

PART 3

RECENT CLIMATE AGREEMENTS AND
NEGOTIATIONS: THE FUTURE
OF THE MECHANISM



CHAPTER 12

THE CONTINUATION OF THE CDM UNDER THE PARIS AGREEMENT AND ITS ARTICULATION WITH THE SDM¹

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1 INTRODUCTION

The use of market mechanisms to combat climate change was introduced by the Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC), adopted in 1997. In force since 2005, the Kyoto Protocol established the Clean Development Mechanism (CDM).⁴

The CDM has scaled emission reduction projects in developing countries and was able to start a fully fungible carbon credits market. Doubts about the Kyoto Protocol, however, cast uncertainty on the mechanism itself.

With a view to extending the CDM's advantages to the post-2020 context, where a new agreement under the UNFCCC would become the main reference for the international response to climate change, Brazil presented, in the negotiations that would culminate in the adoption of the Paris Agreement, in 2015, a proposal for an extended CDM (CDM+). The main elements of the Brazilian proposal were incorporated into the final text of the agreement, in Art. 6, Paragraph 4, in the form of the "Sustainable Development Mechanism" (SDM).

2 SDM BACKGROUND

The concept of a new centralized GHG emission reduction (GHG) certification mechanism within the scope of the Paris Agreement under the UNFCCC was based on a proposal submitted by Brazil to the 20th Conference of the Parties (COP-20) to the UNFCCC and 10th Meeting of the Parties to the Kyoto Protocol (CMP-10) in Lima in December 2014. The Brazilian proposal to COP-20, known as the "proposal for concentric convergence", sought to provide a solution to one

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of the most controversial aspects of the negotiations that would culminate in the Paris Agreement under the UNFCCC: respect for the principle of common but differentiated responsibilities in a scenario in which all countries – both developed and developing – would be called upon to contribute to the mitigation of global GHG emissions.

By concentric convergence, countries' obligations to combat climate change would be differentiated according to their historical responsibility for global warming. Progressively, there would be a prospect of gradual convergence among the State Parties, as the large developing countries increased their individual responsibility for the increase in global average temperature.

Presented in a broader negotiating context, the Brazilian proposal provided, in an ancillary way, for the establishment, under the Paris Agreement, of a new emission compensation mechanism, similar in scope to the CDM, with other functions.

2.1 Conception of the SDM: the Brazilian proposal for a CDM+

The proposal for concentric convergence included a chapter on economic mechanisms, which covered, in particular, an expanded clean development mechanism. The aim of the CDM+ would be to encourage developing countries and economies in transition to implement certified actions to fight climate change as additional to their emissions mitigation pledges under the Paris Agreement and, at the same time, to facilitate the achievement of what would be promised by developed countries.

The CDM+ would aim to reduce anthropogenic GHG emissions and increase removals by sinks by applying the modalities, procedures and methodologies of the Kyoto Protocol's CDM in the process of certifying project activities in developing countries. Similar to the CDM, emission reductions certified under the CDM+ would be converted into carbon credits, which could be used by countries with economy-wide emissions reduction targets, to achieve their commitments under the Paris Agreement. Also similar to the CDM, the CDM+ credits could be acquired by countries with absolute targets, for later offsetting their respective emission levels. This would make it easier for them to demonstrate compliance with what they would later promise under the Agreement.

Again, based on the CDM, Brazil proposed that CDM+ be allowed to voluntarily cancel units defined under its framework in the form of certified emission reductions (CERs). Under the Brazilian proposal, the voluntary cancellation of CERs would be done not only by State Parties to the UNFCCC, but also by non-state entities – such as subnational entities, private sector and even individuals – with a view to fostering the engagement of these actors in actions mitigation and

to increase the ambition and environmental integrity⁵ of the fight against climate change. Parties choosing to allocate financial resources for the cancellation of CERs would have recognized such allocation as part of the fulfillment of their financial obligations under the convention.

According to the Brazilian proposal, the CDM+ was supposed to guarantee a high level of environmental integrity in its use and operation. Achieving the goals of developing countries should be promoted on the basis of positive incentives rather than punitive models.

Brazil, supported by many developing countries, defended that such a centralized mechanism under the Paris Agreement should be an update of the CDM. In addition, Brazil proposed in its 2014 submission for concentric convergence that countries with absolute economy-wide emission reduction targets would have the prerogative to engage in “international emissions trading” under the auspices of the new agreement, or they would be eligible to buy developed and developing country credits that chose to adopt more ambitious absolute targets. Brazil also argued that the eligibility to host CDM+ projects for sustainable development should be restricted to developing countries – including those with absolute goals, such as the Brazilian case. This would allow Brazil a privileged situation: because it is a developing country with absolute goals, it could either buy credits or host the CDM+.

3 BRAZIL AND THE EUROPEAN UNION ON THE WAY TO PARIS

Throughout the negotiations leading up to COP-21 (Paris, December 2015), there was no clarity as to the role of market-based mechanisms under the Paris Agreement. In parallel to the negotiations on the new 2015 agreement, the topic of market-based approaches to combating climate change was discussed in three distinct strands within the UNFCCC: a new market mechanism (NMM), a framework for various approaches (FVA) and non-market approaches (NMA). The degree of divergence between the parties about the appropriateness of market approaches in the Convention was so strong that there was no consensus even about the scope of the three negotiations.

