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UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

**Ad Hoc Working Group on Long-term Cooperative Action
under the Convention**

Fourteenth session, part three

Panama City, 1–7 October 2011

Agenda item 3.2.5

**Various approaches, including opportunities for using markets, to enhance
the cost effectiveness of, and to promote, mitigation actions, bearing in mind
different circumstances of developed and developing countries**

Views on the elaboration of market-based mechanisms

Submissions from Parties

Addendum

1. In addition to the submissions contained in documents FCCC/AWGLCA/2011/MISC.2, FCCC/AWGLCA/2011/MISC.2/Add.1, FCCC/AWGLCA/2011/MISC.2/Add.2 and FCCC/AWGLCA/2011/MISC.2/Add.3, one further submission has been received.
2. In accordance with the procedure for miscellaneous documents, this submission is attached and reproduced* in the language in which it was received and without formal editing.

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FCCC/AWGLCA/2011/MISC.2/Add.4

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**SUBMISSION BY POLAND AND THE EUROPEAN COMMISSION ON BEHALF OF
THE EUROPEAN UNION AND ITS MEMBER STATES**

**This submission is supported by Albania, Croatia, Iceland, the Former Yugoslav Republic of
Macedonia, Montenegro and Serbia.**

Warsaw, 20th September 2011

**Subject: A new market-based mechanism for developing countries consisting of a
common core set of rules and procedures at the international level**

1. The EU welcomes the opportunity to submit its views on new market-based mechanisms.
2. This submission builds on and should be considered in conjunction with our previous submissions, most recently February 11, 2011¹.
3. The EU looks forward to the establishment at COP 17 in Durban of a new market-based mechanism for developing countries consisting of a common core set of rules and procedures at the international level. The EU sees it as an important part of a balanced package. The decision to be agreed in Durban should provide clear guidance on the characteristics of this mechanism, building on those captured in the Cancún Agreements², and a clear process and timeline for the development of modalities and procedures soon thereafter.

Need for coordinated approach for new market-based mechanisms

4. The new market-based mechanism is essential to ensure that global action is sufficient to stay below a 2°C increase in temperatures and to enhance the cost-effectiveness of global mitigation action. The development of such a mechanism should complement existing flexible mechanisms under the Kyoto Protocol.
5. A variety of new market-based mechanisms are currently being developed in a bottom-up manner irrespective of the progress of negotiations at the UNFCCC level. Such initiatives and pilot activities are useful, however they are not coordinated and could lead to market fragmentation, thereby minimising transparency and liquidity of the carbon market and increasing the risk for leakage and free-riding. Finally, the units resulting from the new market-based mechanisms need to represent real, measurable, verifiable and additional emission reductions.
6. A coordinated approach with stringent requirements has following benefits:
 - environmental integrity of carbon credits which represent real and additional emission reductions;
 - higher transparency, predictability and clarity for all market participants;
 - increased efficiency due to a homogeneous market with fully fungible units;
 - quicker enhancement of the international carbon market;

¹ Contained in FCCC/AWGLCA/2011/MISC.2, p. 48.

² Decision 1/CP.16, paragraph 80.

- attracting more private investment to a properly regulated market;
 - facilitates more stringent emissions caps in the future;
 - facilitates comparability in assessment of mitigation efforts;
 - more confidence for developing low carbon technologies due to a larger market.
7. Providing a coordinated approach through a new market based mechanism at the UNFCCC level is critical and should happen without delay. The implementation of this mechanism will take time. The new market-based mechanism should be established now and must not be postponed.

Key principles for the new market-based mechanism

8. The new market-based mechanism will need to build on the characteristics agreed in Cancún: voluntary participation, complementing other means of support for NAMAs, stimulating mitigation across broad segments of the economy, safeguarding environmental integrity, ensuring a net decrease and/or avoidance of global GHG emissions, assisting developed country Parties to meet part of their mitigation targets, ensuring good governance and robust market functioning³.
9. The new market-based mechanism would allow for two basic forms: trading and crediting⁴.
10. The national implementation of the new market-based mechanism results in internationally tradable units representing 1 ton of CO₂-equivalent.
11. Clear rules regarding the complementary relationship between CDM and the new market-based mechanism will need to be agreed. These rules should give incentives for more emission reductions, avoid double counting of emission reductions, provide clarity to investors and ensure the continuing stability of the market.

