

CCAP Submission on Internationally Transferred Mitigation Outcomes

Introduction

The Center for Clean Air Policy (CCAP) has the honor to submit its views in response to the invitation in paragraph 3 of FCCC/SBSTA/2016/L.11 for submissions by Parties and observer organizations on cooperative approaches that involve Internationally Transferred Mitigation Outcomes (hereafter referred to as ITMOs) toward Nationally Determined Contributions (NDCs).

CCAP has worked for thirty years to promote innovative solutions to addressing environmental pollution, including by contributing to the development of flexible instruments like the SO₂ trading system in the US, the EU ETS, and the Clean Development Mechanism. Over the past five years we have also supported developing countries efforts to design transformative Nationally Appropriate Mitigation Actions (NAMAs) and adopt ambitious Intended Nationally Determined Contributions (INDCs).

CCAP is pleased to offer this submission to highlight key issues that should be considered with regards to ITMO guidelines in order to assist the international community in defining an agenda to adopt the necessary rules, modalities, procedures and best practices for ITMOs, whether within or outside the UNFCCC process.

Executive Summary

The Paris Agreement represents a marked departure from the pre-2015 context for mitigation, with nearly all Parties pledging to take on Nationally Determined Contributions (NDCs) that reflect their national circumstances. While this new approach has allowed for broad participation, the diversity of NDCs and the requirement to increase NDC ambition over time in the Paris Agreement present a complexity of issues that merit full consideration by Parties with a view to achieving or exceeding currently pledged NDCs and the broader ambition promised in Article 2 of the Agreement. It will be important to evaluate past approaches and consider new strategies in light of the new context.

Article 6 has the potential to stimulate a new round of innovation in cooperative approaches to mitigation that go beyond existing frameworks and address some of the gaps and deficiencies common to market-based approaches to date.

ITMOs can support the achievement of the global ambition promised in the Agreement by expanding the range of options available to Parties to fulfill or exceed their current NDCs expeditiously and cost-effectively. Transfers can promote enhanced deployment of low-carbon technologies and accelerate the

implementation of projects and programs. ITMOs could also enable Parties to increase the ambition of currently pledged NDCs and consider deeper reductions in future rounds.

As an instrument of the Paris Agreement, ITMOs should be consistent with the Paris Agreement's provisions and objectives, and Parties need to take steps to ensure this consistency. The Agreement requires ITMOs to:

- safeguard environmental integrity;
- prevent double-counting; and
- be voluntary and authorized by Parties.

At the same time, to align with the *objectives* of the Paris Agreement, as laid out in Article 2, ITMOs should also embody the following characteristics:

- ITMO use should support NDC implementation in both source and user country;
- ITMOs should support ambition; and
- ITMOs should seek synergies with other forms of cooperation as appropriate

To achieve these goals, there are a number of steps that Parties can take collectively and individually:

- Given the need to share perspectives and coordinate negotiations, Parties should establish links between ITMO negotiations and those on other forms of cooperation, and request that the Secretariat (or other body as appropriate) organize workshops to facilitate the development and sharing of best practices.
- SBSTA negotiations on guidelines for ITMOs should prioritize negotiation on those areas where risks are greatest without central guidance and that pose the most immediate relevance to Parties' domestic policy planning efforts.
- Individual or groups of Parties will need to take responsibility for ensuring that ITMOs they use or generate support achievement of the Agreement's objective.

Background: A New Context for Mitigation Transfers

While mechanisms to transfer mitigation outcomes have existed previously under the UNFCCC and can provide valuable input into the development of policies related to ITMOs, Parties should consider ITMOs within the Post-Paris context.

Prior to 2015, transfers of mitigation outcomes were provided for in three key ways under the bifurcated Annex I/non-Annex UNFCCC regime: as emissions trading between Annex I countries with legally binding Quantitative Emissions Limitation or Reduction Obligations (QELROs) under the Kyoto Protocol, as Joint Implementation (JI) credits generated in Annex I countries to be used against the targets of other Annex I countries, and as offsets generated in Non-Annex I countries that had no binding targets and transferred to Annex I countries through the Clean Development Mechanism (CDM).