From 2011 to 2015, the Paris Conference, negotiations under the convention for new market-based mechanism, framework for varied approaches and for non-market-based approaches achieved limited progress, and eventually fell into paralysis

5. Environmental integrity is understood here as the prevalence of environmental benefits over economic benefits, and technical accuracy in delivering results. In the case of actions to combat climate change, an action would be considered as environmentally sound if its performance actually contributed to the reduction of GHG emissions. Rigorous environmental integrity review is essential to avoid cases of fraud and deception in conducting green washing projects where an action is presented as allegedly environmentally advantageous, but from the technical-scientific point of view it is counterproductive for environmental efforts.

at COP-20 in Lima. The same applied to the new market mechanism established in the Doha Amendment to the Kyoto Protocol (COP-18/CMP-8, Doha, 2012), which was never discussed or implemented.

The negotiating parties had divergent concerns about a number of aspects related to market-based mechanisms for fighting climate change. In addition to distinct technical views, there were various perspectives on the guarantees of environmental integrity and the intention to stimulate international cooperation involving trade in countervailing credits without the international supervision of the UNFCCC.

This framework of uncertainties undermined market predictability in relation to multilateral market-based mechanisms, which adversely affected the value of countervailing credits with the United Nations “seal”. At the same time, carbon credits gained space without international support and without environmental integrity safeguards, in the sense that what was traded transnationally effectively represented a decrease in the atmospheric concentration of GHG. The negotiating political context within the UNFCCC, which was eminently non-consensual with regard to market-based mechanisms, did not favor the expectation that a solution on the issue could be reached during COP-21.

In 2013, the decision made by the European Union – up to that moment, the largest source of demand for CERs – to stop using CDM credits unless they originated from activities of relatively less developed countries – was similarly unfavorable to multilateral market-based mechanisms. Therefore, CERs from large developing countries, such as Brazil, South Africa, China and India, were no longer accepted, and those were precisely the countries that had contributed most to CDM projects and to the importance achieved by the mechanism.

The European decision led to the collapse of CER prices and, consequently, to the discrediting of the CDM as a whole in the private sector. Since then, there has been a gradual disengagement of project entrepreneurs, Designated Operational Entities (DOEs) and other stakeholders involved in the process of emission reduction certification and CDM unit trade. After 2013, at the end of the first commitment period of the Kyoto Protocol, which extended from 2008 to 2012, there was low registration of CDM project activities.

Despite this unfavorable negotiating context, both Brazil (through the proposal for CDM+) and the European Union gave signs to the use of market-based mechanisms in the Paris Agreement, provided that it is accompanied by robust rules, guarantees of environmental integrity and international supervision to avoid fraud and deception in conducting emission reduction projects.

Brazil, as well as a large number of countries of the Group of 77 and China (negotiating bloc in the UNFCCC involving more than 130 developing countries) supported the use of market-based mechanisms under the Paris Agreement as a continuation of the successful experience with the CDM under the Kyoto Protocol. The success of the CDM is evidenced by the reports of its Executive Board, which at each meeting lists the number of projects, programs of activities (PoAs) and their registered components, as well as issued CERs and voluntarily canceled units. Data from the last Executive Board report indicated that as of July 13th, 2017, 7,776 CDM project activities and 310 PoAs had been registered, with 2,061 components included; 1,843,750,188 CERs would have been issued for CDM project activities and 8,938,800 for PoAs; and 22,464,732 CERs would have been canceled voluntarily.⁶

The perspective of developing countries in supporting the CDM was justified by the benefits in terms of mitigation outcomes proposed by the mechanism, which would not occur in its absence, as well as by the associated environmental, social and economic gains. As a model for multilateral emission reduction certification (by an Executive Board composed of twenty countries), the CDM also served as an alternative to bilateral emissions trading schemes that did not have the supervision of the Convention and, therefore, are seen as a threat to the environmental integrity, effectiveness and credibility of the international climate change regime.

Specifically, Brazil has taken a stand in the negotiations under the convention arguing that only a centralized market-based mechanism under the climate change regime, subject to scrutiny by all parties, could collectively ensure that GHG emission reductions were effectively monitored, verified and certified with the required accuracy of the environmental integrity requirement. According to the Brazilian view, only multilateral surveillance could ensure that the alleged reduction of 1t of CO₂ equivalent actually represents 1t of CO₂ equivalent not released into the atmosphere.

The negotiating position of the European Union, in turn, was to reaffirm that the bloc would not use credits from market-based mechanisms to meet its targets under the Paris Agreement. The objective of the European Union would be to prevent any new mechanism from reflecting the differentiation between developed and developing countries enshrined in the UNFCCC and its Kyoto Protocol, and to introduce rules to avoid double counting in emissions accounting or emission reductions. It should be noted, however, that the alleged double-counting risk is non-existent in the framework of the protocol, since its electronic transfer system, known as International Transaction Log (ITL) – analogous to that of bank terminals – ensures constant verification of the integrity of multilateral credit transfers. Emission trading schemes that run in parallel to the international climate change regime do not have such a safeguard.

6. Report of 95th Meeting of the CDM Executive Board. Available at: <https://goo.gl/eGWVG8>. Accessed on: July 20th, 2018.