Governance framework

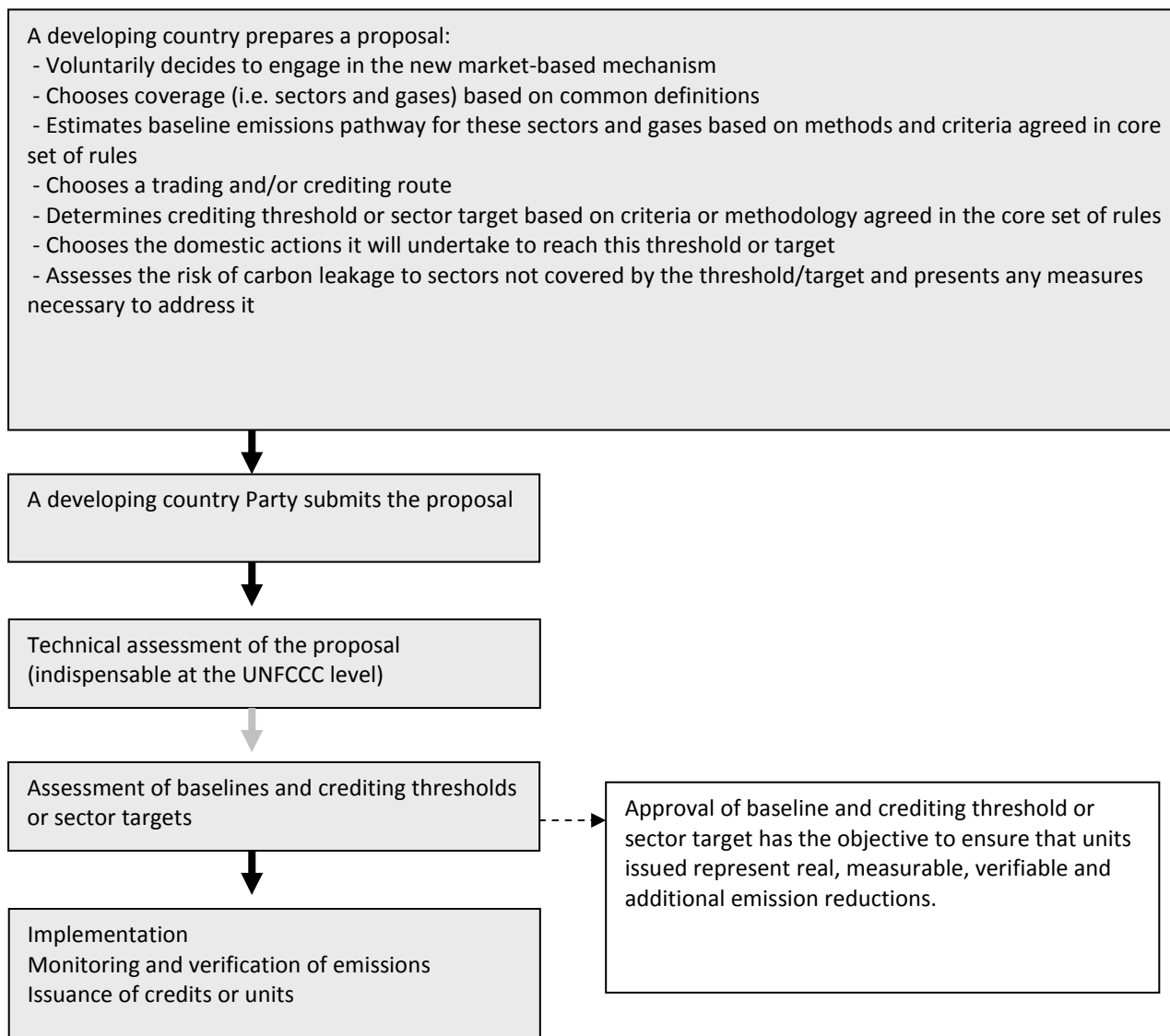
12. The new market-based mechanism under the UNFCCC can accommodate different forms of implementation in host countries.
13. The common core set of rules are to be agreed under the UNFCCC. This would include, inter alia, rules how to define sectors and coverage of gases, methods and criteria for determining baselines, crediting thresholds or sector targets, length of crediting/trading period, guidelines for monitoring, reporting and verifying emissions, accreditation of verifiers. The core set of rules needs to ensure environmental integrity of the national implementation of the new market-based mechanism.
14. Flexibility could be retained for some more detailed design features. National arrangements in developing countries may be different, e.g. how crediting thresholds or sector target are reached, distribution of emission reduction effort within the broad segment of economy, etc.
15. As a general rule of ownership and responsibility, the implementation shall rest with the host country, everything that can be done at the host country level, could be done there. This will provide for greater host country role in implementing the new market-based mechanism.

³ For elaboration of the characteristics agreed in Cancun see EU's submission of 15th February 2011 in FCCC/AWGLCA/2011/MISC.2, p51-57.

