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POLICY PAPER

Article 6.4 of the Paris Agreement and the private sector

Utilising the potential of private sector
engagement through the Paris Rulebook

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Abstract

By providing for substantial financial flows and implementing innovative technology, the private sector could help unlock ambition and achieve cost-effective emission reductions on the way to reaching the climate goals of the Paris Agreement. One important way to utilise the potential of the private sector is through the market mechanisms enshrined in Article 6 of the Paris Agreement. Here, the crediting mechanism of Article 6.4 of the Paris Agreement explicitly calls for the engagement of private entities.

In past rounds of negotiations, no agreement was reached on how the rules for the mechanism should be operationalised. In upcoming negotiations for the rulebook, negotiators will have the option to incorporate provisions into the rulebook to provide investment opportunities for the private sector. The rules for Article 6.4

of the Paris Agreement must be robust while allowing for a strong degree of flexibility. In addition, they must strike a balance between market incentives and environmental integrity.

In order to best achieve private sector engagement through Article 6.4 of the Paris Agreement, we find in this analysis that the rulebook must be designed to increase private-sector trust in the functionality of market mechanisms. Secondly, associated costs must be predictable and must not serve as a deterrent to private sector engagement. Lastly, the Rulebook must not limit the playing field for the private sector, but should allow for activities 'outside' of nationally determined contributions, as well as for demand beyond nationally determined contributions.

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1. Introduction

In 2015, 196 Parties agreed to the Paris Agreement (PA) negotiated under the 1992 United Nations Framework Convention on Climate Change (UNFCCC), aiming at limiting global warming to ‘well below 2°C’. To achieve this goal, all participating countries are required to set national greenhouse gas (GHG) emissions reductions targets, called nationally determined contributions (NDCs).

The Paris Agreement also includes the potential to provide for the resurgence of international markets. Despite a somewhat rocky path for market mechanisms in the Kyoto era, Parties eventually agreed that markets can offer flexibility for Parties and are crucial to fully exploit the potential for cost-effective mitigation. Markets can also help to activate the private sector and thus facilitate important financial flows and technological innovation. While provisions for international carbon markets were included in Article 6 of the Paris Agreement, so far no agreement has been reached on rules for its implementation in the Paris Rulebook.

1.1. Article 6 of the Paris Agreement

Art. 6 PA provides for various voluntary options for Parties to jointly implement their NDCs. According to Art. 6.1 PA, the corresponding measures should serve not only to implement the NDCs, but also to increase ambition regarding future mitigation and adaptation targets and to promote sustainable development and environmental integrity. While Art. 6.1 PA addresses the general concept of voluntary cooperation, Art. 6.2–6.9 PA introduce three different cooperation modalities.

Art. 6.2 and Art. 6.3 PA: These provisions cover bilateral or multilateral cooperative market-based approaches that involve the international transfer of mitigation outcomes by Parties to facilitate the achievement of their NDCs. An important premise is the avoidance of ‘double counting’, meaning that a mitigation outcome may not be counted towards both the NDC of the country in which the mitigation has occurred and the NDC of the acquiring country. While there will not be international oversight of the mechanism under the UNFCCC, international rules for Art. 6.2 PA will provide an accounting framework for international cooperation. This mechanism will make it possible, for example, to link national or subnational emission trading systems and create a common carbon market.

Art. 6.4 to Art. 6.7 PA: These provisions also contain a market-based opportunity to collaborate. They establish a crediting me-

chanism under the auspices of the UNFCCC that issues emission reduction credits for activities authorised by Parties in support of sustainable development. The generated reductions can be acquired by other Parties and used towards their NDC. Rules, modalities and procedures for this ‘Sustainable Development Mechanism’ will be adopted by the Conference of Parties. The mechanism is also explicitly intended to incentivise and facilitate participation in the mitigation efforts of public and private entities.

Art. 6.8 and Art. 6.9 PA: These provisions include a framework for non-market approaches.

The negotiations on Art. 6 PA, especially regarding the market-based provisions of Art. 6.2 PA and Art. 6.4 PA, are still highly contentious. So far, Parties have been unable to reach an agreement on several political and technical issues. However, as mentioned above, countries will not be the only stakeholders potentially participating in international carbon markets: Article 6.4 PA explicitly acknowledges the need to incentivise and facilitate the participation of private entities in the mitigation of greenhouse gas emissions (GHG).

1.2. Scope of this analysis

This analysis provides recommendations on how the rulebook for Art. 6.4 PA can be designed to best enable private sector engagement without putting environmental integrity at risk. To do so, we will first take a general look at the status quo of negotiations and the possible role of the private sector under the mechanisms, taking into account experiences from the Kyoto era (2). We will then consider the status quo of negotiations regarding the issues we deem most relevant for the private sector and assess their potential impact on the private sector, before identifying necessary elements for the Paris Rulebook on Article 6.4 PA (3). We will look at the issues under three overarching categories: how can the rulebook ensure private-sector trust in market mechanisms (3.1)? How can financial barriers be lowered for the private sector (3.2)? And how can a broad scope of activity be ensured (3.3)?