3.1 Discussions with the European Union during the period from 2014 to 2015

Brazil and the European Union have been key interlocutors in the CDM Executive Board and in the market negotiations under the Kyoto Protocol and the UNFCCC. At the same time, the two Parties represent different interests in these discussions, which has led to the emergence of conflicts.

Roughly speaking, Brazil defends the point of view of project participants, because they bring benefits to sustainable development. The European Union, on the other hand, acts from the point of view of the CER market and the allocation of capital in European territory. As a country that develops CDM project activities in its territory, Brazil mainly represents the perspective of project entrepreneurs facing the challenges and risks of engaging in emission reduction projects. As a potential purchaser of CERs, the European Union mainly represents the perspective of market players who want collateral for purchased credits. They also defend the interests of DOEs seeking to mitigate risks related to the verification and certification of emission reductions.

In the UNFCCC negotiations, the European Union has sought to convert the mandate to the “revision of the CDM” into a “reform” of the mechanism. In addition to questioning the procedural legitimacy of the European position, Brazil has challenged the bloc’s proposals, since they would imply perverse incentives, restrictions on national prerogatives or difficulties for new project activities. Disagreements between the Parties have led to a series of “no-conclusion” outcomes in the negotiations on the revision of the CDM under the Kyoto Protocol.

As part of its action, the European Union has consistently advocated the establishment of mandatory standardized baselines to facilitate the demonstration of additionality of projects, which is a CDM key requirement. The proposal would favor the work of DOE, but in many cases, it would penalize the most efficient project entrepreneurs in a single sector, perversely rewarding the largest emitters and preventing recognition of the total mitigation effort of a specific project. The bloc also supports the imposition of supranational requirements related to sustainable development, a position that disrespects international consensus within the United Nations, particularly the newly adopted Agenda 2030 for Sustainable Development, which confirmed the national prerogative of countries in the evaluation of progress in this area. Other European proposals have the potential to hinder new project activities by suggesting the imposition of very low limits on market penetration. According to the European Union, it would be impeded, for example, by the greater penetration of cogeneration of electric energy from bagasse in Brazil and India in the supply of electric energy.

Brazil has always reiterated that considerations on sustainable development are a national prerogative, therefore, they must not be subject to a multilateral analysis under the climate change regime. Therefore, much like the CDM, the rules,

modalities and procedures of the new mechanism should not include top-down criteria for sustainable development. Their promotion, however, should be a key factor in the approval of project activities by the Designated National Authorities (DNAs), recognizing the primary responsibility of government for follow-up and review in this area.

In discussions under the Convention (NMM, FVA and NMA), Brazil also did not share the European Union's position. It feared that if market-based methods were prematurely established under the Convention, outside scope of the Kyoto Protocol or the Paris Agreement, the bottom-up nature of the framework for measurement, reporting and verification under the Convention would be unable to guarantee environmental integrity similar to that which existed in the robust accounting system under the Kyoto Protocol. In the Brazilian view, the Protocol model would be the only one to avoid "fictitious emission reductions" (commonly known as green washing) in the issuance of marketable units and to prevent a single marketable unit from being used twice. The European Union was pressing for discussion of post-2020 accounting to be discussed in the FVA, and Brazil maintained that this would pre-judge accounting discussions in the Paris Agreement. The European Union advocated the elaboration of modalities and procedures for the new market-based mechanism, and Brazil questioned the urgency of such rules in the light of the lack of a global demand for a new mechanism (largely due to the unilateral decisions of the European Union in relation to the CDM).

During COP-20 in Lima, in 2014, the positions of all Parties became more rigid in light of the expectation of a new agreement during COP-21 in Paris in 2015. Formal and informal market discussions have created confusion over the scope of the necessary rules for the agreement. As a result, there has been a proliferation of parallel initiatives on the assumption that it would not be possible to agree on a mechanism for market-based approaches to combating climate change in the context of the new agreement. In the absence of multilateral rules on market approaches, Parties would be free to cooperate without the Conventions' guidelines and without the certification and accounting rules of the Kyoto Protocol. This situation would become even more complex with the variety of types and coverage of nationally determined contributions (NDCs) to the new Paris Agreement, as defined by each Party to the Convention, in their own national interest. This situation reflected the view of the United States and Canada (non-members of the Kyoto Protocol) whose main concern is the responsibility for federal supervision of the exchange of emissions reductions at the subnational level, which were not under their jurisdiction.

The perspective of a complete deregulation of international emissions trading was not, however, of interest to Brazil or the European Union. Both sought to ensure the environmental integrity of the climate change regime. Allowing countries to

demonstrate compliance with their obligations with carbon credits in parallel to the regime could pose serious risks to the effective fight against global warming. Drawing on this common interest, starting in 2014, negotiators from Brazil and the European Union who had worked together as members of the CDM Executive Board began preliminary contacts in the margins of the preparatory negotiations for COP-21. With the Paris Conference approaching, against the backdrop of fundamental disagreement, Brazilian and European negotiators understood that some agreement would be necessary between the two of them, based on the joint understanding that, without a Brazil-European Union agreement and given the different views in the negotiations, the result would be the lack of rules for markets and an environment with different local rules. This would make it impossible for public and private entities to develop emission reduction projects in view of the prohibitive transaction cost of monitoring individual regulations on markets in several countries.