The common target types and compliance periods for Annex I countries enabled the development of fairly straightforward, centralized mechanisms for the transfer and verification of mitigation outcomes, including a “true up” process where Annex 1 countries had to demonstrate they had sufficient Assigned Amount Units (AAUs) to cover their emissions, and a CDM Executive board whose oversight helped ensure the integrity of the system.

The framework established by the Paris Agreement is markedly different. Article 4 of the Paris Agreement establishes an obligation for all Parties – both Annex I and non-Annex I – to adopt NDCs. While some of the mitigation targets in these contributions make use of absolute, economy-wide emissions limits similar to QELROs, there are a variety of other forms that mitigation contributions have taken. For context, of the 50 highest-emitting non-Annex I countries:

- Four have absolute, economy-wide base year targets;
- 30 have mitigation against Business-As-Usual (BAU) targets;
- one has an economy-wide carbon-intensity target;
- two have a target that indicates a peak year for emissions;
- two have a peak year target as well as an intensity target; and
- seven have targets that indicate sectoral actions.

This diversity of target types aligns with the Nationally Determined character of the Paris Agreement, but can clearly present challenges for the transfer of mitigation outcomes between countries. Furthermore, while some targets are for 2025, others are for 2030, adding to the complexity. Lastly, while the Kyoto Protocol QELROs are legally-binding, under the Paris Agreement, parties are only obligated to *adopt* targets; the stringency of those targets is self-determined, and assessment of whether the goals are achieved, including with respect to the use of mitigation outcomes generated in another Party, is determined through a system of transparency and review, with the consequences for not achieving a target being political, rather than legal.

The Paris Agreement regime is not fully specified in terms of the ITMO mechanisms that could be used, with only the mechanism in Article 6.4 specifically referenced. While many parties and observers understand that ITMOs offer a path to carbon markets, there are no specific references in the Paris Agreement that identify carbon markets as the only channel for ITMOs. Parties could choose to advance other types of transfer arrangements that may be enabled by the broad provisions of Article 6, in addition to standard carbon market type mechanisms, including:

- Bilateral/plurilateral arrangements by Parties that do not involve the transfer of tradable securities like emissions reduction credits (ERCs) even if they do transfer a verified reduction from a source Party to a Party that will use it against its NDC;
- Publicly funded reductions, including those supported by multilateral finance entities, that can be verifiably generated and either cancelled or used against NDCs;
- Transfer of *recognition*: in some cases, parties providing support may have an interest in being recognized as contributing to the achievement of emissions reductions, even while such reductions are accounted for only in the *host* country inventory; and

- Transfer of non-greenhouse gas based outcomes: with a number of Parties defining targets or subnational goals related the drivers of emissions and removals – energy from renewable sources, acres of reforestation/afforestation, etc.—ITMOs could be defined in other ways than in tons of CO2 equivalent.

Beyond the altered legal landscape, a variety of practical issues may impact the development of systems to transfer mitigation outcomes. For example, in many developing countries, national CDM authorities may face a new challenge in overseeing ITMOs. For years, private sector actors in many non-Annex I countries have become accustomed to being able to sell emissions reduction credits on an international market. So long as the price was attractive, there was no reason for companies to abstain from selling mitigation outcomes, and governments in these countries had the incentive to allow as many emissions reductions to be sold as possible. These same countries now have their own targets to achieve, are identifying strategies to implement them, and may face tough trade-offs as they attempt to implement or incentivize mitigation actions to achieve their own targets while allowing access by their private sector to international carbon markets.

Developing ITMOs to Achieve the Paris Agreement

Though the Paris language on ITMOs is brief and fairly general, the Agreement does specify several requirements that ITMOs must fulfill. In addition, the Paris Agreement highlights broader goals, and ITMOs should be consistent with these broader outcomes as well. Both the required and the desirable characteristics that CCAP has inferred can be seen in Table 1.

Table 1 -- Desired Characteristics of ITMOs

ITMOs characteristics defined in the Agreement	Additional characteristics to align with the Agreement
ITMOs must ensure environmental integrity	The purpose of ITMO use is NDC Implementation
ITMOs shall use robust accounting to prevent double counting	ITMOs should support ambition
ITMOs shall be voluntary and authorized by Parties	ITMOs and climate finance should be mutually supportive

Each of these characteristics is considered in greater detail below. For the first category (ITMOs characteristics defined in the Agreement), we attempt to elaborate on what each characteristic might mean in terms of ITMO design and identify relevant issues. For the latter, we identify additional characteristics that ITMOs should have to align with the goals of the Agreement.

