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

Sixth session

Accra, 21–27 August 2008, and Poznan, 1–10 December 2008

Agenda item 3 (a)

**Analysis of means to reach emission reduction targets and identification of ways to
enhance their effectiveness and contribution to sustainable development**

Emissions trading and the project-based mechanisms

**Elaboration of possible improvements to emissions trading and
the project-based mechanisms under the Kyoto Protocol**

Note by the Chair

Summary

This note contains an elaboration by the Chair of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP) of possible improvements to emissions trading and the project-based mechanisms, namely the clean development mechanism and joint implementation under the Kyoto Protocol.

The elaboration builds upon the elements contained in annexes I and II of the report of the AWG-KP at the first part of its sixth session, which had been compiled from views submitted by Parties. It also draws upon further input on these elements submitted by Parties and discussions held during sessions and workshops under the AWG-KP.

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I. Introduction

A. Mandate

1. The Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP), at the first part of its sixth session, further considered possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol and ways to enhance the effectiveness of these means and their contribution to sustainable development and to achieving the ultimate objective of the Convention. In this context, the AWG-KP invited Parties to submit to the secretariat, by 17 October 2008, further input in relation to the elements contained in annexes I and II to the report of the first part of its sixth session, which had been compiled from views submitted by Parties.¹ These submissions are contained in document FCCC/KP/AWG/2008/MISC.7.

2. The AWG-KP further requested its Chair to elaborate these possible improvements, based on views submitted previously by Parties under its work and the submissions referred to in paragraph 1, and make the results of this work available to Parties prior to its resumed sixth session.²

B. Scope of the note

3. This note contains an elaboration by the Chair of the AWG-KP of possible improvements to emissions trading and the project-based mechanisms, namely the clean development mechanism and joint implementation, based on the views compiled by the AWG-KP at the first part of its sixth session. In addition to building upon the submissions by Parties, the note draws on discussions held during sessions and workshops under the AWG-KP.

4. The note elaborates only the possible improvements for the period after 2012 with potentially significant implications for the ability of Annex I Parties to achieve mitigation objectives, as contained in annex I to the report of the AWG-KP on the first part of its sixth session. Parties submitted only limited views on the other possible improvements contained in annex II to the report. As a result, the Chair considered that there was insufficient basis on which to prepare an elaboration of these elements. For completeness, annex II to the report has nevertheless been reproduced without elaboration in this note, also as annex II.

C. Possible action by the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol

5. The AWG-KP may wish to consider the elaboration on possible improvements to emissions trading and the project-based mechanisms contained in this note with a view to defining further steps necessary to reach agreement on the possible improvements during 2009 and to identifying how they relate to other elements of the work remaining to be undertaken by the AWG-KP.

II. Approach to the elaboration

6. The elaboration of possible improvements for the period after 2012 with potentially significant implications for the ability of Annex I Parties to achieve mitigation objectives is contained in annex I.

7. At the first part of its sixth session, the AWG-KP noted the importance of further assessing these possible improvements and clarifying any implications for the ability of Annex I Parties to achieve their mitigation objectives, as an input to the work of the AWG-KP pursuant to its work programme. Given the pressing need for the work on the mechanisms to inform other areas of the work programme, and in line with the approach taken by the AWG-KP at the first part of its sixth session, the Chair has kept in mind the need to progress towards legal or decision text when assembling the substantial

¹ FCCC/KP/AWG/2008/5, paragraph 22.

² FCCC/KP/AWG/2008/5, paragraph 23.

contributions made by Parties in their submissions. In doing so, the Chair has made every effort to advance all ideas and alternative options in a balanced manner, to the extent that this was possible given the differing levels of inputs that could be drawn upon.

8. Annex I maintains the structure developed at the first part of the sixth session and addresses all the elements identified during those discussions. Notes have been included to indicate further issues that may need to be considered in further developing the text, based on notes included in annex I to the report of the AWG-KP at the first part of its sixth session.

9. This note does not strive to fully develop all aspects and details of the possible improvements. Instead, a level of detail has been sought that can provide sufficient clarity on how the mechanisms can help Annex I Parties achieve their mitigation objectives after 2012, without overloading the process of reaching agreement with details that can be resolved by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol after the AWG-KP has completed its work.

Annex I

Possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol for the period after 2012 with potentially significant implications for the ability of Annex I Parties to achieve mitigation objectives^{1, 2}

I. Clean development mechanism

A. Include other land use, land-use change and forestry activities³

1. The eligibility of land use, land-use change and forestry (LULUCF) activities under the clean development mechanism (CDM) is extended to include:

- (a) Option 1: Reducing emissions from deforestation and forest degradation;
- (b) Option 2: Restoration of wetlands;
- (c) Option 3: Sustainable forest management and other sustainable land management activities.

