

## IETA Input to Article 6.4 Supervisory Body

### Requirements for the Development and Assessment of Mechanism Methodologies

April 2023

#### INTRODUCTION

The International Emissions Trading Association (IETA) appreciates the efforts by the UNFCCC Secretariat, Parties, the Article 6.4 Supervisory Body (A6.4 SB), Observer Organizations and Non-party stakeholders in operationalising the Article 6.4 Mechanism. We welcome the request for further stakeholder input on requirements for the development and assessment of mechanism methodologies, as requested by the Supervisory Body at its fourth meeting (SB004 meeting report, paragraph 21).

IETA believes it is of utmost important to make the Article 6.4 Mechanism an attractive crediting mechanism for market participants, or project developers may decide to utilise national programmes and private standards. Many of the points currently under discussion within the A6.4 SB have been covered by several initiatives in the context of voluntary carbon markets, including by the Integrity Council for the Voluntary Carbon Market (IC-VCM) and its Core Carbon Principles (CCPs). The A6.4 SB should closely consider these principles and guidance to support coherence and ideally converge across carbon market mechanisms worldwide.

IETA's input is structured around five sections: Baseline Setting, Additionality, Leakage, Non-Permanence and Reversals, and Standardised Baselines.

#### SECTION 1: BASELINE SETTING

IETA takes note of an ongoing debate around what it means to set a baseline in a 'Paris Aligned' manner. For some in the carbon markets community, this is taken to mean a baseline which contains all the mitigation already encompassed within a net-zero aligned NDC of the host Party. However, this would severely limit the potential of the Mechanism to deliver emission reductions and removal at scale and speed. We believe that "net-zero" alignment legitimately includes cooperation with other Parties to achieve the "net" mitigation. While IETA recognises that the market-based mechanisms of Article 6 must increase ambition in mitigation and adaption, **it is the purpose of the Mechanism to enable Parties to both achieve their Nationally Determined Contributions (NDCs) and deliver more mitigation.** In the case of achievement, to ensure integrity and ambition, it is imperative that the baseline is set such that the relationship between the activity and the fulfilment of the NDC is clear.

Considering the elements in paragraph 33 of the Rules Modalities and Procedures (RMPs) on which input is sought, IETA understands that the Mechanism should:

- encourage ambition over time by generating positive climate impacts that remove barriers to the deployment of clean technologies, reduce the cost of decarbonisation and unlock investment in low-carbon solutions;
- encourage broad participation across all types of regions and participants by avoiding excessive complexity;

- be real, transparent, conservative, credible, below ‘business as usual’ by adopting a robust, open, and user-friendly measurement, reporting and verification (MRV) systems;
- avoid leakage by applying safeguards that are common in existing carbon markets (see section 3 below);
- align with the long-term temperature goals of the Paris Agreement by considering emission reductions and removals that deliver mitigation in this decade and avoid creating perverse incentives and/or reward low-ambition NDCs.

We believe that **the Mechanism contributes to the equitable sharing of mitigation benefits between participating Parties by design, thanks to its short-crediting periods and the promotion of a Share of Proceeds (SoP) for adaptation.** Further credit sharing arrangements may be considered by Designated National Authorities (DNAs), but we caution against excessive haircuts that may undermine the economic viability of projects and/or the competitiveness of the Article 6.4 Mechanism in relation to other crediting programmes.

Overall, IETA agrees with paragraphs 59 and 60 of the draft recommendation document, in which the performance-based approaches to set baselines and achieve such elements are defined and have its applications explained. However, when it comes to assessing the economic feasibility of Best Available Technologies (BAT), the cost of ownership as a percentage of average household annual income may not be suitable to all activities. A penetration rate (in absolute terms or as a fraction to uptake in the most mature markets) or other metrics may be used in some cases. Furthermore, when applying an approach based on existing actual or historical emissions adjusted downwards, it would be important to have multiple options for downward adjustment depending on activity types and local circumstances.

