for in the Kyoto Protocol to the Convention?

Key similarities:

- All three voluntary market-based mechanisms work to the benefit of the environment, because they will assist Annex I Parties in meeting their emissions targets and, in the case of projects under Article 6 (hereafter joint implementation -- JI) and project activities under Article 12 (hereafter the Clean Development Mechanism -- CDM), provide an additional incentive to develop and transfer technologies and practices that will reduce emissions.
- Moreover, all three mechanisms will help Parties to meet their emissions target cost-effectively.
- All three mechanisms ultimately involve adjustments in the assigned amounts of Annex I Parties.
- All three mechanisms will provide opportunities for potentially significant technology and resource transfer, from both the public and private sector, to countries with economies in transition and developing countries.
- All three mechanisms permit private sector participation, with responsibility for meeting Protocol obligations remaining with governments.

Key differences:

- International emissions trading (IET) and JI will involve transactions among Annex I Parties and entities, whereas the CDM will involve transactions among Annex I and non-Annex I Parties and entities.

JI and the CDM both involve specific projects, while IET does not.

- With respect to JI and the CDM, there may be similarities with regard to types of projects and methods for measurement of emissions reductions. However, there are also differences, given that JI reductions are ultimately subtracted from the assigned amount of a Party with a national target, whereas CDM reductions are not; therefore, additionality criteria are particularly critical to the integrity of the CDM.
- IET and JI involve reallocating assigned amounts, with the aggregate remaining constant; in contrast, CDM units are “extra-budgetary,” adding additional units to the original Annex I aggregate assigned amount.
- IET, JI and the CDM are mechanisms to assist Annex I Parties in meeting their emissions targets. However, the CDM also serves as a mechanism to assist in achieving sustainable development in Parties not included in Annex I by encouraging investment and transfer of technology.
- Of the three mechanisms, only the CDM calls for the establishment of an Executive Board and requires certification by internationally selected operational entities.
- In terms of decisions on any rules/guidelines, the COP is to make such decisions regarding IET, whereas the COP/moP is to make such decisions regarding JI and CDM.
- Article 12 (CDM) requires further rules regarding project certification, whereas Article 6 (JI) does not necessarily require them.
- Apart from any similarities and differences among the three mechanisms, all should be implemented so as to minimize complexity, provide cost-effective opportunities for meeting emissions targets, keep transaction costs low, and support fungibility of credit units.

2. How to ensure that domestic actions by developed countries are their primary means of GHG limitation and reduction, and that the overseas mechanisms remain supplemental to such domestic actions by developed countries for the purpose of meeting their quantified emission limitation and reduction commitments?

- Articles 6 and 17 of the Kyoto Protocol require that JI and IET are to be “supplemental to domestic action” for the purpose of meeting commitments under Article 3. However, it should be noted that the Protocol does not call for domestic actions to be the “primary means” of limiting greenhouse gas emissions. As will be recalled, proposals related to JI and IET that would have required domestic actions to be the “main means” of meeting Article 3 targets did not command consensus and were not included in the Protocol.
- Annex I Parties are undertaking, and planning to undertake, significant domestic action to reduce emissions. (Please refer to national communications for examples of Parties’ domestic actions.)

- Several Parties have taken on and/or announced specific measures to begin domestic actions to encourage early reductions of greenhouse gases through better diffusion of existing technology, to fund additional research to develop new technology, to continue or enhance the use of economic incentives, and to implement national greenhouse gas emissions trading systems.
- Parties' domestic actions will be examined through the process for in-depth review of national communications.
- Concerning the suggestion that the carefully negotiated compromise term "supplemental" in Articles 6 and 17 be quantified, such an approach is neither authorized nor required by the Protocol.
 - As indicated in the Non-Paper on Principles, Modalities, Rules and Guidelines for an IET Regime (FCCC/SB/MISC.1/Add.1/Rev.1), IET will be more effective in achieving emissions reductions at lowest cost if there are no restrictions on the quantity of assigned amounts units able to be transferred or acquired to contribute to compliance with a Party's assigned amount. If the flexibility inherent in these mechanisms is restricted, the result would increase substantially the cost of achieving our environmental objectives.
 - Such a quantitative restriction on IET would be technically difficult to define and design, and could require an administratively burdensome government monitoring and approval regime to implement, adding significantly to transaction costs.

3. How can it be ensured that these mechanisms lead to real and verifiable limitation and reduction of GHG emissions by developed countries?