Note: Further issues that may need to be addressed include modalities for inclusion of such LULUCF activities, including in relation to non-permanence and methodological issues.

B. Introduce a cap for newly eligible land use, land-use change and forestry activities⁴

2. A Party may use certified emission reductions (CERs)⁵ issued for LULUCF project activities under the CDM for compliance with its emission commitment under Article 3, paragraph 1,⁶ to a maximum of [x] per cent of its assigned amount pursuant to Article 3, paragraphs 7 and 8.

C. Include carbon dioxide capture and storage⁷

3. Option 1: Carbon dioxide capture and storage (CCS) activities are not eligible as CDM project activities.

Option 2: Annex I Parties are to refrain from using CERs generated from CCS activities to meet their commitments under Article 3, paragraph 1.

¹ For each element contained in this annex, there exists a 'status quo' option representing the maintenance of the current approaches and rules adopted by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol.

² Some Parties are of the view that the elements in sections I.E, I.F, I.G, I.J, II.A, III.A, III.B, III.C, IV.C and IV.D would require an amendment to the Kyoto Protocol and would not be within the mandate of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP). Some other Parties are of the view that legal analysis is needed to determine which elements in this annex would require a decision of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol or an amendment to the Kyoto Protocol and that such amendments would be within the mandate of the AWG-KP.

³ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

⁴ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

⁵ In this annex, "CERs" may also refer to temporary certified emissions reductions and long-term certified emission reductions.

⁶ In this annex, "Article" refers to an article of the Kyoto Protocol.

⁷ This issue is being considered by the Subsidiary Body for Scientific and Technological Advice under its work on carbon dioxide capture and storage in geological formations as CDM project activities.

Option 3: CCS activities may be registered under the CDM, and Annex I Parties may use CERs issued for such project activities, on the basis of emission reductions achieved during the second commitment period, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

Note: Further issues that may need to be addressed include:

- *Short- and long-term liability (e.g. in relation to leakage)*
- *Provisions for monitoring, reporting and verification, taking account of data availability*
- *Possible environmental impacts*
- *Definition of project boundaries*
- *Potential for perverse outcomes*

D. Include nuclear activities

4. Option 1: Activities relating to nuclear facilities are not eligible as CDM project activities.

Option 2: Activities relating to new nuclear facilities may be registered under the CDM, and Annex I Parties may use CERs issued for such project activities, on the basis of emission reductions achieved during the second commitment period, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

Note: Further issues that may need to be addressed include:

- *Specific criteria or requirements for eligible nuclear activities*
- *Costs relating to access to the technology*
- *Direct contribution to emission reductions*
- *Issues relating to non-proliferation*
- *Issues relating to permanent disposal of nuclear waste*
- *Safety, security and safeguards*

E. Introduce sectoral clean development mechanism for emission reductions below a baseline defined at a sectoral level

5. Sectoral CDM project activities, covering all emission sources within a defined sector, may be registered under the CDM and shall be subject to all modalities and procedures for the CDM adopted by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) and all procedures and decisions issued by the CDM Executive Board, except where specific modalities, procedures or decisions are defined by the CMP or the Executive Board for sectoral CDM project activities.

6. The supervision of the CDM by the Executive Board shall extend to sectoral CDM project activities. In this context, the Executive Board shall amend and establish its procedures as necessary for the effective functioning of sectoral CDM project activities.

7. Option 1: The baseline for a sectoral CDM project activity shall be the scenario that reasonably represents the anthropogenic emissions by sources of greenhouse gases (GHGs) within the sector boundary, or the sum of the changes in carbon stocks in the carbon pools within the sector boundary, that would occur in the absence of the project activity.⁸

Option 2: The baseline shall be the carbon intensity within the sector boundary during the calendar year 2012.

⁸ This option reflects the current provisions for the CDM and is based upon decision 3/CMP.1, annex, paragraph 44.

8. The sector boundary for a sectoral CDM project activity shall encompass all anthropogenic emissions by sources and removals by sinks of GHGs that are reasonably attributable to the defined sector.
9. Individual CDM project activities, registered at the time a sectoral CDM project activity is registered and falling within the sector boundary, may continue until the end of their current crediting period. The quantity of CERs issued on the basis of such individual CDM project activities shall be deducted from the quantity of CERs to be issued on the basis of the sectoral CDM project activity. Once a sectoral CDM project activity is registered for a sector, no further CDM project activities may be approved in relation to that sector.⁹
10. There shall be no double-counting of emission reductions or removals between sectoral CDM project activities.
11. In relation to sectoral CDM project activities, the CMP shall adopt modalities and procedures for:
- (a) The determination of a sector boundary;
 - (b) The determination of additionality for sectoral CDM project activities;
 - (c) The determination of sectoral baselines, in particular through the use of standardized baselines;
 - (d) The monitoring, verification and certification of emissions, and of emission reductions and removals, within the sector boundary;
 - (e) The treatment of potential leakage from within the sector boundary.