Where the crunch issues examined in the context of Article 6.4 PA are also relevant to Article 6.2 PA, we will indicate this in the text. The non-market-based approaches of Article 6.8 PA will not be part of this discussion.

2. Course of negotiations on Article 6 PA and the role of the private sector in market mechanisms

2.1. Status of discussion regarding the rulebook on Article 6 Paris Agreement

A recent study by Edmonds et al. shows the enormous potential of market mechanisms: it claims that cooperation under Art. 6 PA could reduce the costs of achieving the respective NDCs by \$ 300 billion per year in 2030.¹ However, in order to implement the mechanisms and approaches of Art. 6 PA in practice, a detailed operationalisation rulebook is required.

This issue was already taken up at the 21st Conference of the Parties (COP.21), where the Paris Agreement was agreed on by the Parties of the UNFCCC. The Subsidiary Body for Scientific and Technological Advice (SBSTA)² was tasked with developing appropriate guidance for the accounting procedure for internationally transferred mitigation outcomes (ITMOs) – in particular to avoid double counting in the context of Art. 6. 2 PA – and to present them for decision at the next COP, also referred to as the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA). In addition, the SBSTA was to draft proposals for the rules, modalities and procedures of the new Sustainable Development Mechanism under Art. 6. 4 PA, which was also to be adopted at the next COP/CMA. The same was intended for the non-market approaches of Art. 6. 8 PA.³

However, the corresponding work programmes were not adopted at COP.22/CMA.1 in Marrakesh or at COP.23/CMA.2 in Bonn (hosted by Fiji). At COP.24/CMA.1-3 in Katowice, the Parties were able to agree on many operationalisation rules related to the PA, which were compiled into a rulebook. There was no consensus

on one issue, however: the operationalisation of the voluntary co-operation of Art. 6 PA. The corresponding decision 8/CMA. 1 is mainly of a procedural nature and refers to further elaboration by the SBSTA.⁴

Lastly, the COP.25/CMA.4 in Madrid could not yield a decision on the implementation rules for Art. 6 PA. As a result, the topic was again referred to the SBSTA for further elaboration,⁵ and discussion was postponed until COP.26 in Glasgow in 2021 due to the Corona pandemic.

The unsuccessful attempts at finding common ground on Art. 6 PA indicate that the adoption of a rulebook with specifications for voluntary cooperation is highly contested. Finding an agreement will be a central component of the negotiations at COP.26.

2.2. Private sector engagement through market mechanisms

Private sector engagement is crucial for the implementation of the kind of GHG emissions reductions necessary to reach the Paris Agreements long-term temperature goals. Its role is twofold: on the one hand, the private sector is itself a large emitter of GHG. On the other hand, it can provide the technical innovations and financial investments needed to effectively combat climate change.⁶ Financial input is greatly needed: in 2021, the International Energy Agency found that keeping the increase in the global average temperature to below 2° C would require an investment of around \$ 5 trillion in energy efficiency and low-carbon technologies by 2030.⁷ As current levels of public funding are far from sufficient to reach this goal, significant levels of private finance must be leveraged.

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- 1 Edmonds et al., (2021) Climate Change Economics, How much could Article 6 enhance Nationally Determined Contribution ambition toward Paris Agreement goals through economic efficiency?, p.2, available at: <https://www.worldscientific.com/doi/10.1142/S201000782150007X>
 - 2 UNFCCC. Decision 1/COP.21 Adoption of the Paris Agreement UNFCCC/CP/2015/10, Article 18.
 - 3 Ibid, para. 36-40, available at <https://unfccc.int/sites/default/files/resource/docs/2015/cop21/eng/10a01.pdf>.
 - 4 UNFCCC. Decision 8/CMA.1, Matters relating to Article 6 of the Paris Agreement and para. 36-40 of decision 1/CP.21, FCCC/PA/CMA/2018/3/Add.1, available at https://unfccc.int/sites/default/files/resource/cma2018_3_add1_advance.pdf#page=22.
 - 5 UNFCCC. Decision 9/CMA.2, Matters relating to Article 6 of the Paris Agreement, FCCC/PA/CMA/2019/6/Add.1, available at https://unfccc.int/sites/default/files/resource/cma2019_06a01E.pdf.
 - 6 Füssler et al., (2019) Incentives for Private Sector Participation in the Article 6.4 Mechanism, p. 7, available at https://epub.wupperinst.org/frontdoor/deliver/index/docId/7548/file/7548_Incentives.pdf
 - 7 Bouckaert et al., (2021) for the International Energy Agency, Net Zero by 2050: A Roadmap for the Global Energy Sector, available at: <https://www.iea.org/reports/net-zero-by-2050>.

Market mechanisms have the potential to unlock greater ambition and achieve cost-effective emission reductions.⁸ The key driver of private-sector investment in market mechanisms depends on the expected return on investments in emission reductions, which in turn depend on the carbon price. The carbon price is determined by the balance of demand for, and supply of, these emission reductions.