- The Kyoto Protocol establishes legally binding emissions commitments for Annex I Parties. As a result, accurate measurement and reporting will be critical to the successful implementation of the Protocol, regardless of the extent to which Parties elect to use the flexibility mechanisms.
- Having said that, there are ways that the mechanisms can be structured so as to provide additional incentives for accurate measurement and reporting:
 - Article 6 (JI) already provides that an Annex I Party cannot acquire emission reduction units if it is not in compliance with its obligations under Articles 5 and 7.
 - As indicated in the Non-Paper on Principles, Modalities, Rules and Guidelines for an IET Regime (FCCC/SB/MISC.1/Add.1/Rev.1), we support linkages in the IET rules between the ability to engage in trading and compliance with Articles 5 and 7.
 - Concerning CDM, Article 12 reflects the importance the Parties put on the need for ensuring real reductions. CDM projects will be verified on the basis of agreed guidelines for calculation of project or technology baselines, measurement of

emissions reductions resulting from the project, and transparent reporting of results, open for third party evaluation. The experiences gained during the AIJ Pilot Phase may provide valuable information on useful methodologies in this respect.

4. How to ensure that the COP or COP/mop will maintain the responsibility for every stage of defining, developing, structuring, and institutionalizing the mechanisms?

- Under the Protocol (and as noted in part above), the COP and COP/moP have different functions with regard to the three mechanisms. For example, elaboration of the CDM will require substantial COP/moP decision-making with respect to both substantive and institutional issues. In contrast, JI under Article 6 could be implemented without further decisions by the COP/moP (i.e., because the Article provides that the COP/moP “may” further elaborate guidelines). Concerning Article 17, IET is not legally dependent upon the adoption of guidelines although, once adopted, any principles, rules and guidelines adopted by the COP would govern IET from that point.

5. What are the specific roles of the SBSTA and the SBI with regard to these mechanisms?

- The SBSTA and SBI will continue to serve the function of recommending decisions to the COP or COP/moP to facilitate the implementation of the Protocol, taking into account the submissions of Parties, the FCCC Secretariat, other international bodies, and the input of non-governmental organizations. Specific roles will be identified as progress is made.

6. What will be the systems for ensuring independent auditing, verification, and accountability of the working of the mechanisms?

- As noted above, the three mechanisms have different provisions when it comes to such issues as verification, auditing, etc.
 - Article 6 (JI) and Article 17 (IET) authorize, but do not require, further guidelines on verification and reporting.
 - Article 12 specifically provides for “independent auditing and verification” of project activities.
- Accurate measurement and reporting (including guidelines for standardized reporting) will be critical to the integrity of the Kyoto regime, given that the key obligations involve legally binding emissions limitation targets.
- Depending upon the particular mechanism and its requirements, the use of existing mechanisms in the private sector (for tasks such as auditing and accounting) could be advisable, given that many such mechanisms have already been tested in the demanding private sector markets.

- The expert review process of implementation of Article 3 obligations (to which all three mechanisms relate) will also play an important role in promoting the integrity of the mechanisms.
- Finally, public dissemination of emissions and assigned amount data, through appropriate reports on the Internet for example, can help to ensure transparency.

Article 6 Projects

1. What will be the elements of the guidelines for projects under Article 6, in particular, for ensuring transparency, accountability, reporting, and verification?

- Article 6 contains key criteria and guidelines for cooperative activities.
- Articles 3.10. and 3.11 of the Protocol establish that emission reduction units transferred between Annex I Parties as a result of projects under Article 6 are to be added to or subtracted from Parties' assigned amounts. Thus, activities under Article 6 will not change the total assigned amounts of Annex I Parties, only the distribution of these amounts among individual Parties.
- Changes in assigned amounts will be reported annually and can be tracked on this basis. In this regard, it would be useful initially to consider the Uniform Reporting Format from the AIJ Pilot Phase.
- Guidelines providing for the use of simplified, standardized methods to assess additionality (such as thresholds for specific projects or sectors) could promote transparency.
- It should also be noted that the overall expert review process (including expert review of inventories) regarding compliance with Article 3 (of which JI is a component) will necessarily play a role with respect to accountability and verification.

2. What will be the criteria for deciding the baseline of projects?

- Article 6.1(b) requires that a JI project "provide[] a reduction in emissions by sources, or an enhancement of removals by sinks, that is additional to any that would otherwise occur."
- The AIJ Pilot Phase and related work have provided considerable information on how to establish baselines.
- The basic criterion is to establish a baseline to enable measurement of the effect of the project activity compared to business-as-usual. This baseline could vary between different sectors and countries.