Note: The following table is to clarify the terminology used in this section.

<i>Mechanism under which the activity is undertaken</i>	<i>Clean development mechanism</i>
<i>What would be registered?</i>	<i>Sectoral CDM project activity</i>
<i>What would be the scope?</i>	<i>Defined sector</i>
<i>What would be the reference level?</i>	<i>Baseline</i>
<i>What would be issued?</i>	<i>Certified emission reductions</i>

Note: Further issues that may need to be addressed include:

- *The definition of a sector*
- *Potential for crediting cumulative emission reductions*

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

12. A sectoral crediting mechanism is established. A non-Annex I Party may propose to the CMP a crediting target for emissions or removals within a defined sector to be achieved through national actions. Reductions in emissions by sources in the sector below the crediting target, or enhancements in removals by sinks in the sector above the crediting target, shall result in the generation of credits which may be used by Annex I Parties to meet their emission commitments under Article 3, paragraph 1.

13. The sectoral crediting mechanism shall be supervised by [a dedicated body constituted by the CMP and operating under its authority] [the CDM Executive Board]. Before the supervisory body

⁹ The purpose of this provision would be to avoid the double-counting of emission reductions between a sectoral CDM project activity and other CDM project activities.

registers a sectoral crediting activity, the crediting target shall be recommended to the CMP by the supervisory body and shall be approved by the CMP.

14. A crediting target shall be set below the level of projected anthropogenic emissions by sources of GHGs within the sector boundary or above the sum of the projected changes in carbon stocks in the carbon pools within the sector boundary.

15. The sector boundary for a sectoral crediting activity shall encompass all anthropogenic emissions by sources and removals by sinks of GHGs that are reasonably attributable to the defined sector.

16. CDM project activities, registered at the time a sectoral crediting activity is registered and falling within the sector boundary, may continue until the end of their current crediting periods. The quantity of CERs issued on the basis of such CDM project activities shall be deducted from the quantity of credits to be issued on the basis of the sectoral crediting activity. Once a sectoral crediting activity is registered for a sector, no further CDM project activities may be approved in relation to that sector.¹⁰

17. There shall be no double-counting of emission reductions or removals between sectoral crediting activities.

18. The following LULUCF activities shall be eligible under the sectoral crediting mechanism: [...]

19. The non-Annex I Party may receive financing and technology in advance of credits being generated for a crediting target.

20. No credits shall be generated for a sectoral crediting activity if a crediting target has not been met. There shall be no other consequences for a Party that does not meet a crediting target.

21. In relation to the sectoral crediting mechanism, the CMP shall adopt modalities and procedures for:

- (a) The governance and administration of the sectoral crediting mechanism;
- (b) The determination of a sector boundary;
- (c) The determination and approval of crediting targets;
- (d) The monitoring, reporting and verification of emissions, and of emission reductions and removals, within the sector boundary;
- (e) The treatment of potential leakage from within the sector boundary;
- (f) The issuance of credits.

Note: The following table is to clarify the terminology used in this section.

<i>Mechanism under which the activity is undertaken</i>	<i>Sectoral crediting mechanism</i>
<i>What would be registered?</i>	<i>Sectoral crediting activity</i>
<i>What would be the scope?</i>	<i>Defined sector</i>
<i>What would be the reference level?</i>	<i>Crediting target</i>
<i>What would be issued?</i>	<i>Credits</i>

Note: Further issues that may need to be addressed include:

- *The definition of a sector*

¹⁰ The purpose of this provision would be to avoid the double-counting of emission reductions between a sectoral crediting activity and CDM project activities.

- *The degree to which a crediting target should be set below or above the projected level of emissions by sources or removals by sinks within the sector boundary*
- *Potential for crediting cumulative emission reductions*

G. Introduce crediting on the basis of nationally appropriate mitigation actions

22. Nationally appropriate mitigation actions (NAMAs), as referred to in decision 1/CP.13 (Bali Action Plan), paragraph 1 (b) (ii), may be registered under the CDM and shall be subject to all modalities and procedures for the CDM adopted by the CMP and all procedures and decisions issued by the CDM Executive Board, except where specific modalities, procedures or decisions are defined by the CMP or the Executive Board for NAMAs registered as CDM project activities.