Demand for (and thus the price of) ITMOs under Art. 6.2 PA – or, more specifically, emission reductions certified under Art. 6.4 PA ('A6.4ERs') – will largely depend on the political willingness of governments to introduce mitigation policies consistent with the targets of their NDCs and long-term determined contributions. Countries therefore have the opportunity to provide for functioning and effective international markets with active participation of the private sector using their regulatory powers. Nonetheless, several parameters can be included in the design of Art. 6 PA that have the potential to impact private sector engagement. This is especially true for the Art. 6.4 PA mechanism operating under the auspices of the UNFCCC, as rules, modalities and procedures will be decided on the international level.

2.2.1. Forms of private sector engagement

The private sector includes entities that generate mitigation outcomes or acquire them for compliance or voluntary purposes, private sector co-financiers, and project developers that implement GHG emission mitigation technologies. Within these categories, mitigation action is financed and demand for emission reductions ensured. Other private actors include auditors and traders which are necessary for the mechanisms to operate.⁹

Cooperative approaches under Art. 6.2 PA will be designed and implemented through bilateral and multilateral cooperation. Consequently, the forms private sector engagement can take will be determined first and foremost by the participating Parties, and not through the guidance on Art. 6.2 PA. The Art. 6.4 PA mechanism, on the other hand, will operate under the guidance and authority of the CMA and will be governed by a Supervisory Body which will oversee and approve the issuance of A6.4ERs. While potential private sector participation is not necessarily limited to the mechanism under Art. 6.4 PA,¹⁰ it is also this provision that explicitly

aims to incentivise and facilitate private sector participation in the mitigation of greenhouse gases.

2.2.2. Learning from the past – the Clean Development Mechanism (CDM)

In order to evaluate the manner in which the new mechanism can be designed to best encourage private sector engagement, we will look at the existing market mechanism under the Kyoto Protocol that also explicitly allowed for the involvement of private entities, namely the Clean Development Mechanism (CDM).

The new mechanism of Art. 6.4 PA is in many ways similar to the CDM established under the Kyoto Protocol. Both mechanisms are crediting schemes that operate under a centralised UN Body. Participation of the private sector will likely be comparable to participation under the Clean Development Mechanism, though possibly with greater government involvement.¹¹ The rules for Art. 6.4 PA are to ensure 'real, measurable and long-term' benefits, which was also the case for the CDM, and both mechanisms must ensure the additionality of emission reductions.

It is important to note, however, that there are also substantial differences between the CDM and the new mechanism under Art. 6.4 PA.

Unlike the CDM, the Art. 6.4 PA mechanism is applicable to all Parties, and crediting takes place in the context of the NDC targets of the host country; CDM activities can only be hosted in countries with no targets under the Kyoto Protocol. Additionally, the CDM only applied to projects and programmes, while the Art. 6.4 mechanism could potentially be used on sectors or policies as well.¹² Another important difference is that the new mechanism of Art. 6.4 PA requires an 'overall mitigation in global emissions', which aims at moving beyond the zero-sum offsetting frequently seen in the past.

When designing the new mechanism, it is important to be aware of these similarities and differences in order to benefit from preexisting and possibly transferable 'lessons learned' and working methodologies. This is also relevant when looking at design options to specifically enhance private sector engagement.

8 Bürgi et al., (2017) for the South Pole Group, Operationalising Article 6 of the Paris Agreement, Perspectives of developers and investors on scaling-up private sector investment, p. 12., available at https://www.ieta.org/resources/International_WG/Article6/Portal/operationalising-article-6-of-the-paris-agreement.pdf

9 Michaelowa et al., (2019) Opportunities for mobilizing climate finance through Article 6, p.16 available at: https://www.researchgate.net/publication/336576428_Opportunities_for_mobilizing_private_climate_finance_through_Article_6.

10 Art 6.2 PA does not mention private entities. Yet, private entities could be involved in mechanisms underlying transfers under Art. 6.2 PA, for example in the form of bilateral crediting mechanisms or international linking of Emission Trading Schemes.

11 Ibid, p.22.

12 Kreibich, Obergassel (2019), Scaled-up Crediting under Art. 6.4: Will there be policy crediting under the Paris Agreement? p. 19, available at: https://www.carbon-mechanisms.de/fileadmin/media/dokumente/Publikationen/Policy_Paper/PP_2019_02_Scaled_Up_Crediting_bf.pdf

3. Identifying challenges and finding solutions

3.1. Preserving private-sector trust

When introducing the new market mechanism, it is important to give the private sector a reason to trust in the functionality of that mechanism. Whether this is successful will very likely depend on how the transition from the Kyoto-era projects and credits is handled as well as on the predictability concerning methodologies for the private sector.

3.1.1. Transitioning from the Kyoto era: 'carryover' of certified emission reductions

The issue of carryover of issued certified emission reductions (CERs) from CDM activities can be described as highly political and was one of the major points of contention that prevented the finalisation of the rulebook for Art. 6 PA at COP.25 in Madrid. Considering the progress made since then regarding the transition of activities,¹³ we will limit this discussion to the highly contested issue of the 'carryover' of CERs. The essence of the controversy is whether credits issued through the CDM–Mechanism before 2021 can be used in the context of post 2020 NDCs.