ITMOs in the Agreement

ITMOs Must Safeguard Environmental Integrity

Article 6.2 establishes a requirement for Parties to ensure environmental integrity when using ITMOs. While there is no common definition of environmental integrity in this context, at a minimum Parties should have a high confidence that every ton transferred corresponds to a real ton reduced. This requires attention to the following:

- Measurement, reporting, and verification (MRV) of emissions reduced or removed in the context of an ITMO;
- Additionality compared to business-as-usual actions, raising issues with respect to the baselines used, particular for certain forms of NDCs (e.g., emissions reductions against business-as-usual emissions); and
- ITMO “currency” issues, which will come up in the context of trading between systems based on different units (for example tons of CO₂ equivalent per GDP, per capita, per kWh, versus absolute tons).

ITMOs Must Prevent Double Counting

Article 6.2 states that “Parties shall apply robust accounting to ensure...the avoidance of double counting” when using cooperative approaches. Parties further requested (1/CP.21 paragraph 36) for SBSTA to develop guidance on this, specifically noting that double counting is to be avoided “on the basis of a corresponding adjustment by Parties.”

Concerns about double counting as an *accounting* issue are broadly recognized within negotiation circles, and Parties should ensure that emissions reductions transferred to other Parties are not claimed by the host party. At the same time, there other ways in which double counting can occur. For example, if a Party decides to count resources expended to acquire ITMOs to comply with their NDCs as part of their *finance* contribution as well counting the ITMOs themselves as part of their *mitigation* contribution, there could be concerns of double counting, particular if no effort is made to discount the financial flows reported or to account for any economic benefit of reduced mitigation costs to the acquiring country.

ITMOs Must Be Voluntary and Authorized by Parties

According to Article 6.3, the use of ITMOs shall be “voluntary and authorized by participating Parties.” It follows that the governments of the countries in which mitigation outcomes are produced and to which they are transferred must authorize said transfer, explicitly by transaction or through the authorization of a regime that “covers” such transactions. This places an onus on countries that is significant, particularly given the need to prevent double counting, with respect to the transfer out of mitigation outcomes that could impact the country’s NDC implementation.

The requirement for transfers to be authorized can also have particular implications for internationally linked sub-national trading systems – e.g., the Western Climate Initiative which has already seen emissions trading between Quebec and California. For such systems to produce ITMOs that can be counted toward the achievement of NDCs, there needs to be engagement with national governments. If

not appropriately accounted for in national inventories and reporting, there is a risk that either the transfers will not be recognized in either country or will be counted in both countries. Subnational authorities will play a key role, as recognized by paragraph 133 of Decision 1/CP.21, in the achievement of NDCs.

Additional Important ITMO Characteristics

ITMO Use Should Support NDC Implementation in both source and user country

Access to a broader range of mitigation opportunities can improve the cost-effectiveness of mitigation efforts, accelerate the achievement of planned actions, and potentially allow countries exceed their NDC targets or increase the ambition of future NDCs, helping close the emission gap and achieve greater global ambition.

However, use of ITMOs must be consistent with NDC implementation for the countries generating ITMOs; the transfer of mitigation outcomes must not compromise achievement of the NDC of the source countries even as they promote NDC attainment in recipient countries. In this respect, there are risks that Article 6 can create incentives that may not be consistent with NDC achievement, including transferring mitigation outcomes that might otherwise be needed to meet the NDC in response to domestic pressures, as well as to provide insufficient oversight of transfers out by institutions used to handling CDM credits.

ITMOs Should Support Ambition

In addition to implementing their NDCs, Article 6.1 recognizes that parties may choose to pursue voluntary cooperation...*“to allow for higher ambition”*. CCAP is pleased that several countries are already considering how ITMOs can allow them to enhance their NDC ambition by taking advantage of mitigation opportunities abroad.

While ITMOs may have the potential to increase global ambition, assigning value to mitigation outcomes can have the perverse incentive of putting downward pressure on national and sectoral targets so as to have a larger volume of ITMOs that can be transferred, leading to the possibility of “hot air.” The progression provision in Article 4.3 of the Agreement calls for each successive NDC to represent a progression beyond the current NDC and commits Parties to aim for maximum ambition in their NDCs, but this is left as an individual obligation, and at no point is individual NDC ambition evaluated or verified. At this stage, there is no way to tell whether ITMOs are supporting countries to adopt more ambitious NDCs, either now or in the future. What will be more apparent is whether an ITMO is contributing to meet an existing NDC, or helping a country to do more than was originally promised.