23. The baseline for a NAMA registered as a CDM project activity shall be the scenario that reasonably represents the anthropogenic emissions by sources of GHGs within the NAMA boundary, or the sum of the changes in carbon stocks in the carbon pools within the NAMA boundary, that would occur in the absence of the project activity.

24. The NAMA boundary shall encompass all anthropogenic emissions by sources and removals by sinks of GHGs that are reasonably attributable to a defined NAMA.

25. Individual CDM project activities, registered at the time a NAMA is registered as a CDM project activity and falling within the NAMA boundary, may continue until the end of their current crediting period. The quantity of CERs issued on the basis of such individual CDM project activities shall be deducted from the quantity of CERs to be issued on the basis of the NAMA registered as a CDM project activity. Once a NAMA is registered, no further CDM project activities may be approved in relation to activities within the NAMA boundary.¹¹

26. There shall be no double-counting of emission reductions or removals between NAMAs registered as CDM project activities.

27. NAMAs meeting the following criteria shall be eligible under the CDM: [...]

28. In relation to NAMAs registered as CDM project activities, the CMP shall adopt modalities and procedures for:

- The determination of a NAMA boundary;
- The determination of additionality for NAMAs registered as CDM project activities;
- The determination of NAMA baselines;
- The monitoring, verification and certification of emissions, and of emission reductions and removals, within the NAMA boundary;
- The treatment of potential leakage from within the NAMA boundary.

Note: The following table is to clarify the terminology used in this section.

<i>Mechanism under which the activity is undertaken</i>	<i>Clean development mechanism</i>
<i>What would be registered?</i>	<i>NAMA as a CDM project activity</i>
<i>What would be the scope?</i>	<i>Defined NAMA</i>
<i>What would be the reference level?</i>	<i>Baseline</i>
<i>What would be issued?</i>	<i>Certified emission reductions</i>

¹¹ The purpose of this provision would be to avoid the double-counting of emission reductions between a NAMA registered as a CDM project activity and other CDM project activities.

Note: Further issues that may need to be addressed include:

- *Nature of participation of Parties*
- *Definition of NAMAs and the attribution to them of emission reductions and removals*
- *Consequences if an emission reduction or removal goal is not achieved*
- *Potential for perverse outcomes*
- *Potential for crediting cumulative emission reductions*

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

29. Option 1: The CDM Executive Board shall define standardized baselines for specific project activity types under the CDM by establishing parameters and procedures and making them available for use by project participants and designated operational entities (DOEs) in the application or development of baseline methodologies. The Executive Board may define such standardized baselines for types of project activities meeting the following criteria: [...]

Option 2: The use of standardized baselines as the basis for the determination of additionality and emission baselines shall be mandatory for the registration of new CDM project activities of the following types: [...]

30. Option 1: Parameters and procedures shall be established by the Executive Board on the basis of similar project activities undertaken in the previous five years, in similar social, economic, environmental and technological circumstances, whose performance is among the top [20] per cent of their category. Such parameters and procedures shall reflect national circumstances and shall be periodically adjusted.

Option 2: Parameters and procedures shall be established by the Executive Board on the basis of top performing installations or processes in the relevant sector, based on, inter alia, the performance of key technologies that are beyond common practice and technology penetration rates.

Note: Further issues that may need to be addressed include:

- *Types of project activities for which standardized baselines may be approved*
- *Further criteria for the definition of standardized baselines*

I. Ensure environmental integrity and assess additionality through the development of positive or negative lists of project activity types

31. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by the following categories of project activities are deemed to be additional to any that would occur in the absence of the project activities:

- (a) [Criteria based on the primary technology employed in the project activity];
- (b) [Criteria relating to the host Party of the project activity];
- (c) [Criteria based on the scale of the project activity (small-scale or large-scale)].

Note: Further issues that may need to be addressed include:

- *Categories of project activities to be included on a positive list*
- *Process for periodic review of the positive list*
- *Consequences for project activities registered without an additionality test if the project circumstances or the list change such that the project activities are no longer covered by the positive list*

32. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by the following categories of project activities are deemed not to be additional to any that would occur in the absence of the project activities, and the project activities are not eligible as project activities under the CDM:

- (a) [Criteria based on the primary technology employed in the project activity];
- (b) [Criteria relating to the host Party of the project activity];
- (c) [Criteria based on the scale of the project activity (small-scale or large-scale)].