⁴ See paragraphs 18-20 in EU's submission of 15th February 2011 in FCCC/AWGLCA/2011/MISC.2, p51.

16. The national implementation of the new market-based mechanism should be facilitated by capacity building where such is needed. The EU is willing to strengthen its cooperation and support to improve carbon market readiness in developing countries.

The illustrative operation cycle for new market-based mechanism



New market-based mechanism in the accounting framework

17. As outlined in a separate submission⁵, the EU considers that establishing a rigorous, robust and transparent international accounting system is indispensable to ensure the environmental integrity of the climate regime and to secure comparability between Parties' commitments. As part of this international accounting system, one essential element is to define common rules to account for the use of market-based mechanisms. This is especially important as market-based mechanisms require specific and robust rules to i.a. ensure their environmental robustness and avoid double counting. The proposals formulated by the EU in the present submission fully form part of this overall accounting framework.

⁵ Cf Submission on need for a rigorous, robust and transparent international accounting system.

Annex: draft decision text

Non paper⁶ on elements for a decision on enhanced action on mitigation - 3.2.5 (markets – 1bv of the BAP) - LCA - /CP.17

The Conference of the Parties,

Recalling the decision 1/CP.16

Recognising that enhancing the cost-effectiveness of, and promoting mitigation actions requires a broad range of approaches, including market-based approaches to establish a value for emissions of greenhouse gases,

Recognising that enhancing the cost-effectiveness of mitigation actions minimises the global costs of climate change mitigation to society and enables an increase in the overall ambition to reduce emissions,

Emphasising the importance of contributing to sustainable development, including through technology transfer and other co-benefits,

Acknowledging the mechanisms established under the Kyoto Protocol and supporting the continuation of the use of these mechanisms,

- 1 *Decides* to establish a new market-based mechanism for developing countries consisting of a common core set of rules and procedures at the international level, that complements other means of support for nationally appropriate mitigation actions by developing country Parties, enhances the cost-effectiveness of mitigation and assists developed country Parties in meeting part of their mitigation commitments, while ensuring that the use of such a mechanism is supplemental to domestic mitigation efforts;
- 2 *Decides* that the establishment of the new market-based mechanism referred to in paragraph 1 above shall be guided by the following:
 - (a) Ensuring voluntary participation of Parties, supported by the promotion of fair and equitable access for all Parties;
 - (b) Stimulating mitigation across broad segments of the economy, which constitute a significant proportion of a country's emissions or a significant proportion of a country's GDP, and can contain sectors or subsectors;
 - (c) Safeguarding environmental integrity by ensuring that emission reductions and removals are additional to any that would otherwise occur, providing for robust measurement, reporting and verification, preventing the different types of double-counting, inter alia between developed and developing country mitigation, mitigation and public finance and with existing mechanisms and minimizing the risk of carbon leakage;
 - (d) Ensuring a net decrease and/or avoidance of global greenhouse gas emissions and reflecting contributions by developing country Parties to global mitigation efforts;
 - (e) Promoting investment by the private sector;

⁶ The EU distributes this text as a suggestion in order to move forward the discussion in the run-up to the Durban Climate Conference.

- (f) Ensuring good governance and robust market functioning and regulation; the governance of the mechanism shall ensure environmental integrity, robust accounting system, efficiency, minimised administrative costs and contribute to sustainable development;
- (g) Compliance with a common and reliable accounting requirements and MRV framework.

3 [Placeholder: use of units]

4 *Requests* [SBI] to elaborate modalities and procedures for the abovementioned mechanisms with a view to forwarding a draft decision on this matter to the Conference of the Parties for adoption at its eighteenth session. In the elaboration of modalities and procedures, the SBI shall take into consideration outcome of the expert workshop to be convened before its 36th session.

5 *Decides* that the modalities and procedures referred to in paragraph 4 shall elaborate on the following elements:

- definition of basic forms: trading and crediting;
- rules how to define sectors and coverage of gases;
- methods and criteria for calculating baselines;
- methods and criteria determining crediting thresholds or sector targets;
- length of crediting/trading period;
- provisions for monitoring, reporting and verification of emissions;
- provisions for issuance of units;
- accreditation standard for validators and verifiers.

6 *Invites* Parties and accredited UNFCCC observers to submit to the secretariat, by [date], their views on the matters referred to in paragraph 3;

7 *Recognises* the role of public sources of finance in the implementation of market readiness activities;

8 *Encourages* Parties and intergovernmental organizations to pursue capacity-building initiatives, including through pilot schemes, in developing country Parties to enable their participation in market-based mechanisms referred to above.