3.2 Joint work between Brazil and the European Union and joint proposal of SDM Brazil-European Union in the first week of Paris

In Paris, Brazilian and European Union negotiators worked together to find a text language for the new agreement that would include a robust market accounting system and a centralized certification mechanism to eventually succeed the CDM and, at the same time, abide by the negotiation limits of each of the Parties.

In negotiating the joint proposal during the first week of Paris, the European Union and Brazil worked on the draft text of December 3rd, 2015, which included the two basic provisions supported by the European Union and Brazil respectively: rigid accounting in international emissions trading, and the establishment of an emissions trading market-based mechanism. This text, however, also reflected the diversity of views of the Parties.

The result on December 8th, 2015 was a game changer, and is presented below in its original version (box 1),⁷ including a clear accounting device for use of internationally transferred mitigation outcomes (ITMOs) – in relation to emissions trading, with additional environmental integrity safeguards proposed by Brazil, accepted by the European Union, as well as an ambitious Brazilian proposal for a mechanism based on Art. 12 of the Kyoto Protocol, accepted by the European Union, with a mention of contribution “beyond the NDC”, and explicit prohibition of the use of the same certified emission reduction unit by two Parties, in order to comply with its NDC.

7.The text was kept in English in order to avoid, in a future translation, inadvertently resolving ambiguities that allowed the Brazilian and European visions to agree with this version.

The Brazil-European Union proposal outlined the view that a broader agreement would be possible for market-based approaches, and quickly became the focus of discussions in Paris. However, a range of additional interests from other parties in both market elements still required a solution, before consensus could be reached on the issue.

The joint proposal did not include language on “non-market mechanisms”, a matter advocated mainly by the Bolivian delegation, which questioned any usefulness of market-based mechanisms to fight climate change. This issue was resolved in the last hours of COP-21, with a significant joint effort from the United States and Bolivia. The final version of Art. 6 firmly anchors the market-based mechanisms in the Paris Agreement. Parties now need to address rules, nature and scope of regulation to be developed.

BOX 1

Joint Proposal Brazil-European Union

1. A mechanism to contribute to the mitigation of greenhouse gas emissions and to support sustainable development [in developing countries] is hereby established. This mechanism shall be under the authority and guidance of the CMA, supervised by a body designated by the CMA, and would aim to:
 - (a) Promote mitigation of greenhouse gas emissions [in developing country] Parties, while fostering sustainable development;
 - (b) Enhance ambition [by developing country Parties], by incentivizing supplementary voluntary mitigation of greenhouse gas emissions, beyond their ####;
 - (c) Assist Parties with a #### that reflects an absolute target in relation to a base year to fulfil their ####, through the use of emission reductions from mitigation activities [in developing countries];
 - (d) Incentivize and enable participation in mitigation of greenhouse gas emissions by public and private entities authorized by a Party.
 2. The CMA shall adopt modalities and procedures for the above-mentioned mechanism, on the basis of:
 - (a) Voluntary participation approved by each Party involved;
 - (b) Real, measurable, verified and long-term benefits related to the mitigation of climate change;
 - (c) Reductions in emissions that are additional to any that would otherwise occur, certified by operational entities to be designated by the supervisory body;
 3. The CMA shall ensure that a share of the proceeds from the certification of emission reductions is used to cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation.
 4. Emission reductions resulting from this mechanism cannot be used to demonstrate achievement of the host Party's ####, if used by another Party to demonstrate achievement of its ####.
- #### "place holder" for NDC defined later in the Paris Agreement

Authors' elaboration.

The issue of differentiation of the Parties by the application and use of the mechanism by only a certain group of Parties was left open in the joint proposal and the text that differentiated its application was left in square brackets so that the issue was discussed by all Parties.

In the proposal, the mechanism would be monitored by a supervisory body under the Conference of the Parties to the Paris Agreement (CMA),⁸ similar to the governance structure of the CDM. The joint proposal also established a list of objectives.

The role and involvement of “authorized by the party” public and private entities would be a potential strengthening of the joint proposal on the CDM. The joint proposal “encourages and enables” the participation of these entities. In addition, the CDM eligibility criterion, originally restricted to Parties that ratified the Kyoto Protocol, excluded Non-Parties, which represented an unnecessary restriction on the demand for CERs. The new mechanism was designed to foster universal engagement by stakeholders rather than Parties, providing a way for countries outside the Paris Agreement and non-state stakeholders to continue to engage in the multilateral environment and thus strengthen the international regime of climate change.

In other words, while the demand for CERs under the CDM was originally addresses towards Annex B Parties of the Kyoto Protocol (voluntary cancellation of CERs was only regulated in 2012), the SDM would already have, since the beginning, been designed to allow that issued certified reductions were used by any stakeholder – either state or non-state; public or private – for any purpose that corresponds to the measurement, reporting and verification of action – including for financial instruments, corporate strategies of socioenvironmental responsibility, financing based on results, positive pricing etc. This would allow the SDM to be operationalized, since the beginning, to favor the access of non-state entities. If properly developed, the rules, modalities and procedures of the SDM could effectively enhance the fight against climate change by state and non-state stakeholders, and would thus contribute to a comprehensive and ambitious response to the urgency of combating climate change.