Note: Further issues that may need to be addressed include:

- *Categories of project activities to be included on a negative list*
- *Process for periodic review of the negative list*
- *Consequences for registered project activities if the project circumstances or the list change such that the project activities are now covered by the negative list*

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

33. Non-Annex I Parties meeting the following criteria shall [not] be eligible to host [particular types of] project activities under the CDM: [...]

34. Annex I Parties meeting the following criteria shall [not] be eligible to use CERs issued for [particular types of] project activities under the CDM for the purpose of compliance with commitments under Article 3, paragraph 1: [...]

Note: Further issues that may need to be addressed include:

- *Appropriate indicators and thresholds, taking account of differing national circumstances*
- *Project activity categories affected by the eligibility determination*
- *Transition issues*

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

35. For [specified host Parties] [least developed countries and small island developing States] the following provisions shall apply:

- (a) The definition of a small-scale project activity is amended to [...];
- (b) Project activities that meet the requirements of small-scale project activities shall be [exempt from the requirement] [subject to simplified requirements] to demonstrate additionality;
- (c) The validation, verification and certification of project activities shall be funded through the [CDM management plan] [financial mechanism of the Convention].

Note: Further issues that may need to be addressed include:

- *Determination of the host Parties for which provisions are applicable or definition of criteria for subsequently determining the host Parties for which provisions are applicable*
- *Identification of further measures to improve access*
- *Potential measures to improve the enabling environment for CDM project activities*

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

36. Option 1: Project activities that demonstrate specific co-benefits shall be promoted through the following means:

- (a) Exemption from payment of registration fees;
- (b) Exemption from the share of proceeds to cover the administrative expenses of the CDM and/or assist with the costs of adaptation;
- (c) Expedited time lines for the registration of project activities.

Option 2: Each project activity shall demonstrate specific co-benefits.

37. A DOE shall, as part of its validation of a project activity, confirm [that the designated national authority of the host Party has confirmed that its stipulated co-benefits are demonstrated by the project activity] [that the proposed project activity demonstrates [any of] [all] the following co-benefits:

- (a) Energy efficiency;
- (b) Technology transfer;
- (c) Environmental services such as conservation of biodiversity, management of hydrological resources and maintenance of air quality;
- (d) Poverty alleviation;
- (e) Economic growth;
- (f) Social benefits.]

Note: Further issues that may need to be addressed include:

- *Provisions for the measurement of co-benefits*
- *Definition of a sufficient level of co-benefits*
- *Contribution to minimization of negative spillover effects*
- *Potential for perverse outcomes*

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

38. Option 1: A CDM project activity shall receive CERs equal to the emission reductions that are certified by the DOE multiplied by a factor decided by the CMP. Multiplication factors may be greater or less than one. The total quantity of CERs issued for a commitment period shall not exceed the aggregate quantity of emission reductions or removals achieved by CDM project activities during the commitment period.

Option 2: Specific CDM project activities shall receive CERs equal to the emission reductions that are certified by the DOE multiplied by a discount factor decided by the CMP.

39. The CMP shall adopt, and periodically review, the [multiplication factors] [discount factors] on the basis of the following criteria:

- (a) [Criteria based on environmental integrity;]
- (b) [Criteria based on the primary sectoral scope of the project activity;¹²]

¹² The sectoral scope of the project activity refers to the classification used under the CDM for the sector in which the project activity is located.

- (c) [Criteria based on the primary technology employed in the project activity;]
- (d) [Criteria based on the global warming potential of the gases whose emissions are reduced through the project activity;]
- (e) [Criteria relating to the host Party of the project activity;]
- (f) [Criteria based on the scale of the project activity (small-scale or large-scale).]

Note: Further issues that may need to be addressed include potential for perverse outcomes.

II. Joint implementation

A. Introduce modalities for treatment of clean development mechanism project activities upon graduation of host Parties

40. Option 1: Where a Party becomes eligible to host joint implementation (JI) projects, any registered CDM project activities hosted by that Party shall continue as CDM project activities until the end of their current crediting period and a quantity of assigned amount units (AAUs) equal to the CERs issued from this time onwards shall be cancelled.

Note: Further issues that may need to be addressed include:

- *Specific provisions for CDM afforestation and reforestation project activities*
- *Provisions for the cancellation of AAUs*

Option 2: Where a Party becomes eligible to host JI projects, any registered CDM project activities hosted by that Party shall be converted to JI projects and shall be subject to provisions for JI.