It is first important to note that the Paris Agreement itself does not address compulsory transitions of any sort. In fact, COP actually encouraged the voluntary cancellation of Kyoto-era units.¹⁴ Still, some countries continue to host substantial numbers of on-going projects and desire a full transition of activities and CERs.

While some Parties seek to exclude the transition of CERs to the new mechanisms altogether because they fear a serious threat to the

overall mitigation of global emissions, other Parties see the carryover as necessary. They argue that project developers must be assured a return on investment for pre-2020 actions in post-2020 markets.¹⁵

The Parties tried to find middle ground between these positions by developing further options. The final draft text in Madrid therefore included certain filters to enable the transfer of CERs. Key provisions include the registration date of the project¹⁶ and the reductions achieved prior to 31 December 2020 in order to use the CERs. According to the third draft version, CERs are to be used towards the NDC no later than 31 December 2025, while an earlier version included the option of 2023.¹⁷ Another provision of the third presidential draft demands that CERs not eligible under these rules be put in a reserve and used towards the NDC only in accordance with a future decision of the CMA.¹⁸

One initial problem in the negotiations seems to be the lack of clarity with regard to the actual numbers of residual CERs that could be available for use according to different transaction parameters. Concerns were expressed mainly regarding the effect those numbers could potentially have on the carbon market.¹⁹

Impact on the private sector

With regard to the transition of Kyoto-era methodologies,²⁰ projects and carbon credits, a number of project developers and buyers of CDM credits have made clear that they would lose trust in the new mechanisms if registered activities and issued credits are not eligible for transition into Art. 6.²¹

When approaching the transition of CER units in the context of private sector engagement, it is important to consider several factors. For example, if there is no carryover, private investors may

13 See e.g. Michaelowa et al., (2020) Update 2020 - Negotiating cooperation under Art. 6 of the Paris Agreement, p. 14.

14 Decision 1/CP.21 Decisions adopted by the Conference of the Parties, regarding the Paris Agreement states that Parties are encouraged to cancel units issued under the Kyoto Protocol (para. 106).

15 Michaelowa et al.(2019), Negotiating Cooperation under Article 6 of the Paris Agreement, p. 21, available at: https://www.perspectives.cc/fileadmin/Publications/Michealowa_et_al_2019_-_Negotiating_cooperation_under_Article_6_of_the_PA.pdf.

16 UNFCCC (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration); Draft CMA decision on Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4 of the Paris Agreement (para.75 (a)): states that the date is yet to be decided by the CMA,available at: https://unfccc.int/sites/default/files/resource/CMA2_11b_DT_Art.6.4_.pdf

17 UNFCCC (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (second iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement (para 88 (c)). Available at: https://unfccc.int/sites/default/files/resource/DT.CMA2_.i11b_.pdf?download

18 UNFCCC (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration); Draft CMA decision on Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4 of the Paris Agreement (para.75 (a)): states that the date is yet to be decided by the CMA, para. 76.

19 Duggal et al., (2020) ADB, Decoding Article 6 of the Paris Agreement Version II, p. 49, available at: <https://secureservercdn.net/160.153.137.163/z7r.689.myftpupload.com/wp-content/uploads/2021/01/Decoding-Article-6-part-II.pdf>.

20 As the transfer of methodologies is not as contested, this element will not be looked at in this analysis.

21 Rashmi, Ahuja, (2019) Clean Development Mechanism as Catalyst for Sustainable Development Mechanism under Article 6.4, p.11, available at <https://www.teriin.org/sites/default/files/2019-11/clean-development-mechanism.pdf>.

avoid participating in market mechanisms due to a loss of trust. At the same time, this action will also prevent a flooding of the market with carbon credits.²² Achieving the latter could very well serve as an incentive for private sector investment, as the potential supply of carryover CDM- credits is likely to heavily dilute the market of the Art. 6.4 PA mechanism from the start.²³ Next to these market-based considerations, the underlying issue again is finding a balance between market incentives and environmental ambitions. A main issue identified is the potential of the carryover to undermine further action taken to reduce emissions.

Recommendation for the rulebook

The rulebook for Art. 6.4 PA must strive to balance out these aspects to provide a meaningful incentive for the private sector without undermining emission reduction efforts. While either of the detrimental positions (no transition vs. full transition) undeniably has negative effects on either market incentives or ambition, partial carryover can offer a compromise and prove to be a tangible solution.

Effective restrictions which are at the core of the negotiations involve establishing time-related limits for the eligibility of CERs. They can help to promote new or recently developed abatement action while generally limiting the use of CERs.²⁴ The Parties will have to decide for how long their credits will be used towards their NDC, defining a cut-off year. We recommend choosing the later date of 2025 in order to provide for a sufficiently long transition period.