3. How can compliance with Articles 5 and 7 of the Protocol be ensured, and how is this related to the work to be accomplished under Article 18?

- Accurate measurement and reporting are critical to the integrity of the Protocol generally, given the nature of the target obligations.
- Article 18 may ultimately be relevant to promoting compliance with Articles 5 and 7.
- However, it would not appear helpful to rely exclusively on Article 18, particularly given that the Article 18 procedure may require amendment to the Protocol and therefore potentially substantial time to become operative.
- Rather, the flexibility mechanisms themselves should be structured to provide their own relevant incentives to comply with Articles 5 and 7.
- In the case of JI, the Protocol itself (through Article 6.1(c)) provides that an Annex I Party may not acquire emission reduction units if it is not in compliance with its obligations under Articles 5 and 7. Such a provision should provide a useful incentive for Annex I Parties, at least for those interested in using JI, to comply with the Protocol's measurement and reporting provisions.
- In addition, we believe the COP should focus early attention on elaborating measurement and reporting guidelines called for under Articles 5 and 7. Such work will be important not only for flexibility mechanisms, but for the Protocol generally.

4. What will be the procedure for transferring or acquiring emission reduction units resulting from projects under Article 6?

- The transfer of emission reduction units between Annex I Parties, which ultimately results in adjustments in their assigned amounts, will have to be approved and agreed by the involved Parties.
- Based on this approval and agreement, adjustments to assigned amounts will have to be recorded, for example in these Parties' annual inventories and/or national communications.
- The Parties will be subject to any guidelines, including for verification and reporting, that COP/moP may further elaborate.

5. What will be the system for auditing and verifying projects under Article 6?

- Each Party involved in JI will have the responsibility to approve, monitor, and report each JI project in which it or one of its legal entities is involved.
- The COP/moP may develop further guidelines concerning the credibility and transparency of national verification systems.

- The extent to which a JI project meets applicable international criteria can also be the subject of the expert review process of implementation of Article 3 obligations, to which JI is obviously related.
- 6. How will “legal entities” to be involved in these projects be defined and how will the responsibility of the Party over “legal entities” for the purpose of the projects be ensured?**
- It is up to individual Annex I Parties to decide if and how it will allow its “legal entities” to participate. If it does allow some or all legal entities to participate, it is up to that Party to ensure, through its national system, that such entities participate in a way that is consistent with any relevant Protocol provisions or rules adopted thereunder.
 - However, an Annex I Party’s national decision to allow private sector participation does not absolve that Party of its obligations, at the governmental level, under the Protocol.
- 7. How will the benefits of a project under Article 6 be equitably shared between the participating Parties?**
- The sharing of all of the various benefits of a project are a matter for negotiation between those involved (noting the requirement under Article 6.1(a) that any project have the approval of the Parties involved).
 - JI projects could also enhance the capacity of host countries to take national action of their own and could create other secondary benefits in the host country, such as a reduction in local pollution effects.
- 8. What will be the reporting criteria of a project under Article 6 to the COP/mop?**
- The COP/moP is authorized, under Article 6.2, to further elaborate guidelines, including for reporting. Thus, reporting criteria could be developed, possibly taking into account the uniform reporting format for AIJ under the pilot phase.
 - Reports from Parties should include, at a minimum, information on the project; what baseline emissions and “with-project” emissions were, and how they were determined; and adequate information to demonstrate that the project was accepted by the Parties involved.

Article 12- Clean Development Mechanism

- 1. What will be the criteria for ensuring a balance wherein each CDM project attains the objective of assisting developing country Parties in achieving sustainable development in accordance with their national priorities and strategy, and assisting developed country Parties in achieving compliance with their commitments under Article 3?**

- Article 12.5 provides that emission reductions resulting from each project activity are to be certified on the basis of, inter alia, voluntary participation approved by each Party involved.
- Thus, a host country will have the opportunity to ensure that any proposed CDM project in which it is potentially involved respects its national priorities and strategy concerning sustainable development.

2. How to ensure that the CDM shall be subject to the authority and guidance of the Conference of Parties serving as the meeting of the Parties to the Protocol?