IETA observes that **the adoption of performance-based approaches in paragraph 36 of the RMPs would achieve increasing stringency over time by default without the need to review baselines over time.** However, if baseline reviews take place, these should be at predictable time intervals. Regarding scalability and replicability, IETA considers that an expanded user base of low-carbon solutions after initial deployment supported by carbon markets is also one of the critical ways to encourage ambition over time. Baseline contraction factors can be a helpful tool, but they are not the most suitable approach for all methodologies. In light of the above, we believe that both approaches outlined in paragraphs 11 and 12 of the draft recommendation document should be acceptable and applied to methodologies.

On the question of whether the stringency over time should be in the form of a net-to-gross adjustment to the emission reductions achieved applied in all methodologies or be sought through a sector or region-specific adjustment factor, IETA believes that the best approach should differentiate between activity types, sectors, and regions under consideration.

**With respect to CCS/BECCS/DACCS activities, careful consideration must be given to the use of forward-looking baseline adjustments over time.** Typically, in the absence of other sources of revenue, the only economic case for undertaking these engineered/technology climate solutions is the carbon price. Reducing these activity baselines over time will diminish crediting levels awarded in the future, which will erode economic attractiveness of such activities. Similar issues may also arise in the case of other carbon removal methods (e.g., soil carbon). IETA therefore suggests careful consideration of whether engineered/technology mitigation technologies, such as CCS and certain carbon removal methods, might warrant differential treatment of baselines relative to other types of creditable reduction activities under Article 6.4.

## SECTION 2: ADDITIONALITY

Considering how the different elements of additionality requirements in paragraph 38 of the RMPs should be demonstrated, IETA understands that the Mechanism should:

- require counterfactual analysis based on realities on the ground to demonstrate that the project ‘would not have occurred in the absence of the incentives from the mechanism’;
- consider what is expected to happen in light of existing and planned policies for ‘taking into account all relevant national policies, including legislation’;
- demand clarity on what is required by law or regulation for emission reductions or removals in a given jurisdiction by providing evidence that the activity goes beyond those requirements to ensure it is ‘representing mitigation that exceeds any mitigation that is required by law or regulation’; and
- require an assessment of how the activity promote low-emission and sustainable development pathways aligned with the long-term goals of the Paris Agreement to ensure the activity is ‘taking a conservative approach that avoids locking in levels of emissions, technologies, or carbon-intensive practices incompatible with paragraph 33 of the RMP’.

IETA emphasises that the application of such additionality requirements should not create an excessive burden to project developers that might undermine engagement with the Mechanism and, eventually, its potential to promote emission reductions and removals. More specifically, when developing recommendations on how methodologies should account for national policies and legislation, the existence of ambitious high-level targets enshrined in legislation but not backed up by incentive or enforcement mechanisms should not necessarily disqualify some activities as non-additional. We believe **enforcement rates should be included in the assessment of additionality**. Otherwise, this assessment would create a perverse incentive that penalise countries putting in place ambitious policies and favours those that do not.

**New laws and regulations enforced during the crediting period should be considered at the time of renewal of the crediting period to avoid compromising the financial viability of projects** and attract a regulatory risk premium. Short crediting periods, stringency of baselines and robust additionality tests will already reduce the scope for over issuance. If changes are considered necessary, they should be predictable and take place at pre-determined intervals (e.g., every 5 years for non-renewable crediting periods).

**IETA supports the development of global and country-specific positive lists** to provide guidance to investors and reduce administrative burdens. Sectors outside the host Party’s NDC and high abatement cost activities are some broad activity types that Parties might want to include in positive lists. Given the need to balance between stability and the dynamic nature of policy and technology developments, positive lists should be subject to periodic reviews at predictable intervals (e.g., every 5 years). It is also important to emphasize that by establishing positive lists, Parties are only easing the process for activities on the list, and, eventually, facilitating the work of the Secretariat, the A6.4 SB, DOEs, and project participants. However, such lists should not preclude other activities to be allowed under the Mechanism.