Secondly, Parties should agree on vintage restrictions. Generally, they can relate to the timing of project implementation or the timing of emission reductions. The latter, however, is arguably not feasible due to the significant administrative efforts that would be necessary in order to define the timing of occurring emission reduction.²⁵ If the use of vintage criteria should help promote new or recently developed abatement action, eligibility criteria based on the implementation, meaning the ‘start date’ of a project is most effective. If the projects in question are additional and robust accounting is applied, this option would safeguard environmental in-

tegrity and provide high incentives to increase mitigation action.²⁶ Recent analysis suggest that the volume of credits will decrease substantially when carryover is limited to CERs issued under projects registered after 2013 or even 2016.²⁷ We recommend the adoption of a comparatively conservative date to effectively limit the amount of CER carryover, meaning no date earlier than 2016.

Elements for the Article 6.4 rulebook:

- Time-related limitations (vintage date and cut-off date)

3.1.2. Baselines

Regarding Art. 6.4 PA, the elements of strict baselines and additionality are often considered to be of special importance in order to set in motion a functioning mechanism that ensures environmental integrity. Parties seem to have agreed on certain principles: according to the current draft, methodologies must involve a transparent and conservative approach and must take into account relevant policies and be consistent with the countries’ NDCs and the goals of the Paris Agreement. Additionally, the methodologies should encourage an increase in ambition over time.²⁸ Nevertheless, the question of what the baseline for a corresponding emission reduction should be, and how the scope of additionality testing is to be defined, has not been clarified between the Parties.

Setting Baselines

There are three main proposals on how crediting baselines should be determined.²⁹ First, ambitious and highly developed countries in particular demand that the reference value for a project be the best available technology (BAT) or a certain performance standard. Some add that regional differences and exemptions for developing countries should be taken into account. Others apply a so-called business-as-usual scenario (BAU), i.e., baseline is the business-as-usual value if no measures were taken. Finally, the use of ‘historical’ emissions as a reference value has been proposed. In addition, it is proposed to allow all the above baselines cumulatively or alternatively, and in the latter case to let the host Party decide.³⁰ An

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- 22 Lo Re et al., Market negotiations under the Paris Agreement: a technical analysis of two unresolved issues (2019), p. 39 <https://www.oecd-ilibrary.org/docserver/99d9e615-en.pdf?expires=1627989844&id=id&accname=guest&checksum=B3FA77E7F4C082614F511689F8A397D7>
- 23 Schwieger et al., (2019) for the Swedish Energy Agency Pricing of Verified Emission Reduction Units under Art. 6 - Gaining a better Understanding of possible Scenarios, p. 19, available at https://www.perspectives.cc/fileadmin/Publications/SEA_Pricing_Study.pdf
- 24 Schneider, La Hoz Theuer, (2017) Using the Clean Development Mechanism for nationally determined contributions, p. 43, available at: <https://mediamanager.sei.org/documents/SEI-PR-2017-Using-the-Clean-Development-Mechanism.pdf>
- 25 *ibid.*, p.44.
- 26 Füssler et al., (2019) Transitioning elements of the Clean Development Mechanism to the Paris Agreement, p. 43 , available at: https://www.dehst.de/SharedDocs/downloads/EN/project-mechanisms/discussion-papers/transitioning_elements.pdf?blob=publicationFile&v=2
- 27 Michaelowa et al, (2021) Volumes and types of unused Certified Emission Reductions (CERs); Lessons learned from CDM transactions under the Kyoto Protocol, transparency gaps and implications for post-2020 international carbon markets, p. 39, available at https://ercst.org/wp-content/uploads/2021/06/20210621_unused_CERs_final_clean.pdf.
- 28 UNFCCC (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration); Draft CMA decision on Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4 of the Paris Agreement, para. 35, available at: https://unfccc.int/sites/default/files/resource/CMA2_11b_DT_Art.6.4_.pdf
- 29 *Ibid.*
- 30 SBSTA, (2021)Chair’s summary informal consultations/informal technical expert dialogue on Article 6 of the Paris Agreement (June 2020) - Any other matters identified by Parties, p. 2 et seq., available at: https://unfcccint/sites/default/files/resource/IN.SBSTA2021.i15a.1_i15b.1_i15c.1.pdf.

agreement could not be reached on this issue at COP.25, and the last draft only provided that the CMA should develop guidelines in the future.³¹ During the informal meeting of the SBSTA in June 2021, two options were identified regarding the decision on baseline-setting at the upcoming COP.26 in Glasgow. One option calls for the negotiators to work from the principles while a more detailed guidance should be developed through a work programme or by decision of the supervisory body on more technical details. The second option calls for the adoption of operational language on baselines and additionality with a clear mandate by the CMA to the supervisory body, principles not being enough.³²

Impact on the private sector

Robust rules on baseline setting can help the objectivity and predictability of the process for the private sector. It again will be crucial to strike a balance. On the one hand, it is important to establish clear principles in order to provide a certain degree of predictability. On the other hand, it is important to provide a sufficient room for flexibility so that developers can operationalise the principles in different activity-contexts and at different aggregation levels.³³

Suggestions for the Paris Rulebook

Given the status of negotiations, agreeing on principles while pushing the question of methodology to an operational level will likely be much easier than deciding on a clear mandate and possible baseline approaches. We recommend, however, the inclusion of some operational language in the text for the Paris Rulebook in order to provide a minimum level of predictability for the private sector.