- Article 12.4 expressly provides that the CDM shall be subject to the authority and guidance of the COP/moP.
- The oversight role of the COP/moP will be carried out through:
 - its mandate for the Executive Board;
 - its ongoing review of the operation of the Executive Board and operational entities; and
 - its elaboration of the governing modalities and procedures for ensuring transparency, efficiency and accountability through independent auditing and verification of project activities.
 - its designation of operational entities.

3. How to ensure that the Executive Board of the CDM shall function under the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to the Protocol?

- See the response to question 2 above.

4. What will be the constitution, character and functions of the Executive Board of the CDM?

- The constitution, character and functions of the Executive Board will in part depend on the form and functions of the CDM as a whole.
- It is therefore logical and practical to decide first on the functions of the various aspects of the whole mechanism before starting to consider what functions and form the various institutional components might have. We look forward to further discussing this important issue with the G-77 and China, as well as other Parties.

5. How will the emission reductions of a CDM project be certified? What will be the certification procedure, and by whom will this be accomplished?

- According to Article 12.5, certification of CDM projects would be based on three criteria: a) voluntary participation approved by each Party involved; b) project activity provides real, measurable and long-term benefits related to the mitigation of climate change; and c) emissions reductions must be “additional to any that would occur in the absence of the certified project activity.” Clear and transparent certification procedures for these criteria would need to be developed to provide assurance that CDM investments will yield sound certified emission reductions (CERs).
- Reductions will be determined once they actually occur and will reflect the performance of the project as measured against a set of performance measures. Reporting of CDM activities, both by Parties and by the operational entities, will provide additional information on transfers and acquisitions of certified emission reduction benefits. We have a preference for independent and decentralized operational entities to reduce potential transaction costs.

6. How to define and quantify “part” in “...part of quantified emission limitation and reduction commitments” in Article 12.3 (b) of the Protocol?

- Article 12.3(b) provides that Annex I Parties may use the CERs accruing from project activities to contribute to compliance with part of their commitments under Article 3, as determined by the COP/moP.
- Article 12.3(b) provides for a determination by the COP/moP regarding how “Parties included in Annex I may use the certified emissions reductions accruing from such project activities to contribute to compliance with part of their quantified emission limitation and reduction commitments under Article 3”; however, we would not agree that the COP/moP should seek to quantify “part of” because, for example:
 - Fewer projects would be initiated and therefore direct benefits (e.g., new technology, investment) to non-Annex I Parties would be reduced.
 - If the “scale” of CDM project activities is diminished, fewer funds would be available for adaptation (Article 12.8) efforts in vulnerable developing countries.
 - Imposing a ceiling on CDM project activities would create implementation problems for individual Annex I Parties. For example, the closer a Party approached any such ceiling, the greater the difficulty the Party, or a private company, would have in assessing whether it could actually count possible CERs toward compliance with Article 3 commitments.

7. How to ensure the responsibility and role of governments at each stage of the CDM projects?

- Responsibility for implementing obligations under the Protocol rests with governments.
- To the extent that a Party chooses to allow its private sector to participate in the CDM, it is a matter of national responsibility to ensure that such participation is consistent with any Protocol provisions, or rules/guidelines adopted thereunder.
- Non-Annex I governments will have a key role in determining which projects within their borders are eligible for certification under the CDM and in determining if and how private entities under their jurisdiction will participate in the CDM.
- Within the framework established by the COP/moP (and Executive Board, as appropriate), Parties will have full discretion to determine the extent of their participation in CDM projects and resulting CERs.

8. How will it be ensured that the operational entity of the CDM, as designated by the COP, functions under the authority of the COP, and that its governance is separate from those of existing institutions?

- First, the COP/moP will have the role of designating any operational entities of the CDM.
- Second, operational entities will be subject to whatever substantive and procedural rules/guidelines govern operation of the CDM.
- Third, operational entities will be supervised by the Executive Board, which in turn functions under the authority and guidance of the COP/moP.

9. How will Article 12.6 of the Protocol be implemented? What will be the criteria and processes for the CDM for arranging due funding?

- In our view, the bulk of CDM projects will be achieved through private investment. In some instances, Parties may participate. Investments will flow based on the availability of qualifying projects, the potential rate of return on investments, and the value of CERs if there is a market.
- In those cases where funding does not exist, the CDM may assist in arranging such funding, for example, by acting as a clearing-house and making widely known the nature of the proposed projects for which funding is necessary.
- While a “process” may be needed to assist in arranging funding (so as, for example, to ensure that there is no potential conflict of interest between institutions that are certifying emission reductions and that may also be arranging financing), it is not clear that “criteria” will be necessary, in that the CDM will not itself be providing funding.