As outlined in Table 2 below, an ITMO may be more or less likely to support or accelerate achievement of pledged ambition under the Paris Agreement depending on whether the ITMO is generated within the scope of an NDC or beyond it, and whether it is acquired to meet or exceed a target. There is a high risk that an ITMO generated within an NDC and used to meet an existing NDC would not result in additional ambition and would result in the same emissions reductions being counted towards two separate NDCs. In contrast, an ITMO generated in excess of an existing NDC and used to go beyond an existing NDC would lead to an increase in aggregate ambition.

Table 2 Risk to achieving currently pledged ambition under the Paris Agreement

		Buyer/User	
		Acquire to meet NDC	Acquire to Exceed NDC
Seller/ Originator	Produce ITMOs within NDC Scope or Ambition	High: could result in total mitigation being less than the sum of promised reductions under both Parties' NDCs	Medium: could have no net impact on the sum of pledged ambition, but risk to seller/originator that NDC will not be fulfilled
	Produce ITMOs beyond NDC Scope or Ambition	Low: unlikely to produce reductions above the combined pledges of both Parties, but consistent with both NDCs being achieved	Very low: total mitigation likely to exceed sum of both NDCs

This recalls the complementarity principle that has been argued for in the carbon markets context – but given the Paris Agreement context, it now needs to be considered from both ends of the transfer, rather than just from the side of the acquirer. In other words, not only should there be an expectation that ITMOs acquired to meet a target are supplemental to a significant domestic effort to reduce emissions, but also that ITMOs generated to be transferred out of a country should be above and beyond some level of autonomous domestic effort that is achieved without benefiting from a financial flow or other consideration generated through an ITMO transfer.

ITMOs Should Seek Synergies with Other Forms of Cooperation as Appropriate

ITMOs will emerge in a context of expanding amounts of international climate finance flowing, and as such there are certain to be interactions between flows of climate finance intended to support developing country action – such as support from the Green Climate Fund – and flows of capital involved in transactions that involve ITMOs. Through technology transfer, capacity building, and finance, support from Annex 2 Parties can improve developing country Parties' abilities to effectively generate and/or use ITMOs for mitigation. Similarly, ITMO-related action on the ground can similarly support conditions that allow for the more effective application of support.

However, this interaction presents risks as well. Without safeguards, emissions reductions occurring as a result of climate finance may result in ITMOs that benefit another country, potentially a developed country. In such an instance, climate finance would be acting as a subsidy for the purchase of ITMOs, undermining the goal of climate finance under Article 9.

Additionally, as noted above, the possibility for double counting of mitigation and climate finance exists. Though it is possible that others interpret the Agreement differently, CCAP believes that Parties' Finance commitments should be separate from their Mitigation commitments, as an alternative approach would effectively allow a Party to reduce their Mitigation contribution by focusing their use of Finance on

achieving their own NDC. Irrespective of whether Parties hold this view, a practice of double counting Mitigation and Finance is likely to erode trust in the new system.

Conclusions: Nationally Determined ITMOs for a Nationally Determined Agreement?

ITMOs can support the fulfillment of the diverse Paris objectives in a cost-effective manner, and can help enhance global ambition. To ensure that ITMOs play a supportive role and maintain their alignment with the Agreement and its objectives, robust governance arrangements are essential, whether on a formal basis through shared institutions under the Convention, including multilateral rules and guidelines for how Parties use and report on the use of ITMOs, or through the informal diffusion and adoption of norms and best practices by involved Parties.

At this stage, the international community needs to discuss how ITMO governance can ensure that ITMOs align with the requirements and broad principles of the Paris Agreement. One approach is a centralized model, like that adopted under the Kyoto Protocol, which defines approved flexibility mechanisms and creates instruments for their monitoring. At the other extreme, Parties might elect to take a more decentralized approach that defines some rules, modalities and procedures, but relies to a much greater degree on the Parties themselves to define and implement the transfer systems, with accountability achieved through reporting and review.