Note: Further issues that may need to be addressed include:

- *Specific provisions for CDM afforestation and reforestation project activities*
- *Provisions relating to the crediting period*
- *Transition issues*
- *Ability to select the JI Track 1 procedure if the relevant eligibility requirements are met by the host Party*

B. Include nuclear activities

41. Option 1: Activities relating to nuclear facilities are not eligible as JI projects.

Option 2: Activities relating to new nuclear facilities are eligible as JI projects, and Annex I Parties may use emission reduction units issued for such projects, on the basis of emission reductions achieved during the second commitment period, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

Note: Further issues that may need to be addressed include:

- *Specific criteria or requirements for eligible nuclear activities*
- *Costs relating to access to the technology*
- *Direct contribution to emission reductions*
- *Issues relating to non-proliferation*
- *Issues relating to permanent disposal of nuclear waste*
- *Safety, security and safeguards*

C. Include projects that reduce greenhouse gas emissions from deforestation and forest degradation¹³

Note: Projects that reduce GHG emissions from deforestation and forest degradation are not currently excluded from JI.

D. Ensure environmental integrity and assess additionality through the development of positive or negative lists of project types

42. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by the following categories of projects are deemed to be additional to any that would occur in the absence of the projects:

- (a) [Criteria based on the primary technology employed in the project;]
- (b) [Criteria relating to the host Party of the project;]
- (c) [Criteria based on the scale of the project (small-scale or large-scale).]

Note: Further issues that may need to be addressed include:

- *Applicability to JI Track 1 projects*
- *Categories of projects to be included on a positive list*
- *Process for periodic review of the positive list*
- *Consequences for projects that have received a final positive determination without an additionality test if the project circumstances or the list change such that the projects are no longer covered by the positive list*

43. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by the following categories of projects are deemed not to be additional to any that would occur in the absence of the projects, and the projects are not eligible as projects under JI:

- (a) [Criteria based on the primary technology employed in the project;]
- (b) [Criteria relating to the host Party of the project;]
- (c) [Criteria based on the scale of the project (small-scale or large-scale).]

Note: Further issues that may need to be addressed include:

- *Applicability to JI Track 1 projects*
- *Categories of project activities to be included on a negative list*
- *Process for periodic review of the negative list*
- *Consequences for projects that have received a final positive determination if the project circumstances or the list change such that the projects are now covered by the negative list*
- *Potential for perverse outcomes*

E. Include co-benefits as criteria for the final determination for projects

44. Option 1: Projects that demonstrate specific co-benefits shall be promoted through the following means: [...]

Option 2: Each project shall demonstrate specific co-benefits.

¹³ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

45. An accredited independent entity shall, as part of its determination regarding a project, determine [that the designated focal point of the host Party has confirmed that its stipulated co-benefits are demonstrated by the project] [that the proposed project demonstrates [any of] [all] the following co-benefits:

- (a) Technology transfer;
- (b) Environmental services such as conservation of biodiversity, management of hydrological resources and maintenance of air quality.]

Note: Further issues that may need to be addressed include:

- *Applicability to JI Track 1 projects*
- *Determination of the means of promoting projects*
- *Provisions for the measurement of co-benefits*
- *Definition of a sufficient level of co-benefits*
- *Potential for perverse outcomes*

III. Emissions trading

A. Introduce emissions trading based on sectoral targets¹⁴

46. Sectoral emissions trading may occur between Parties on the basis of emission targets established in relation to a defined international sector for each participating Party. The emission targets shall correspond to a compliance period ending with the commitment period defined in Article 3, paragraph 1.

47. Sectoral emissions trading shall be supervised by a dedicated body constituted by the CMP and operating under its authority. Before the supervisory body registers a sectoral emissions trading scheme, the emissions target shall be recommended to the CMP by the supervisory body and shall be approved by the CMP.

48. The aggregate emission target for an international sector, comprising the emission targets of participating Parties, shall be set below the level of projected anthropogenic emissions by sources of GHGs within the sector boundary.

49. The sector boundary for a sectoral emissions trading scheme shall encompass all anthropogenic emissions of GHGs that are reasonably attributable to the defined international sector. The geographical scope of the international sector may encompass Annex I Parties and non-Annex I Parties.

50. Subject to meeting eligibility requirements for participation in sectoral emissions trading, a non-Annex I Party shall issue emission allowances corresponding to its emission target. The emission allowances may be transferred and acquired internationally. The emission allowances may be used by Annex I Parties to meet their emission commitments under Article 3, paragraph 1, and may be used for compliance with emission targets established under all sectoral emissions trading schemes.

51. AAUs issued by Annex I Parties for the commitment period shall constitute emission allowances under sectoral emissions trading. AAUs and other tradable units defined under the Kyoto Protocol may be used for compliance with emission targets established under sectoral emissions trading schemes.

52. Registered CDM project activities in the defined international sector may continue in parallel with the sectoral emissions trading scheme. A quantity of the emission allowances under the sectoral

¹⁴ This element differs from sectoral crediting below a no-lose target (see section I.F) in several respects.