Eligibility criteria should be as open as possible to encourage engagement by state and non-state stakeholders. Although restricted to parts of the Kyoto Protocol, the CDM was used for the first time for non-compliance purposes when CERs were voluntarily canceled by Brazil to offset emissions from the United Nations Conference on Sustainable Development (Rio + 20) organization, in Rio de Janeiro in 2012. The voluntary cancellation of CERs was one of the four steps taken by COP-19 in Warsaw in 2013 to help reduce the so-called pre-2020 ambition gap.

An essential measure to retaining the CDM rationale in the proposed new mechanism was the objective of contributing to the reduction of the level of emissions of the Party carrying out the project activity and would benefit from

8. Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA). Paris Agreement on Climate Change (CMA).

the resulting mitigation activities, which could also be used by another Party to comply with their NDC. The idea behind this mechanism, which was negotiated extensively by the end of COP-21, is that the Party developing the project would benefit from the positive mitigation impacts resulting from the certified emission reduction activity. At the same time, marketable units of such activities could be used by a second Party who purchased the units to service their NDC. In this case, contrary to what happens under the Kyoto Protocol, in emissions trading (Article 17) or in the joint implementation mechanism (Article 6), there would be no corresponding adjustments applicable to the country that is developing the project. The logic of the new mechanism of art. 6 of the Paris Agreement would in fact follow the model of the CDM of the Kyoto Protocol, with the aim of encouraging project entrepreneurs and the involvement of developing countries. It should be noted, however, that for NDCs purposes, each SDM unit could be used only once, by a single Party.

The Brazil-European Union joint proposal also makes clear that the mechanism's objective includes an additional incentive to mitigate GHG "beyond the NDC". This was a crucial step in terms of compromise as it bridges the longstanding conflict between the European Union and Brazil over the country's additional contribution. This text, however, did not prevail after the broader negotiation with all Parties, both for lack of clarity in its definition and because of its nature being perceived as tending to the scarcity of projects.

One of the key components of the agreement in the joint proposal and, later, in the adoption of Art. 6 of the Paris Agreement, was the explicit exclusion of double counting of emissions reductions. With the proposed alternative formulation, the double counting potential was clearly avoided.

The agreed formulation avoided an open reference to double counting that could not be accepted by Brazil. In the Brazilian view, there is no possibility of double counting when using the ITL system of the Kyoto Protocol – a system similar to that of bank transfers by remote terminals – because it is not possible to transfer the unit and maintain the unit – putting it in a metaphor: one cannot make an omelet without breaking the eggs. In the Brazilian perspective, the European Union's repetition of this idea (avoid double counting) to exhaustion, as a mantra, led other parties (besides the European umbrella group, the Independent Association of Latin America and the Caribbean – AILAC and the Alliance of Small Island States – AOSIS) to erroneously start replicating this idea (in a different context of pledges of Cancun and Kyoto Protocol operating simultaneously). Cancun's pledges were not internationally supervised, unlike the Kyoto Protocol, which would allow the Parties to meet both commitments, in theory, with the same unit, which resulted in the idea that countries would use the same unit for domestic compliance and

emissions trading. Such confusion remains in the process of regulation, given the existence of several interpretations of what should be the implementation of Art. 6.

4 ADOPTION OF THE SDM AS PER ART. 6.4 OF THE PARIS AGREEMENT

The establishment of a mechanism such as the CDM under the Paris Agreement was among Brazil's highest priorities in market-related negotiations, as well as the introduction of safeguards for the transfer of mitigation results for NDC compliance.

The mechanism outlined in the Brazil-European Union joint proposal was essentially a successor to the CDM, and there was no reference to the joint implementation mechanism of the Kyoto Protocol.

The mechanism mentioned in Paragraph 4 of Art. 6 of the Paris Agreement, largely reflects the Brazilian proposal for a CDM+ mechanism (box 2). The basic structure of the initial version follows directly the basic structure of Art. 12 of the Kyoto Protocol. It retains, without modification, concepts such as voluntary participation authorized by the Party involved; the need for real, measurable and long-term benefits for mitigating climate change; emissions reductions, which are additional to those that would occur in their absence; and verification and certification of emission reduction. It also established supervision by a body under the authority of the CMA and part of the resulting units for the cost of administrative expenses and for the adaptation.

BOX 2

Art. 6 of the Paris Agreement, and creation of the SDM, as per Paragraph 4 (and subsequent paragraphs, from 5 to 7)

4. A mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development is hereby established under the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement for use by Parties on a voluntary basis. It shall be supervised by a body designated by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement, and shall aim:

- i. To promote the mitigation of greenhouse gas emissions while fostering sustainable development;
- ii. To incentivize and facilitate participation in the mitigation of greenhouse gas emissions by public and private entities authorized by a Party;
- iii. To contribute to the reduction of emission levels in the host Party, which will benefit from mitigation activities resulting in emission reductions that can also be used by another Party to fulfil its nationally determined contribution; and
- iv. To deliver an overall mitigation in global emissions.

5. Emission reductions resulting from the mechanism referred to in paragraph 4 of this Article shall not be used to demonstrate achievement of the host Party's nationally determined contribution if used by another Party to demonstrate achievement of its nationally determined contribution.