10. How to ensure the independent auditing and verification of CDM projects activities?

- Ensuring independent auditing and verification of CDM projects is the very objective of the modalities/procedures to be elaborated by the COP/moP under Article 12.7.
- Auditing and verification rules need to be both robust and cost-effective, inasmuch as any funds spent on auditing and verification will ultimately be drawn from projects -- and will therefore decrease the number of projects undertaken.
- To avoid conflicts of interest, entities involved in auditing and verification should not be the same as those involved in project development or promotion.
- Using existing institutions, including those already in use in the financial sector, may substantially streamline the process, and lead to a robust system built on already proven principles.
- Multiple operational entities may be valuable, as each may develop expertise in individual regions or types of projects that will engender greater confidence in their results.

11. What will be the criteria for deciding the baseline of projects?

- The measurement of real, long-term mitigation benefits would require the development of baselines to demonstrate that projects result in actual greenhouse gas emissions that are less than baseline (business-as-usual) emissions. An important question to ensure consistency between similar projects, while minimizing transaction costs, is to determine the appropriate level of detail for developing project baselines (for example, whether to use project-, sector-, or country- benchmarks for emissions baselines). Guidelines for baseline measurement and verification should consider how baselines may evolve in the future.
- One method of establishing baselines (for example, to determine “additionality”) is by employing a “benchmark” approach. A benchmark is a standard of performance which can be either historical or forward-looking. This distinguishes between those activities that generate greenhouse gas reductions in excess of baseline reductions and those that do not. Simply put, those activities that perform better than the benchmark meet the additionality criterion. Projects which would not be eligible under the benchmark approach, or for which criteria had not or could not be developed, could be considered separately on a case-by-case basis.

12. When should the benefits of CDM projects accrue to the participating developed country Parties?

- Regarding participation by an Annex I Party in the CDM through acquiring CERs, such reductions would be certified as they occur from project activities (including from 2000

to 2008) and could be used during the commitment period to assist in meeting Article 3 commitments.

13. What will be the action for non-compliance if a CDM project goes against the CDM criteria?

- This hypothetical situation seems unlikely if a two-step certification process is adopted:

project certification to estimate expected emission reductions for a project to qualify as a CDM project; and

certification of a precise number of emission reductions based on actual emissions monitored after commencement of the project.
- However, assuming such a case, the consequence would be that any reductions achieved from that project could not be used by an Annex I Party to meet part of its Article 3 commitment.

14. How to define “a share of the proceeds”, and how will this share be apportioned between administrative expenses and adaptation?

- A “share of the proceeds” should be a part of the CERs resulting from a project activity, be determined in advance and be applied on a predictable basis.
- The apportionment between administrative expenses and adaptation funds cannot be determined until the institutional and operational structure of the CDM is determined. The lower the administrative costs, however, the greater amount of funds could be available for adaptation.

15. How will the responsibility of a Party be ensured over the private/public entities authorized by the Party to be involved in CDM projects?

- It will be up to the national system of an Annex I Party to ensure that any entities it authorizes to participate in CDM do so in a manner consistent with relevant Protocol provisions and rules/guidelines adopted thereunder.
- Responsibility for compliance with Protocol obligations ultimately rests with the Party, not with entities which may have been authorized nationally to participate.

16. How to ensure that CDM projects are equitably distributed so as to benefit all developing country parties, in particular the least developed country parties, and that the distribution of projects does not exacerbate existing regional/sub regional imbalances?

- The Secretariat should be requested to report at regular intervals to the COP/moP on the regional distribution of CDM projects.

- In addition, Parties should be encouraged to assist developing country Parties in capacity-building and other activities to facilitate utilization of the CDM in potential host countries, based on requests for such assistance from such countries. Some such activities are already underway, but further capacity building should be encouraged as the CDM is being further elaborated.
- The CDM is a market-based mechanism, and investment decisions (particularly from the private sector) will influence the distribution of CDM projects. Developing countries can influence the distribution of CDM project activities by promoting an investment climate that will encourage the development of CDM projects within their borders.

17. How will it be ensured that the financing for CDM projects shall be additional to ODA and other international funding, additional to and separate from the financial obligations under GEF, and additional to the financial obligation of the Parties as provided in the Convention and the Protocol?