We suggest adopting an approach in line with Option B of the SBSTA 51³⁴ negotiation for the rulebook. The default approach for this option is to set baselines following a best available or performance-based approach, or if these approaches are not deemed appropriate, to allow baselines to be set with regard to a business-as-usual approach or historic emissions. Both the best available technology and best performance approach have the potential to reach high levels of conservativeness and environmental integrity while providing objectivity in applying the baseline.³⁵

The applicability of the baseline approaches will depend on the type of activities. To obtain a certain degree of flexibility, the use of other approaches must be possible if the default approaches are not deemed appropriate for the activity in question. Here, the BAU and historic approach do provide a feasible fall-back option. The exemption from the default action should be limited to ensure comparability of the A6.4ERs that are issued through the mechanism.³⁶

In order to ensure that baselines are conservative, the agreed framework for Art. 6.4 PA should task the Supervisory Body or another technical body with assessing the conservativeness of assumptions and methodologies used when applying a baseline approach in order to ensure that baselines are transparent, robust, conservative and lead to environmental integrity. The mandate should also include the assessment of the ‘appropriateness’ of the chosen baseline.

Regarding the possible standardisation of baselines, we suggest including a provision as put forward in the 3rd Draft Presidency Text of COP 25.³⁷ As indicated in the text, an international body should develop standardised baselines at the request of the host Party, or these may be developed by the host Party and approved by the Supervisory Body. They should be established at the highest possible level of aggregation in the relevant sector of the host Party. While providing these services on the highest administrative level might increase the administrative costs, this will provide for a lower barrier for countries and project developers to engage in upscaled crediting approaches.³⁸

Elements for the Article 6.4 Rulebook:

- Include operational language according to the Negotiation Text of SBSTA 51
- Assessment of conservativeness and ‘appropriateness’ through Supervisory Body
- Include provision facilitating standardisation on a high aggregational level

3.1.3. Additionality

In addition to baselines, the question of how to determine additionality has not been resolved. Additionality is central to ensuring

31 UNFCCC (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration); Draft CMA decision on Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4 of the Paris Agreement, para. 36, available at: https://unfccc.int/sites/default/files/resource/CMA2_11b_DT_Art.6.4_.pdf

32 SBSTA, (2021) Chair’s summary, informal consultations/informal technical expert dialogue on Article 6 of the Paris Agreement (June 2021) - Any other matters identified by the Parties, available at: https://unfccc.int/sites/default/files/resource/IN.SBSTA2021.i15a.1_i15b.1_i15c.1.pdf

33 Michaelowa et al. (2021), Setting crediting baselines under Article 6 of the Paris Agreement, p. 4.

34 UNFCCC, (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration) Draft CMA decision on the rules, modalities and procedures for the mechanism established by Art. 6, paragraph 4, of the Paris Agreement, para. 41-42.

35 Lo Re et al., (2019) Designing the Article 6.4 mechanism: assessing selected baseline approaches and their implications, p. 28, available at <https://www.oecd.org/environment/cc/Designing-the-Article-6-4-mechanism-assessing-selected-baseline-approaches-and-their-implications.pdf>.

36 Michaelowa et al., (2019) Opportunities for mobilizing private sector finance through Article 6, p. 28.

37 UNFCCC, (2019) Draft text on Matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration) Draft CMA decision on the rules, modalities and procedures for the mechanism established by Art. 6, paragraph 4, of the Paris Agreement, para. 37.

38 Michaelowa et al., (2019) Mobilizing private climate finance through Article 6, p. 28.

that market-based mechanisms are used effectively and productively in international climate protection. In a nutshell, the concept requires any mitigation activity to show that the emission reductions would not have happened in the absence of the support from the market-based mechanism. Without effective verification of additionality, there is a risk that the transfer of units that do not represent real emission reductions (so-called 'hot air') especially against a non-ambitious NDC occur and will lead to an increase in overall emissions and thus undermine environmental integrity.

Various methods for determining additionality, some of which have already been used under the CDM,³⁹ are at issue. For example, additionality can be determined by investment tests, by discussing costs and barriers, by determining the transformative-ness of projects, or by positively listing additional project types.⁴⁰ In the context of the Paris Agreement, the question of how strictly additionality is to be determined remains open.⁴¹ In this respect, a consensus seems to be in sight that activities are only additional if they are not required by the respective law ('regulatory additionality'). A contentious and yet unresolved issue is whether additionality also requires that the measure go beyond the measures and regulations associated with an NDC of the host country.⁴²

Impact on the private sector

For the private sector, the standardisation of additionality testing, in particular, has the potential to enhance objectivity while possibly also reducing transaction costs.