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6. The Conference of the Parties serving as the meeting of the Parties to the Paris Agreement shall ensure that a share of the proceeds from activities under the mechanism referred to in paragraph 4 of this Article is used to cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation.

7. The Conference of the Parties serving as the meeting of the Parties to the Paris Agreement shall adopt rules, modalities and procedures for the mechanism referred to in paragraph 4 of this Article at its first session.

Related Decision Paragraphs

37. Recommends that the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement adopt rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Agreement on the basis of:

- (a) Voluntary participation authorized by each Party involved;
- (b) Real, measurable, and long-term benefits related to the mitigation of climate change;
- (c) Specific scopes of activities;
- (d) Reductions in emissions that are additional to any that would otherwise occur;
- (e) Verification and certification of emission reductions resulting from mitigation activities by designated operational entities;
- (f) Experience gained with and lessons learned from existing mechanisms and approaches adopted under the Convention and its related legal instruments;

38. Requests the Subsidiary Body for Scientific and Technological Advice to develop and recommend rules, modalities and procedures for the mechanism referred to in paragraph 37 above for consideration and adoption by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement at its first session;

Authors' elaboration.

The formulation of the mechanism in the joint proposal was heavily negotiated in the days following submission of the joint proposal. The major difference between the joint proposal and the mechanism mentioned in Art. 6 is that there is no differentiation of groups of Parties.

The objectives of the agreement are focused on the shared interests of mitigation and sustainable development, rather than serving the interests of different stakeholder groups.

5 OVERALL MITIGATION

Another major difference is a more explicit wording relating to the provision about the contribution "beyond the NDC", which includes a new paragraph with reference to overall mitigation.

What is relevant to SDM is to ensure that CERs are not used twice, as defined in Art. 6.4 (c). The modalities and procedures should create incentives for the overall development of project activities. Although they ensure environmental integrity and overall mitigation in global emissions, modalities and procedures should not be designed to impose additional barriers to the host country in complying with

the NDCs. The lack of effective incentives and comparative advantages for host Parties to authorize SDM project activities in their jurisdiction would prevent additional action by public and private entities that the Party may authorize, and generate perverse incentives for the parties not to reflect their level of maximum ambition in their progressive NDCs.

The SDM should deliver more action, greater engagement and greater ambition. Firstly, it should encourage and facilitate action by the private sector, civil society and public authorities, which are complementary to national policies and measures on climate change within the NDC, thereby broadening the ambition of the Party. As already mentioned, SDM project activities should either contribute to compliance with the NDC by the host Party, or go beyond the host Party's policies and measures if CERs are effectively used to comply with another Party's NDC.

Second, the SDM must provide environmental integrity, to be guaranteed by multilateral rules and governance for certification activities under Art. 6.4. Brazil believes that a key element in ensuring that the SDM effectively results in comprehensive mitigation of global emissions and goes beyond the policies and measures envisaged by the host Party is based on the concept of additionality. Pursuant to Paragraph 37d of Decision 1/CP-21, certified activities must correspond to emission reductions that are additional to any that would occur otherwise.

Additionality can be assessed by demonstrating that the mitigation activity is the first of its kind and by means of common practice, barrier or investment analysis demonstrates that the project activity would never have been developed without the adoption of Art. 6 of the Paris Agreement.

Overall mitigation in global emissions can also be ensured by strict environmental integrity requirements and time-limited crediting periods.

5.1 REDD+

REDD+ activities are not eligible for the SDM, since they are provided for in Art. 5 of the Paris Agreement, in a separate provision and with no relation to Art. 6. REDD+ relates to positive incentives, not to emissions compensation activities.

In addition, REDD+ is, by definition, related to mitigation outcomes achieved through national-level policies – with subnational approaches admitted on a provisional basis.

Through the existing framework, as established by the guidelines and decisions already agreed by the convention, it is the Developing Country Party that performs the measurement, reporting and verification procedures, and as such, ultimately assumes responsibility for its REDD+ results. Attempts to link Arts. 5.2 and 6.4 are equivalent to reopening the discussion of the scale of REDD+ activities, which

has already been agreed upon in decisions made previously by the Convention, with rejection of the project scale.

5.2 SDM Registry

The SDM Executive Board should maintain a record of CERs issued to participants from public and private entities, which includes serial numbers. In accordance with the authorization of the public or private entity participating in the project activity, CER units shall be transferred by means of a mechanism similar to the ITL of the Kyoto Protocol for the national accounts of the host Party or the acquiring Party.

The SDM registry shall also receive CERs issued under the CDM and converted to SDM that have not been canceled or retired for compliance under the Kyoto Protocol.

This would set a positive signal for the private sector and, at the same time, extend pre-2020 action with rigid environmental integrity guarantees in recognition of the efforts of participants in CDM project activities. CDM participants have invested resources in good faith in the multilateral response to climate change. If their efforts are not recognized, trust and legal certainty about the regime and the new mechanisms of the Paris Agreement will be seriously threatened.

6 THE PHASE THAT INITIATES THE REGULATION OF ART. 6 AND SHALL FINISH IN 2018

The practice of conventions adopted by the United Nations, and in particular the Framework Convention on Climate Change, is to establish a regulatory deadline for the two-year agreement. However, the Paris Agreement is following a different path, since each negotiating process for regulating the different provisions of the agreement is following different mandates and deadlines.