Without centralized compliance mechanisms, each party or groups of like-minded parties will need to define their own approaches to approving and using transfers to ensure consistency with the requirements of the Paris Agreement. Even if UNFCCC Parties determine that universal rules should be the goal of the negotiations, the adoption and demonstration of high standards on the acceptable use of ITMOs against NDCs by certain Parties could help advance international consensus on systems that produce the best results.

While allowing more freedom and experimentation, a decentralized approach can increase transaction costs for transfer participants and make it more difficult and time-consuming to evaluate the validity of different transfer regimes. The approach taken is a political decision, though it is likely that that certain, more mechanical aspects of ITMO governance are more compatible with centralized mechanisms (e.g. a registry to track all ITMOs and other mechanisms to prevent double-counting), where other important elements may be more compatible with a decentralized approach relying on norms and best practices underpinned as appropriate by UNFCCC guidelines on reporting and transparency (such as ensuring that NDCs support global ambition).

A Collective Agenda to Facilitate Effective ITMO Use

To support efforts to effectively use ITMOs, SBSTA (and other COP bodies as appropriate) should seek to develop rules, modalities and procedures to promote international transfers in the context of meeting NDCs and higher ambition. This includes the issues that must be addressed, as well as guidance on which elements might best be addressed through a centralized system. Table 3 above provides a

summary of the key issues identified in the text above, as well as some potential approaches that Parties may wish to consider.

Table 3 Goals, Issues, and Possible Approaches for Paris-Aligned ITMO use

Goals	Issues	Possible Approaches
Safeguard Environmental Integrity	<ul style="list-style-type: none"> • Transfers between NDC types • MRV capacity • Additionality 	<ul style="list-style-type: none"> • Guidelines for transfers between NDC types (currency, baseline rules) and for reporting ITMO transfers out or in • Support (such as through Capacity Building Initiative for Transparency)
Prevent Double-Counting	<ul style="list-style-type: none"> • Double issuance • Double claiming • Double counting finance and mitigation 	<ul style="list-style-type: none"> • COP guidance on types of double counting • UNFCCC institutions, such as a registry
Ensure ITMOs are Voluntary and Authorized by Parties	<ul style="list-style-type: none"> • National capacity and political will to oversee ITMOs • Actions by subnational entities 	<ul style="list-style-type: none"> • Capacity building • Best practices on subnational actions • Reporting and transparency
Ensure ITMOs help achieve NDCs	<ul style="list-style-type: none"> • Whether ITMOs transferred out will be needed to achieve NDC 	<ul style="list-style-type: none"> • Capacity building for developing country institutions
Ensure ITMOs support ambition	<ul style="list-style-type: none"> • Preventing “hot air” in subsequent rounds of NDCs • Disincentive to expand coverage of NDCs • Lack of complementarity for user or source country 	<ul style="list-style-type: none"> • Guidelines on baselines, etc. • Requirement to report on complementarity
Align ITMOs and climate finance	<ul style="list-style-type: none"> • Climate Finance subsidizing Annex I mitigation • Double counting of finance and mitigation 	<ul style="list-style-type: none"> • SCF guidance on use of finance to generate ITMOs • Article 9.1 rules on accounting for finance

The potential solutions identified in the table above are indicative, and the selection of appropriate choices taken in many cases may be interdependent with other decisions.

Recommendations

Based on the above analysis, CCAP provides recommendations to Parties both in terms of the specific SBSTA negotiations related to ITMO guidance, as per paragraph 36 of Decision 1/CP.21, as well as broader efforts under the UNFCCC negotiations that can complement these efforts. Additionally, given the importance of national institutions in ensuring integrity of ITMOs, CCAP provides recommendations for individual Parties, or groups of Parties, as appropriate.