**The approach to additionality for removals should take into account the unique and specific nature of these activities.** As the primary purpose of many engineered/technology removal activities is climate mitigation (e.g., Direct Air Capture, DAC, and Storage or Bioenergy with Carbon Capture and Storage, BECCS), carbon market investments are therefore likely to be a necessary source of financing. Unless they are mandated by legislation, such projects are most likely to be highly additional.

Finally, it is important to be pragmatic when assessing “lock-in” levels as, by definition, any project that generates residual emissions would lock-in some emissions. **Instead of promoting negative lists, a broader assessment** should be conducted – an assessment focused on how the activity promotes low-emission and sustainable development pathways aligned with long-term goals of the Paris Agreement.

### SECTION 3: LEAKAGE

IETA highlights the importance of clearly defining leakage while noting how the term “carbon leakage” is used to indicate two distinct phenomena in carbon markets. First, carbon leakage can be used when referring to the relocation of emission-intensive trade exposed (EITE) activities from jurisdictions with a higher cost of carbon to jurisdictions with a lower one. Second, carbon leakage can also refer to an increase in emissions outside the boundary of an emission reduction or removal activity as a result of activity implementation. This type of leakage is also called the “waterbed effect”. **We believe that the Article 6.4 Mechanism should be largely focused on minimising the second type of leakage.**

Activities in the land-use and industrial sectors are the ones where the risk of leakage tend to be higher. To address such a risk, nesting of activities and jurisdiction-level crediting are proving to be effective approaches. A thorough lifecycle assessment of the impact of an activity should be the starting point to address the risk of leakage. Robust MRV systems and integrated registries are also key to identify carbon leakage and reduce such risks across different types of activities and countries.

### SECTION 4: NON-PERMANENCE AND REVERSALS

Carbon markets have addressed the risk of non-permanence and reversals through the implementation of pooled buffers, which we consider a suitable tool that should continue to be used in the Article 6.4 Mechanism. Such **buffers should be based on the actual risk for each specific activity and in each geographical area**, avoiding situations in which low risk activities subsidise high risk ones through unreasonably high buffers. Buffers should also take into account and not duplicate existing domestic regulations that require collateral for addressing reversals.

### SECTION 5: STANDARDISED BASELINES

Unless Parties wish to apply standardised baselines regionally or globally due to the benefits they can generate for measurement and monitoring costs, **such approaches should be determined country-by-country.**

Standardised and jurisdictional baselines for sectors or activities could be helpful in some cases as they would reduce transaction costs and support Parties with limited technical capacity to participate in the Mechanism. Use of standardised procedures and datasets can reduce the cost of proving additionality and determining crediting baselines, which could increase the commercial viability of some projects and simplify the project development process. This means that standardised baselines can make the Mechanism more easily accessible to a broader range of stakeholders. However, IETA recognises that the inevitable conservativeness of such simplified procedures may rule out some projects that would otherwise be considered additional. To address such issues, Parties should have the option to allow

projects facing specific circumstances to forgo the use of these standardised tools and establish additionality and baseline emissions for the individual project.

## ABOUT IETA

IETA is a non-profit business organisation with a membership of over 300 leading international organisations operating in compliance and voluntary carbon markets. Since its foundation in 1999, IETA has been the leading voice of business on market-based ambitious solutions to climate change. We are a trusted adviser to governments to support them build international policy and market frameworks to reduce greenhouse gases at lowest cost, increase ambition, and build a credible path to net-zero emissions. See [www.ieta.org](http://www.ieta.org) for more information.

IETA and its members look forward to further engaging with the Secretariat on these topics. Do not hesitate to contact Pedro Venzon ([venzon@ieta.org](mailto:venzon@ieta.org)) or Andrea Bonzanni ([bonzanni@ieta.org](mailto:bonzanni@ieta.org)) if you would like to discuss further.

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