- It is expected that the bulk of CDM financing will come from the private sector, in which case the issue of ODA funding and financial obligations under the Framework Convention does not arise.
- Further, the establishment of the CDM would not alter in any way the funding obligations of Annex I Parties under the Framework Convention. In the case where a Party government were to participate in the CDM, it could not “double count” CDM funding as also in implementation of its funding obligations under Article 4.3 of the Framework Convention.

18. How will the additional economic benefits, if any, of a CDM project be shared equitably between the participating Parties?

- It is not entirely clear what is meant by “additional economic benefits” in this question (a term not found in Article 12). However, the share of benefits from project activities is entirely a matter to be resolved through negotiations between the Parties or private entities involved in the specific project.

19. How will the participating Parties report their CDM projects to the COP/mop?

- Unlike in Article 6, Article 12 of the Protocol does not specifically address reporting of project activities or CERs resulting from individual projects.
- The use of certified emissions reductions from CDM project activities to meet Article 3 commitments will be reported pursuant to Article 7 of the Protocol; more detailed reporting requirements may be part of the modalities/procedures to be adopted under Article 12.7, to the extent they relate to auditing and verification.

20. What are the implications of Article 12.10 of the Protocol?

- Article 12.10 provides for the accrual of credits from 2000 to the beginning of the first commitment period.
- The provision:
 - gives an incentive to Parties and their private entities to start projects early, which would be of benefit to both Annex I and non-Annex I countries, as well as the atmosphere;
 - provides for investments and new technologies in non-Annex I countries earlier than during the first commitment period;
 - will provide a share of proceeds from project activities that will assist vulnerable developing country Parties to meet the costs of adaptation sooner.
- Recognizing that the modalities, procedures, and institutions necessary for the operation of the CDM may not be operational until after the year 2000, it should be made clear that operational entities may retroactively certify emission reductions obtained from the year 2000 resulting from a project activity begun before the CDM is operational, provided the emission reductions meet any applicable criteria.

AIJ Pilot Phase

Although a question section on the AIJ Pilot Phase was not included in the G-77 MISC.1/Add. 5 document, we have provided additional comments on this issue:

What are the next steps for the AIJ pilot phase?

- Parties are in the process of submitting their third report on Activities Implemented Jointly to the UNFCCC. These reports will provide the foundation on which the UNFCCC Secretariat will prepare a synthesis report for consideration at COP4, leading to a decision on the AIJ pilot phase.
- To move toward a decision to continue or end the pilot phase, the following steps are necessary:
 - Prepare a synthesis report on progress of the AIJ pilot phase to include discussion of methodological issues, baseline calculations, potential and actual emission reductions from projects, geographic and sectoral distribution of projects, institutional structures established in Annex I and non-Annex I Parties, and lessons learned;
 - Solicit comments from Parties on the Synthesis report in advance of COP4 and prepare a report on Party submissions;

- Solicit comments from Parties on the Uniform Reporting Format, and prepare a report for consideration;
- Between COP4 and COP5, a final assessment of the AIJ Pilot Phase could be carried out to summarize the experience gained. Such an assessment could be carried out by the Secretariat based on a decision by COP4, and should include procedures for further inputs from Parties, as well as from major groups outside Governments.

International emissions trading, Article 17

1. How will the emission rights and entitlements of developed country Parties be determined and created for trading emissions? Will this be consistent with the principle of equity keeping in view the historical and current responsibility of developed countries to climate change and the ultimate objective of the Convention?

- The question appears to contemplate some further negotiation concerning the allocations from which IET begins. The allocations from which IET begins are the assigned amounts reflected in the Protocol.
- The assigned amounts in the Kyoto Protocol were negotiated so as to reflect enhanced developed country responsibilities (in that they do not apply to developing countries) and to reflect “equity” (in that they are differentiated in light of various equitable considerations).

If Article 3 principles of the Framework Convention are to be invoked in the context of IET, it should be noted that Article 3.3 provides that “policies and measures to deal with climate change should be cost-effective so as to ensure global benefits at the lowest possible cost.” IET certainly provides the opportunity to implement greenhouse gas emissions targets at the lowest possible cost.

2. How to ensure that any emissions trading between the developed country Parties shall be supplemental to domestic actions for the purpose of meeting their quantified emission limitation and reduction commitments?

- Please refer to the answer given for Question 2 in the General Section.

3. How to ensure that emissions trading between developed country Parties will lead to real and verifiable limitation and reduction of GHG emissions for meeting the objective of the Convention, and contributing to the protection of the environment?