The item of Art. 6 Paragraph 4 is being negotiated with an understanding between the Parties that the deadline for finalizing such regulation will be two years, with a view to completing the work in 2018. However, there was no decision establishing this deadline, which was presented only as a proposal by the facilitators of the regulation of the agenda item of the mechanism.

6.1 The need to clarify the eventual transition process from CDM to SDM (mechanism, project activities and institutions) after 2020

Since Brazil understands that the SDM is the successor to the CDM, it is of the utmost importance that there is a smooth transition between these two mechanisms, especially with regards to: *i)* the continued validity of CDM units, through the conversion of CDM CERs for use in NDCs, or cancellation by Parties, public and

private entities for other uses; *ii)* continued validity of the CDM methodologies within the SDM; *iii)* the issuance of CERs from SDM to CDM registered project activities; and *iv)* the transposition of the CDM accreditation system to SDM.

Consistent with the text of the Paris Agreement, the scope of Art. 6, Paragraph 4, is similar to that of the CDM. In that sense, its rules, modalities and procedures should encompass the verification and certification of CERs by a DOE and the long-term, measurable and real benefits related to additional emission reductions resulting from voluntary activities authorized by each party involved and supervised by a body designated by the CMA. Brazil sees the SDM as the maximum international mechanism to certify action to fight climate change and issue credits.

Proper operationalization of the concept of “additionality” is central to SDM’s goal and its potential to broaden the ambition of the climate change regime. Additionality should reward projects that would not be possible in the absence of the mechanism of Art. 6.4. With the progressive implementation of the Paris Agreement and policies in the context of the NDC, it should be expected that earlier policies will not be able to demonstrate that they are first-of-their-kind or pass in the analyzes of common practice, barriers or investment. Brazil believes that CDM methodologies should also be applied to the SDM to ensure that additionality is adequately assessed.

The rules, modalities and procedures of the SDM should reflect the fact that the mechanism innovates in relation to the CDM by further aiming to “encourage and facilitate participation in the mitigation of greenhouse gas emissions from public and private entities authorized by the Party”. While the demand for CERs under the CDM was originally conducted by Annex B Parties to the Kyoto Protocol, units issued under the SDM may be used by any stakeholder for any purpose that encompasses measurement, reporting and verification of actions to fight change climate change, including finance.

The rules, modalities and procedures of the SDM shall further establish that any certified emission reduction unit issued by the SDM Executive Board is made available in the SDM Registry. Units in the SDM Registry may be used either by the Party, to comply with its NDC, or by another non-Party stakeholder, for its voluntary strategy or commitment to fight climate change. If a Party acquires a unit to comply with its NDC, that unit shall be transferred to its national registry within the multilateral registry to be established, in accordance with the guidelines in Art. 6.2. Once transferred to a national account, the SDM unit accounting will follow the guidelines of Art. 6.2. In the event that the units are acquired by non-Party stakeholders, such units shall be canceled in the SDM registry, with a clear statement of the purpose of the unit’s proposed cancellation and use.

6.2 Obstacles for transition

6.2.1 Acknowledgement of a smooth transition from the CDM to the SDM

The ability of the climate change regime to ensure continuity and a smooth transition from the CDM to the SDM will be key to the convention's reputation. Failure to ensure that CDM stakeholders, especially project developers, will have their efforts recognized and honored, and will continue to have tangible effects in the context of the Paris Agreement, would jeopardize legal security, which is crucial to an environment conducive to new projects, preventing CERs from contributing to immediate action and increased ambition pre-2020. Ultimately, it would promote the loss of credibility of the international regime by CDM project participants and would undermine the effectiveness of the mitigation instrument by the lack of participation of public and private entities.

6.2.2 Corresponding adjustments

Under the Paris Agreement, the parties must demonstrate the scope of their NDCs, including accounting for their emissions in relation to what they have promised internationally. Such accounting shall include the use of ITMOs relating to emissions trading. That is, if a Party has promised to issue up to a certain aggregate and national limit, it may overtake it, but still comply with its NDC if it compensates for its non-reduced emissions through acquisitions of ITMOs. In the context of emissions trading, i.e., Art. 6.2 of the Paris Agreement, the transaction of an ITMO will entail a corresponding adjustment, through additions and subtractions, between the buying Party and the selling Party, in order to avoid the so-called "double counting". This adjustment, however, does not apply to the mechanism described in Art. 6.4 of the Paris Agreement.

It should be noted that once a Party acquires a CER, there will be a settlement of accounts to add it to the national account of the Party acquiring it and to subtract it from the record of the SDM. The subtraction, however, does not happen in relation to the host country of the SDM activity, but in the record of the SDM. In any case, a situation could be envisaged in which the host country decided to purchase CERs derived from activities in its own territory to demonstrate the scope of its own NDC. In the latter case, there would be a set of accounts to be added to the national account of the Party that acquires it – which, in this case, is also the host country – and to subtract it from the SDM registry. If, in a second transaction, the host country decided to sell the CER they had purchased, the logic would be that of Art. 6.2, i.e. there would be a corresponding adjustment between national accounts. However, in the first transaction, the settlement of accounts will always be between the purchasing country national account and the multilateral register of the SDM, never between the national account of the latter and the national account of the host country. This is explained from the legal, technical and environmental integrity point of view.

