WHAT DOES THE COP26 OUTCOME ON ARTICLE 6 MEAN FOR NON-PARTY STAKEHOLDERS?

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BACKGROUND

Article 6 of the Paris Agreement applies to market-based approaches at the level of countries—more specifically Parties to the Paris Agreement. Parties can choose whether to participate in these market-based approaches or not. In other words, Article 6 has no direct impact or regulatory control over carbon markets that involve non-Party stakeholders (NPS).[1]

The term 'voluntary carbon market' (VCM) applies to any carbon market that is not exclusively between countries and is not a compliance market.[2] NPS have participated over the past 15 years or so in the VCM, which was borne out of companies' interest to expand the pool of carbon credits or offsets supplied by the Kyoto Protocol's Clean Development Mechanism (CDM).

Article 6.2 of the Paris Agreement established high-level principles regarding the implementation of cooperative approaches, which essentially envisage arrangements between two or more Parties involving the international transfer of mitigation outcomes (units traded are called "internationally transfered mitigation outcomes," or ITMOs) in a way that facilitates the achievement of mitigation targets in Nationally Determined Contributions (NDCs) of the buying country. These high-level principles comprise environmental integrity and transparency, and the avoidance of double counting.

Article 6.4 established an international mechanism to credit reductions and removals in greenhouse gas emissions from projects through approved methodologies, so that they can be used by one Party as Article 6.4 emission reductions (A6.4ERs) or transferred internationally as ITMOs to be used by another Party to fulfill the mitigation target in its NDC. In general terms, Article 6.4 can be seen as an evolution of the CDM.

COP26 OUTCOME ON ARTICLE 6

At the 26th Conference of the Parties (COP26), Parties completed most of the implementing guidance (the 'guidance') needed to fully operationalize Article 6. Below are the significant takeaways:

- In order to operationalize the no double counting provision in Article 6.2, the guidance sets out that the transfer of all ITMOs requires a corresponding adjustment (CA). The application of a CA entails that the host country or seller of ITMOs deducts the emission reduction from its greenhouse gas inventory so it is not counted toward its NDC. This is necessary to ensure that the recipient country or buyer becomes the sole user of the emission reduction when counting it toward its NDC.
  - An A6.4ER becomes an ITMO when internationally transferred, therefore subject to the definitions, rules, and procedures set out in Article 6.2.
  - Article 6.4 activities are required to demonstrate both financial and regulatory additionality.[3]
  - Article 6 allows countries to authorize ITMOs and A6.4ERs to be used for "other purposes," such as by NPS in the VCM. It is through this 'use authorization' that there is a possibility of an indirect link between Article 6 and the VCM.
    - When the A6.4ER is authorized for use by a NPS domestically for "other purposes" (i.e., the VCM), the host country still needs to apply a CA.

It is the host country that specifies whether an ITMO is to be used toward achieving another country's NDC or if it is to be used for "other purposes," such as in the VCM. If the host country authorizes ITMOs or A6.4ERs to be used for other purposes, NPS can buy these emission reductions directly from a host country for their exclusive use and claim, and the host country cannot then count those emissions reductions toward its NDC.

However, there is still some uncertainty regarding how the process of authorization and consequent application of a CA will work in practice. There is also discussion on the way in which carbon credits authorized under Article 6 for other purposes used in the VCM could be best accounted for, as only Parties have an emission reporting obligation to the United Nations Framework Convention on Climate Change, and host countries would have deducted those emission reductions from national inventories.[4]

IMPLICATIONS FOR NON-PARTY STAKEHOLDERS

As in Article 6, a unit traded in the VCM represents a ton of carbon dioxide equivalent reduced or removed. Governed by private standards and not by international or national regulatory bodies, the VCM is essentially driven by NPS' demand for carbon credits to meet voluntary emission reduction targets, beyond any greenhouse gas reductions and removals mandated by policy. Carbon credits in the VCM may also be purchased and retired without offsetting, which drives reductions in overall greenhouse gas emissions and may enable buyers to claim other social and environmental contributions.