- Please refer to the answer given for Question 3 in the General Section.

- In addition:
 - Accuracy of measurement and reporting by Annex I Parties is critical to the successful implementation of the Protocol's target obligations, regardless of IET. Prompt work on measurement and reporting guidelines is therefore of high priority.
 - IET will not have adverse environmental effects. Trading will serve to reallocate existing assigned amounts among Annex I Parties, with the aggregate obligation of Annex I Parties remaining constant. Much more likely is that emissions trading will greatly contribute to environmental protection by having enabled Parties to adopt more ambitious targets with trading than otherwise would have been the case, encouraging Parties to ratify the Protocol, and enabling cost-effective compliance with Article 3 commitments.
 - Some have expressed concern that some Parties will have "extra" emissions allowances which should not be traded because that would permit emissions that would not otherwise occur. Apart from the technical and administrative problems that such an approach would entail (and the fact that the Protocol permits such trading), it is simply not true that the trading of such allowances would lead to higher emissions than would be the case in the absence of trading, because a Party with "extra" emissions allowances would in any event be allowed to "bank" such allowances under Article 3.13 for use in a subsequent commitment period.

4. What will be the environmental or economic impacts in any area due to emissions trading between developed country Parties?

- The environmental aspects are addressed in the response to question 3 above.
- From an economic point of view, IET among Annex I countries should lead to emissions reductions where abatement costs are lowest, thus minimizing the economic impacts. IET should provide the greatest global benefit by maximizing the use of limited financial resources. The voluntary nature of participation generally in the trading system, as well as in each trade in particular, in effect ensures that each of the participants will be made better off because Parties will only choose to trade if and when it is to their advantage to do so.

5. How to ensure that any emissions trading between developed country Parties fully reflects the principle of equity between developed and developing countries?

- IET, in that it only reallocates assigned amounts and does not change the overall assigned amount of Annex I Parties, will not alter the "equity" between developed and developing countries that was established by adopting the Kyoto Protocol.

6. How to ensure that emissions trading between developed country Parties shall conform to the principles, modalities, rules, and guidelines including any compliance procedure to be defined by the COP?

- Views on this matter are contained in detail in the Non-Paper, FCCC/SB/1998/MISC.1/Add.1/Rev.1.
- Once principles, modalities, etc. were adopted under Article 17, they would govern IET and Annex I Parties would be bound to follow them.
- To the extent that an Annex I Party chose to allow the participation of its private sector, it would be the national responsibility of that Party to ensure that such participation was consistent with any Article 17 rules, etc.
- Apart from any compliance procedure that may ultimately become effective pursuant to Article 18, the trading rules under Article 17 could (and should) provide appropriate compliance-related elements, in particular for verification, reporting and accountability. For example,
 - there should be linkages between the ability to trade and being in compliance with measurement and reporting obligations under Articles 5 and 7, as well as maintaining appropriate national recording systems;
 - there should be annual reporting on trading activity;
 - there should be public accessibility to emissions and assigned amount data;
 - there needs to be an assessment for compliance at the end of the commitment period, with appropriate disincentives particularly relevant to IET built into the system.
- One disincentive under the trading rules could be to deny or to restrict the right of a Party (and therefore its legal entities) to transfer assigned amounts if it is found to be in breach of the trading rules and/or is no longer in compliance with the conditions for participation in the system.
- We look forward to a full exchange of views on the principles, modalities, rules and guidelines for IET at COP4, as requested by decision 1/CP.3.