From a legal point of view, corresponding adjustments to avoid double counting are restricted to the guidelines referred to in Art. 6.2, and do not apply to the rules, modalities and procedures established by Art. 6.4. It is equally important to consider that one of SDM's objectives is "to contribute to the reduction of emission levels in the developing Party, which will benefit from mitigation activities resulting from emission reductions that can also be used by another Party, in complying with its NDC".⁹ The application of "corresponding adjustments", in the context of Art. 6.4, would therefore be contrary to the Paris Agreement and international law.

From a technical perspective, since the CERs issued by the SDM Executive Board will be in the SDM Registry, and not in a national account, it is illogical to think of units being subtracted from the national accounts of the country developing the project, since the country where the project is located did not participate in this first transaction. It should be noted that the availability of CERs in the SDM registry will be critical to ensuring that the SDM is fully accessible to non-Parties, as well as to maintain its prerogative to multilaterally market certified emission reduction units for purposes other than demonstrating compliance with NDCs.

In addition, if a Party holding mitigation activities under the SDM had units subtracted from its national account by a corresponding adjustment, the Party's ability to demonstrate compliance with its NDC would be significantly impaired. This would create disincentives for Parties to approve SDM mitigation activities on their territory, undermining the mechanism's potential to deliver long-term, measurable and real benefits for additional emissions reductions.

Finally, from an environmental perspective, environmental integrity concerns related to double counting applicable to Art. 6.2 do not apply to the dynamics of the mechanism of Art. 6.4. This is because Art. 6.5 prevents double counting by not allowing SDM CERs to be used by the country where the project is located if used by another Party to demonstrate compliance with its NDC.

Some have suggested that, even with the safeguard of Art. 6.5, there would be a risk of double counting of a mitigation result from a CER: the unit could be used by the acquiring Party to count in its NDC at the same time that the host country of the project would be able to benefit from the mitigation mentioned in its inventory.

This assumption is not supported by the accounting rules of the international climate change regime. Similar to the CDM, the SDM mitigation activities will not necessarily affect the calculation of emission levels in national inventories. The calculation of emission levels in national inventories follows the guidelines of the Intergovernmental Panel on Climate Change (IPCC) for National Greenhouse Gas Inventories. These guidelines correspond to actual estimates, and reflect actual

9. Paris Agreement, Art. 6, Paragraph 4, item "c".

emissions. The amount of CERs generated by a CDM/SDM project activity, in turn, is determined by the application of a monitoring methodology and a baseline approved by the Executive Board. This emission reduction is a counterfactual estimate, and reflects hypothetical emissions, which never existed.

According to the IPCC Inventory Guide, anthropogenic GHG emissions are estimated at *bona fide*. In the energy sector, for example, which is traditionally the main source of emissions, the estimation of emissions requires, in most cases, the use of an average emission factor for the combination of source and fuel category.

In contrast, as an example, the CDM's methodological tools determine the CO₂ emission factors of the electricity generated by power plants by calculating the "combined margin" emission factor of the grid. Consequently, there is no correspondence in the calculation of the CERs issued and the estimated emissions in the national inventories that would justify a "corresponding adjustment".

Instead of a risk of double counting of mitigation results, corresponding adjustments, in the context of Art. 6.4, would correspond to a double-counting risk to the detriment of the host country. In the worst-case scenario, they would imply additional emissions to the host country which, in practice, did not occur – as in the case of wind turbines. This would again create disincentives for the Parties to approve SDM mitigation activities within their territory, which would undermine the potential of the long-term measurable and real benefit mechanism for emission reductions.

From an environmental perspective, therefore, corresponding adjustments are not required for the SDM's goal of "delivering comprehensive mitigation in global emissions".¹⁰ The additionality requirement for the issuance of CER units ensures that emissions reductions occur at a level beyond what would be achieved by the NDC of the host Party and the acquiring Party in the aggregate. In addition, conservative baseline and monitoring methodologies additionally contribute to comprehensive mitigation of global emissions.

In summary, if the results of the SDM mitigation activity are used by another Party, the host Party should restrict itself to further efforts to achieve its own commitments. This means that in the case where there is no transfer of an SDM CER to a second party, the host country will retain the benefit of the mitigation, and if it acquires CERs for project activities within its territory, it will also be able to use those units for the fulfillment of its NDC. Conversely, in case SDM credits are transferred to second Party, the host country will retain the mitigation benefit – through its inventory – but will not be able to account for the units for its own NDC.

10. Paris Agreement, Art. 6, Paragraph 4, item "d".

Finally, it should be stressed again that, under the Paris Agreement and Decisions, the reference to “*guidance to ensure that double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks*”¹¹ is applicable only to Art. 6.2, and not to Art. 6.4. This issue of double counting should not be covered by the rules, modalities and procedures of the mechanism of Art. 6.4.

REFERENCE

BRAZIL. Submissions in the UNFCCC process on Article 6, 2017, two submissions made at: <http://unfccc.int>; and a new one to be submitted by COP-23.

11. COP-21, Decision 1/CP.21, Paragraph 36.