Suggestions for the Paris Rulebook

Other than what has been suggested in the past, the mere presence of NDCs does not shield the participants from the necessity to do additionality testing: given the absence of international oversight over the pledged NDCs there is no guarantee for strong striving for ambition. Additionality is integral to safeguard environmental integrity and the implementation of additional testing must be ensured. In order to prevent 'hot air' from being produced, it should be laid out in the rulebook that additionality testing cannot be waived unless the host country agrees to an independent assessment of their NDC. If this is not the case, specific additionality testing for all activities should be implemented, depending on the type of the activity.⁴³

The concrete operationalisation poses many technical and methodological questions, such as how to implement additionality testing for different kinds of activities. Another crucial point is how to treat conditional and non-conditional NDC targets when assessing additionality. These issues are beyond the scope of this paper.

Independent from the testing design however, the private sector could benefit from a high level of standardisation of additionality testing. Where possible, the standardised activity parameters that have been used under the CDM could be utilised. Additionally, the Supervisory Body could make use of benchmarks, e.g. using emission intensity rates below which activities would be deemed additional. Such benchmarks have only been used for a small subset of sectors and technologies and never for policy instruments. Developing globally applicable benchmarks without leading to adverse effects for certain activities in certain countries will likely not be possible. The supervisory body should therefore be tasked to check for which activities which level of aggregation of benchmarks would be appropriate.⁴⁴

Introducing standardised baselines where possible has the potential to lower transaction costs and increase comparability by facilitating the process. Both effects are very much beneficial for the private sector. We therefore argue that standardised additionality assessment should be enshrined and encouraged through the Rulebook for Art. 6.4 PA. It is important to note that any form of standardisation must be either highly competitive or adapted regularly in order to account for regional or global economic shift as well as technological development.⁴⁵

Element for the Article 6.4 Rulebook:

- Enable standardization of additionality testing including updates

3.2. Limiting costs for the private sector

In order to make the use of the mechanism attractive for the private sector, it is important that financial barriers to participation are limited.

39 UNFCCC, Tool for the demonstration and assessment of additionality, available at: <https://cdm.unfccc.int/methodologies/PAMethodologies/tools/am-tool-01-v3.pdf>.

40 SBSTA, (2021) Chair's summary, informal consultations/informal technical expert dialogue on Article 6 of the Paris Agreement (June 2021), Any other matters identified by the Parties, p.4 et seqq. available at: <https://unfccc.int/sites/default/files/resource/IN.SBSTA2021.i15a.1.i15b.1.i15c.1.pdf>

41 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (second iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement, para. 43 et seqq., available at: <https://unfccc.int/sites/default/files/resource/DT.CMA2.i11b.pdf>.

42 Michaelowa et al., (2019) Negotiating Cooperation under Article 6 of the Paris Agreement, p. 26, available at: https://www.perspectives.cc/fileadmin/Publications/Michaelowa_et_al._2019_-_Negotiating_cooperation_under_Article_6_of_the_PA.pdf.

43 Michaelowa et al. (2019) Additionality revisited: guarding the integrity of market mechanisms of the Paris Agreement, p. 1221, available at: <https://www.tandfonline.com/doi/pdf/10.1080/14693062.2019.1628695?needAccess=true>

44 Michaelowa et al., (2019) Additionality in Art. 6 - Options for negotiations and cooperating parties, p. 21, available at: <https://www.zora.uzh.ch/id/eprint/175366/1/ZORA17366.pdf>

45 Ibid.

3.2.1. Share of proceeds

One of the key and still very much contested points, concerns the topic of levies that could be introduced to finance adaption measures in developing countries, a provision that was also included in the CDM. After being strongly debated in Paris, the PA only establishes the « share of proceeds » (SOP) under Art. 6.4 PA according to Art. 6.6 PA and not under Art. 6.2 PA. Some Parties demand that the SOP should also be implemented under Art. 6.2 PA i.a. to create a reliable revenue stream for the Adaption Fund.⁴⁶ Other states, including the U.S.A. and the EU, strongly oppose the integration of SOP into Art. 6.2 PA due to concerns that such a taxation could be in conflict with their domestic legal system⁴⁷ and could prevent the linking of emission trading schemes. The latest draft text by the COP.25 Presidency primarily stipulated an aspirational goal by ‘strongly encouraging’ the Parties to ‘commit to contribute resources to adaptation’.⁴⁸

In contrast, an SOP is provided for in Art. 6.6 PA for the Sustainable Development Mechanism of Art. 6.4 PA. In this context it remains controversial how exactly it is to be structured. Due to the differing views of the Parties, an informal technical dialogue was held on this issue in May 2021.⁴⁹ Under the CDM of the Kyoto Protocol a share of proceeds (SOP) is to be channeled towards both administrative expenses of the mechanism as well as towards helping developing countries to meet the cost of adaption. While the administration fee is levied as a monetary fee at issuance of CDM credits, the adaption fee is levied in kind, meaning that 2% of issued CERs are given to the Adaption fund.⁵⁰ Such a distribution is also foreseen in the latest draft of the President of COP.25, setting the in-kind contribution at 2% of the units.⁵¹

Impact on the private sector

For private entities, the question on how SOP is operationalized under Art. 6.4 PA can be significant. It acts like a tax on achieved emission reductions and correspondingly sold units. Depending on the amount of the levies, they could be counterproductive for the investment of private actors in relation to the expected profits. In addition, the different effect of levies that have a fixed price and those that represent a contribution in kind must be considered.⁵² If the

share of proceed works as a deterrent for private sector engagement however will also largely depend on how lucrative the involvement is, meaning that if the achieved profits are high enough, a robust share of proceeds will likely not hinder private sector involvement.