There are currently efforts underway to standardize and ensure the integrity of voluntary markets, including:

- The Integrity Council for the Voluntary Carbon Market (ICVCM) sets overarching principles as a threshold standard for high-integrity carbon credits and assesses VCM methodologies based on these principles.[5]
- The Voluntary Carbon Market Integrity Initiative (VCMI) sets guidelines for credible and transparent claims by NPS when buying carbon credits in different scenarios.[6]

There are multiple reasons why NPS—and companies in particular—might want to participate in the VCM, including:

- Companies can keep on track with their net-zero pathway as a complement to emission reductions within their value chains.
- Companies may want to support the host country in achieving its NDC when purchasing emission reductions effectively occurring within its jurisdiction, without use authorization (no CA). As such, whether certified under Article 6 or by a VCM standard setting organization, the emission reduction will stay and be reflected in the host country's greenhouse gas inventory.
- Companies may want to support the 'societal' long-term goal of a just transition to 1.5 degrees C by: (i) purchasing correspondingly adjusted emission reductions (e.g. authorized for other purposes), which would go 'above and beyond' the host country's NDC, as those reductions would get deducted from the host country's inventory; or (ii) purchasing high-quality carbon credits that are additional to, and not a substitute for, any effort to reduce emissions within companies' value chains.
- Regardless of the authorization status of the carbon credit, companies can support host communities' sustainable development through the potential environmental and socio-economic co-benefits associated with mitigation activities occurring on the ground (e.g., job creation, diminished local pollution, biodiversity conservation).

There are also multiple reasons why countries might want to encourage the development of the VCM, for example:

- They may contribute to the achievement of its NDC, particularly in those NDC-covered sectors where solutions are hard to finance domestically. Governments may in fact decide to use the VCM to channel private climate finance for mitigation that would not have otherwise been met by public spending or incentivized by a domestic carbon pricing scheme (e.g., carbon tax or carbon market).
- They may benefit from the potential environmental and socio-economic value-added that comes with these additional mitigation activities, as mentioned earlier.

The implications of allowing countries to authorize emission reductions to be used in the VCM include:

- The impact on the NDC of the host country, since it must adjust its greenhouse gas inventory (i.e., subtract the Article 6 units authorized for other purposes). This may disincentivize some countries to authorize emission reductions that could serve toward one's own NDC.
- NPS may find potential reputational benefit in that they are, from an accounting standpoint, contributing to mitigation activities beyond the host country's NDC.
- Potential uncertainty of market conditions associated with the process of authorization and application of the CA, due to the following reasons:
  - The host country can decide to authorize ITMOs or A6.4ERs for use in the VCM (or not) once the mitigation activity has begun, not ex-ante when the investment is being assessed. The timing of the authorization can have an impact on investment costs and carbon credit prices.
  - The host country needs to be capable of applying the CA according to Article 6 methodologies, which vary depending on how NDC targets are designed and the capacity of the host country. Uncertainties around Parties' application of CAs can undermine the integrity of the system and confidence in it.
  - There is a potential risk of double counting the emission reductions toward the host country's NDC and corporate net-zero claims, for the abovementioned reason and in case of non-overlapping reporting periods by both the company and host country involved.

Other C2ES Resources:

Designing a Meaningful Global Stocktake, January 2022.

Outcomes of the UN Climate Change Conference in Glasgow, November 2021.

The Global Goal on Adaptation: Issues for COP26, October 2021.

Article 6: Issues for COP26, October 2021.

Transparency of Action: Issues for COP26, June 2021.

ENDNOTES

1 Non-Party stakeholders is a term used by the United Nations Framework Convention for Climate Change (UNFCCC) to indicate all stakeholders to the Paris Agreement that are not signatory countries, namely, civil society (e.g. businesses, NGOs, academia, youth, single individuals) and sub-national governments (e.g. state, regional, local).

2 A compliance market (of which the EU ETS is an example) is one that is meant to create an economic incentive for companies to comply with regulation. This regulation usually consists of an emission cap for industry sectors declinated to regulate single emitting entities within a jurisdiction (or several linked jurisdictions). This is an efficient way for a jurisdiction to achieve its emission reduction target while allowing regulated entities to make profits through the trading of carbon credits or emission permits ('allowances').

3 That is, A6.4ER certification requires the Article 6.4 activity to demonstrate that it would not have occurred without the incentives from the mechanism, and that it takes into account existing and developing policies of the host country when setting the baseline from which to calculate the achieved emission reductions.

4 For the time being, each standard setting organizations' VCM registry will account for such correspondingly adjusted emission reductions, albeit without a unified view. See International Carbon Reduction & Offset Alliance, *Article 6 of the Paris Agreement and implications for the Voluntary Carbon Market* (Geneva: International Carbon Reduction & Offset Alliance, 2021), https://www.icroa.org/_files/ugd/653476_4cb8eae730b04813b63180619f16ae5b.pdf.

5 "Home," The Integrity Council for the Voluntary Carbon Market, accessed April 12, 2022, https://icvcm.org.

6 "Home," Voluntary Carbon Markets Integrity Initiative, accessed April 12, 2022, https://vcmintegrity.org.

CENTER FOR CLIMATE AND ENERGY SOLUTIONS

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