PAPER NO. 7: POLAND

**VIEWS ON THE MECHANISMS REFERRED TO IN DOCUMENT
FCCC/SB/1998/CRP.2**

1. Considering similarities of all flexible mechanisms (Articles 6, 12 and 17), their common elements should be clearly defined, distinguished and later discussed together.
2. According to Article 12.10 of the Kyoto Protocol, Clean Development Mechanism can start from the year 2000. Therefore elaboration of guidelines and rules for its implementation is indispensable and should have priority. Rules and guidelines should be accepted by CoP 5 in 1999. The introduction of CDM before acceptance of new principles isn't advisable.
3. Considering rules for all mechanisms one should take into account first of all methodological and institutional aspects. Political problems can be discussed later.
4. In accordance with protocol provisions, mechanisms have to be additional to activities taken by the Parties. Poland supports EU position that determination of quantitative criterion of additionality is indispensable. We believe however that the first step in negotiations and basis for establishment of such criterion should be proposals by all Annex I Parties based on their political decisions. According to us additionality should be determined in flexible way and may differ for different Parties, depending on their national circumstances.
5. JI pilot phase (AIJ) did not allow to gather appropriate experience to begin joint implementation activities. Therefore the JI pilot phase should be continued at least to MOP 1.
6. Emissions trading should be formed by market mechanisms. Launching a pilot phase is advisable to gain adequate experiences by governments and companies. Gradual development and implementation of rules for this mechanism is indispensable. Domestic and international markets should be developed simultaneously. In our opinion emissions trading should be admissible for all Annex B Parties.
7. By the time of establishment of stable market for emissions trading, purchase emission should be used only for own need of the Party and cannot be subject to transfer to third Parties or speculations.

PAPER NO. 8: SWITZERLAND

**AGENDA ITEM 4(F): ACTIVITIES IMPLEMENTED JOINTLY
UNDER THE PILOT PHASE (DECISION 5/CP.1)**

Switzerland believes that COP4 should take a decision to review the experience of the pilot phase for activities implemented jointly (AIJ) in order that COP5 can take a decision on the conclusion of the pilot phase. Our initial contribution to this process is the draft of a possible COP4 conclusion presented below.

One important question not dealt with in our proposed decision is to what extent the review should involve NGOs, project developers, local populations affected by the projects and other stakeholders and how such inputs could be sought/incorporated into the review process. We would welcome a dialogue on this issue with other Parties and interested groups prior to COP4.

**Draft Decision CP.4
Activities implemented jointly under the pilot phase**

The Conference of the Parties,

Recalling that the Conference of the Parties shall, at its annual session, review the progress of the pilot phase for activities implemented jointly with a view to taking appropriate decisions on the continuation of the pilot phase,

Recalling that in so doing, the Conference of the Parties shall take into consideration the need for a comprehensive review of the pilot phase in order to take a conclusive decision on the pilot phase and the progression beyond that, no later than the end of the present decade,

1. *Takes note* of the synthesis report on activities implemented jointly prepared by the secretariat (FCCC/CP/1998/2) and of the information contained in document FCCC/CP/1998/INF.3,
2. *Decides* to conduct a review of the pilot phase in accordance with decision 5/CP.1, including consideration of institutional, procedural and methodological aspects as well as performance, impact and operational questions.
3. *Further decides* that the review will address the following points:
 - (a) Emissions reductions achieved through the projects and the associated costs, including a breakdown of transaction costs.
 - (b) Consistency of projects with the criteria in decision 5/CP.1, based on a synthesis of the information included in the reports submitted by Parties using the uniform reporting format and other available assessments.

- (c) Impact of projects on national standards/best practices.
- (d) Contribution of projects to capacity building, institutional strengthening and stakeholder participation.
- (e) Any problems encountered in using the uniform reporting format to report on national programmes and AIJ project activities and recommendations for improvements, as appropriate (e.g. expand URF to request information on AIJ projects that were rejected).
- (f) Any difficulties encountered by host country Parties in ensuring that AIJ are compatible with and supportive of their environment and development priorities and strategies.
- (g) Methodological progress made by the secretariat in developing practical options for each of the items in the indicative list of methodological issues in paragraph 3(d) of the conclusions regarding activities implemented jointly under the pilot phase of the 5th session of the SBSTA (FCCC/SBSTA/1997/4).
- (h) Experience gained with monitoring and verification.
- (i) Recommendations for guidelines and methodologies related to project-based mechanisms under Art. 6 and 12 of the Kyoto Protocol or further work required, as appropriate, in particular with respect to project eligibility criteria, baseline determination, project monitoring and verification procedures, long-term effects and benefits sharing.
- (j) Recommendations regarding a conclusive decision on the pilot phase and the progression beyond that.

4. *Further decides that:*

- (a) With the assistance of the secretariat, the Subsidiary Body for Scientific and Technological advice will be responsible for reviewing items 3(a) and 3(c)-(i) and the Subsidiary Body for Implementation will be responsible for reviewing items 3(b) and 3(j).
- (b) A joint progress report on the review process will be made at the 10th sessions of the SBSTA and the SBI, and the final results of the review will be submitted for consideration at the 11th sessions of these bodies.
- (c) The Conference of the Parties at its Fifth session shall consider the results of the review and take a decision on the pilot phase and the progression beyond that.