For example, the sector is “international” and encompasses actors from the same industrial sector in many Parties. As a result, trading would, in the first instance, be among these actors, as well as possibly through links to other schemes. Furthermore, emission allowances would be issued at the beginning of a compliance period and would therefore be available for transfer from that point.

emissions trading scheme, issued for the host Party of the CDM project activity and equal to the CERs issued during the compliance period, shall be cancelled.

53. Emission targets shall be based on the most recent available data. There shall be no double-counting of emissions between emission targets established for international sectors.
54. Parties may devolve emission targets and allowances to legal entities and allow them to participate in a sectoral emissions trading scheme.
55. An emission target established for an Annex I Party in the context of sectoral emissions trading shall not impact on the emission commitment of that Party under Article 3, paragraph 1.
56. In relation to sectoral emissions trading, the CMP shall adopt modalities and procedures for:
- (a) The governance and administration of sectoral emissions trading;
 - (b) The definition of an international sector;
 - (c) The determination of a sector boundary;
 - (d) The determination and approval of emission targets;
 - (e) The monitoring, reporting and verification of emissions within the sector boundary;
 - (f) Accounting of emission allowances, including their issuance;
 - (g) Eligibility requirements for participation in sectoral emissions trading, in particular in relation to the monitoring, reporting and verification of emissions and accounting of emission allowances, including requirements for the issuance of emission allowances;
 - (h) The treatment of potential leakage from within the sector boundary;
 - (i) Non-compliance with emission targets.

Note: The following table is to clarify the terminology used in this section.

<i>Mechanism under which the activity is undertaken</i>	<i>Sectoral emissions trading</i>
<i>What would be registered?</i>	<i>Sectoral emissions trading scheme</i>
<i>What would be the scope?</i>	<i>Defined international sector</i>
<i>What would be the reference level?</i>	<i>Emission target</i>
<i>What would be issued?</i>	<i>Emission allowances</i>

Note: Further issues that may need to be addressed include:

- *The definition of a sector*
- *Form of the emission targets*
- *Definition of the tradable unit*
- *Differences in implementation if sectoral emissions trading is initiated and administered by Parties or by organizations*

B. Introduce emissions trading on the basis of nationally appropriate mitigation actions

57. CERs that are generated on the basis of a NAMA registered as a CDM project activity may be transferred and acquired under international emissions trading pursuant to Article 17.¹⁵

¹⁵ See section I.G. CERs issued on the basis of a NAMA registered as a CDM project activity would automatically be eligible for transfer and acquisition under emissions trading pursuant to Article 17.

C. Introduce the linking of emissions trading schemes in Annex I Parties to voluntary emissions trading schemes in non-Annex I Parties

58. Where a national or regional emissions trading scheme implemented on a voluntary basis by a non-Annex I Party or non-Annex I Parties meets specific eligibility requirements, emission allowances issued under the scheme may be transferred and acquired internationally and may be used by Annex I Parties to meet their emission commitments under Article 3, paragraph 1.

59. The specific eligibility requirements shall be:

- (a) [Requirements relating to the basis for establishing emission targets;]
- (b) [Requirements relating to the monitoring, reporting and verification of emissions;]
- (c) [Requirements relating to the accounting of emission allowances;]
- (d) [Requirements relating to the avoidance of double-counting with emission reductions under the CDM.]

IV. Cross-cutting issues

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

60. Option 1: There shall be no restrictions on the carry-over of Kyoto units to a subsequent commitment period.

Option 2: Limits on the carry-over of specific Kyoto units to a subsequent commitment period shall be as follows: [...]

Note: Further issues that may need to be addressed include proposed limits on carry-over, by Kyoto unit type.

B. Change the limit on the retirement of temporary certified emission reductions and long-term certified emission reductions¹⁶

61. Option 1: There shall be no restrictions on the use of temporary certified emission reductions (tCERs) and long-term certified emission reductions (lCERs) by Annex I Parties to meet their emission commitments under Article 3, paragraph 1.

Option 2: Limits on the use of tCERs and lCERs by Annex I Parties to meet their emission commitments under Article 3, paragraph 1, shall be as follows: [...]

Note: Further issues that may need to be addressed include proposed limits on retirement for tCERs and lCERs.

C. Introduce borrowing of assigned amount from future commitment periods

62. An Annex I Party may borrow assigned amount from the subsequent commitment period and use it for the purpose of compliance with its emission commitment under Article 3, paragraph 1, in the current commitment period in accordance with the following provisions: [...]