a) Recommendations for ITMO-related guidance

- **Discuss where central guidance is needed and what can be left to Parties:** Parties should have an open discussion on which of the Paris Agreement’s provisions and implications require centralized action to ensure transparency around transferred mitigation outcomes. The language in paragraph 36 of the decision text is relatively broad in what SBSTA may consider, and in this context Parties should wish to consider all aspects identified above.
- **Prioritize needs that will enable domestic action:** As CCAP has noted in other publications, many Parties are now in the process of “converting” their Nationally Determined Mitigation Actions into policies, measures, and finance-ready investment strategies. For some Parties, understanding the tools at their disposal may influence their domestic efforts in these areas. Parties should therefore prioritize early action on broad questions that are most likely to influence countries’ abilities to effectively plan. Parties may wish to establish a mechanism, such as an informal workshop or informal dialogue outside of the UNFCCC context, to allow Parties to identify which ITMO-related aspects have the most bearing on their domestic policy processes.
- **Consider “double use” aspects of double counting:** As considered above, the use of the same resources to achieve two different obligations under the Agreement (such as counting ITMO purchases/acquisition in both markets and finance) in some cases may give an impression of double counting. Parties should address key interactions between ITMOs and Means of Implementation (finance, technology, and capacity building), and provide appropriate safeguards against double counting.

Encourage innovation in low-risk areas: As considered in Table 2, some ITMO arrangements are lower risk than others, such as those where Parties are transferring mitigation outcomes not needed to achieve their NDC to Parties using ITMOs to enhance the ambition of their NDC. Parties’ collective action should encourage innovative use of transfers in these areas, including through facilitative means discussed above, and in the short term should avoid excessive restrictions that could stifle innovation in this low-risk category.

b) Process recommendations

- **Develop facilitative mechanisms to support Parties’ efforts:** As discussed above, Parties’ levels of capacity to use mitigation transfers, and experience with their use, vary significantly. Acknowledging this, the COP should request that the UNFCCC establish a process of facilitative workshops, possibly regional in scope, such as those addressed above, to improve capacity and share best practices. Along with Parties, such workshops should draw from insight of non-Party stakeholders, including sub-national authorities, who in many cases have experience with transferring mitigation outcomes across jurisdictions.
- **Design appropriate channels to integrate discussions where overlaps exist:** The considerations on ITMOs outlined above have implications for several other ongoing processes related to implementation of the Paris Agreement. To achieve consistency, addressing double counting

will require effective engagement with the ongoing Transparency process under the APA. The “double use” question addressed above may require establishing an appropriate mechanism for integrating SBSTA discussions on Article 6.2 and 6.4 related to ITMOs with discussions on Article 9.7 on accounting for financial resources. Other relevant processes may include, *inter alia*, the NDC guidance and information process (APA), the technology framework established under Article 10.4 (SBSTA), the Paris Committee for Capacity Building (SBI), and the Global Climate Action Agenda.

c) *Recommendations for Individual Party Action*

- **Directly consider risks and opportunities for ambition, NDC implementation, and complementarity with climate finance in design of ITMO policies:** In the past, Parties involved in carbon markets have developed their own set of policies for what credits are acceptable in their national systems. This can involve MRV standards, limitations on use of certain types of credits for compliance (such as CDM), or other provisions. As part of their shared responsibility to work toward the global goals identified in Article 2 of the Paris Agreement, Parties should structure their *individual* policies toward ITMO use in ways that support global ambition, NDC implementation, and efficient and appropriate use of climate finance. CCAP expects that demand for ITMOs will be concentrated among a relatively small number of high-demand Parties, and as such policies adopted by these Parties in relation to the use of ITMOs can have a significant impact on emerging norms in this space.
- **Develop domestic rules on ITMOs that align with NDC implementation strategies:** As noted above, many Parties may have pressures to allow unrestricted transfers of mitigation outcomes. Parties should be encouraged to develop strategies to implement their NDCs, considering the possible role ITMO generation, including where it may or may not be appropriate for national circumstances. In doing so, Parties should focus ITMO generation primarily on those mitigation outcomes not required to meet their NDC targets. Developing country Parties may require capacity building support to effectively develop these strategies.

CCAP is conducting research and analysis on how ITMOs can support Parties’ efforts to fulfill their NDC goals towards meeting the broader objectives set out in the Paris Agreement, and will continue to engage with our partners and other Parties and stakeholders to strengthen common understanding of key issues in ITMO use. We look forward to engaging further on these issues with interested Parties, international organizations, private sector actors, NGOs, and other stakeholders.

Contacts:

Laurence Blandford
Director of International Policy Analysis
Center for Clean Air Policy
lblandford@ccap.org

Stacey Davis
Senior Program Manager
Center for Clean Air Policy
sdavis@ccap.org

Paolo Cozzi
International Policy Analyst
Center for Clean Air Policy
pcozzi@ccap.org