Note: Further issues that may need to be addressed include:

- *Timing of the 'repayment' of the assigned amount*
- *Limits on borrowing*

¹⁶ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

- *Cost of borrowing, including through an ‘interest rate’*
- *Consequences for non-compliance in the subsequent commitment period*
- *Implications for the environmental integrity of the Kyoto Protocol*

D. Extend the share of proceeds¹⁷

Note: Further issues that may need to be addressed include pros and cons of keeping the current provisions and extending the share of proceeds to JI and emissions trading under Article 17 or to the issuance of assigned amount units and removal units.

¹⁷ This issue is being considered by the CMP under its work on the second review of the Kyoto Protocol pursuant to its Article 9.

Annex II**Other possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol^{1, 2}****I. Clean development mechanism**

- A. Introduce a different supervisory structure and institutional arrangement in case of modification of the scope of the clean development mechanism**
- B. Change the composition of the Executive Board membership to ensure equitable representation of Parties**
- C. Move the secretariat's function of supporting the Executive Board to another organization**
- D. Introduce alternative institutional arrangements for validation, verification and certification**
- E. Broaden the role of host Party governments**
- F. Differentiate the treatment of types of project activities by Party**
- G. Allocate proportions of demand to project activity types that contribute more to the sustainable development of host Parties**
- H. Allocate proportions of demand to specific groups of host Parties to enhance their sustainable development**
- I. Introduce alternative accounting rules for afforestation and deforestation project activities in order to increase demand³**
- J. Restrict the clean development mechanism to bilateral project activities**
- K. Use global temperature potentials instead of global warming potentials⁴**
- L. Include technology transfer as a criterion for the registration of project activities**
- M. Revise criteria for accreditation of designated operational entities, especially financial criteria, to enhance the accreditation of designated operational entities based in non-Annex I Parties**

¹ For each element contained in this annex, there exists a 'status quo' option representing the maintenance of the current approaches and rules adopted by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol.

² Some Parties are of the view that the elements in sections I.F, I.G, I.H, I.K, II.I, II.K, II.L and II.M would require an amendment to the Kyoto Protocol and would not be within the mandate of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP). Some other Parties are of the view that legal analysis is needed to determine which elements in this annex would require a decision of the CMP or an amendment to the Kyoto Protocol and that such amendments would be within the mandate of the AWG-KP.

³ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

⁴ Global warming potentials are being considered by the AWG-KP under its work on greenhouse gases, sectors and source categories.

II. Joint implementation

- A. Ensure that approaches for land use, land-use change and forestry projects under joint implementation are in line with the treatment of land use, land-use change and forestry under Article 3, paragraphs 3 and 4, of the Kyoto Protocol⁵**
- B. Introduce approaches for land use, land-use change and forestry projects under joint implementation that are parallel to the treatment of clean development mechanism afforestation and reforestation project activities⁶**
- C. Introduce crediting on the basis of nationally appropriate mitigation actions**
- D. Introduce a different supervisory structure and institutional arrangement in case of modification of the scope of joint implementation**
- E. Change the composition of the Joint Implementation Supervisory Committee membership to ensure equitable representation of Parties**
- F. Move the secretariat's function of supporting the Joint Implementation Supervisory Committee to another organization**
- G. Introduce alternative institutional arrangements for determination and verification**
- H. Broaden the role of host Party governments**
- I. Differentiate the eligibility of Parties through the use of indicators**
- J. Improve access to joint implementation projects by certain host Parties**
- K. Differentiate the treatment of types of projects by Party**
- L. Allocate proportions of demand to project types that contribute more to the sustainable development of host Parties**
- M. Allocate proportions of demand to specific groups of host Parties to enhance their sustainable development**
- N. Restrict joint implementation to bilateral projects**
- O. Introduce multiplication factors to increase or decrease the emission reduction units issued for specific project types**
- P. Use global temperature potentials instead of global warming potentials⁷**
- Q. Include technology transfer as a criterion for the final determination for projects**

⁵ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

⁶ Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

⁷ Global warming potentials are being considered by the AWG-KP under its work on greenhouse gases, sectors and source categories.

III. Emissions trading

- A. Eliminate restrictions on the trading and use of certain Kyoto unit types under national and regional emissions trading schemes**
- B. Enhance equivalence among Kyoto unit types**
- C. Reduce the commitment period reserve**
- D. Increase the commitment period reserve**
- E. Encourage disclosure of information on transactions of Kyoto units**
- F. Move the secretariat's function of maintaining and operating the international transaction log to another organization**

IV. Cross-cutting issues

- A. Reduce the number of unit types under the Kyoto Protocol**
- B. Introduce a mid-commitment-period assessment and review process**