Suggestions for the Paris Rulebook

Other than adherence to the tried-and-tested system of using monetary fees for the administration of the mechanism while using an in-kind fee for the adaption fund⁵³ we suggest with Michaelowa that a combination of both approaches be applied and made part of the rulebook. This would mean that both administration and adaption share of proceeds will be levied as a mix of monetary fees and in-kind payments. Through this a stable income could be achieved through a predictable monetary fee. At the same time this would offer benefits to the developer as well: an in-kind contribution in credits would lead to higher revenue in case of market prices increasing.⁵⁴

It must be noted, however, that this suggestion does not entail the recommendation to apply the same rules regarding operationalisation and level of payment under Art. 6.4 PA to Art. 6.2. PA. Rather, a differentiated treatment of both mechanisms should serve the reconciliation of interests, especially given the possible implications for national jurisdictions. Utilising SOP on a voluntary basis thus appears to be a feasible solution for Art. 6.2 PA.

Elements for Article 6.4 Rulebook:

- Pay out as a mix of in-kind and monetary fee for both purposes
- Balance out the level of payments

3.2.2. Overall Mitigation in Global Emissions

The component of ‘overall mitigation in global emissions’ (OMGE) is another strongly debated issue. Including a component of OMGE means, that the results of respective instruments should be more than mere offsetting, but an actual reduction in global emissions. The ongoing debate regarding the question whether the aspect of OMGE should be included in the framework of Art. 6.2 PA is very similar to the discourse on SOP. Just like with the SOP, the

46 Obergassel et al., (2020) COP 25 in Search of Lost Time for Action, p. 11.

47 Obergassel et al., (2020) COP 25 in Search of Lost Time for Action, p. 11.

48 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration): Draft CMA decision on guidance on cooperative approaches referred to in Article 6, paragraph 2 of the Paris Agreement, para. 37, available at: https://unfccc.int/sites/default/files/resource/DT.CMA2_i11a.v3_0.pdf.

49 SBSTA, (2021) Chair’s summary, informal consultations/informal technical expert dialogue on Article 6 of the Paris Agreement (June 2021), Financing for adaption/Share of Proceeds (Article 6.2 and 6.4), available at: https://unfccc.int/sites/default/files/resource/2021A6ITED1on_SOP_SBSTA%20Chair%20summary.pdf.

50 A share of proceeds must not be paid if the CDM activity took place in a least developed country (LDC).

51 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement, para. 64, available at: https://unfccc.int/sites/default/files/resource/DT.CMA2_i11a.v3_0.pdf.

52 Michaelowa et al., (2019) Opportunities for mobilizing climate finance through Article 6, p. 29 et seqq., available at: https://www.perspectives.cc/fileadmin/Publications/Private_finance_through_Art._6_2019.pdf.

53 This structure has also been part of the 3rd Presidency Draft of COP 25:

54 Michaelowa et al (2019), Operationalizing the share of proceeds, p. 13, https://www.climatefinanceinnovators.com/wp-content/uploads/2019/06/Operationalizing-the-SoP_web.pdf.

aspect was explicitly included in the PA only in relation to Art. 6.4. PA. Again, the SBSTA 51 elaborations of 2019 shows a variety of proposals regarding this issue.⁵⁵ However, no corresponding agreement could be reached.

Just as with the issue of SOP, the problem arises as to how OMGE is to be operationalized in the first place.⁵⁶ This becomes apparent with a view to Art. 6.4 PA, which as stated before, explicitly requires for overall mitigation in global emissions. The understanding of what constitutes OMGE already differs. Some Parties see OMGEs as a co-benefit, which can be achieved solely through a robust mechanism under Art. 6.4 PA.⁵⁷ However, the vast majority of Parties see the need for a specific requirement to achieve OMGE. The most widely supported approach, which is also reflected in the latest draft of a decision on Art. 6.4 PA, therefore provides for a mandatory, automatic cancellations of a certain percentage of the transferred units (according to the draft at least 2%).⁵⁸ Proponents argue that this is the only way to achieve a ‘real’ benefit for climate protection beyond the respective NDCs and that countries not participating in Art. 6 PA would also benefit from the mechanism.⁵⁹

Concerns are raised by opponents of such a regulation who argue automatic cancellation could lead to a race to the bottom and that projects with supposedly high savings rates would be preferred to high-quality abatement projects.⁶⁰

Furthermore, a mere voluntary cancellation of corresponding certificates is proposed.⁶¹ Finally, another possible option is seen as an approach to achieve an OMGE through conservative baselines.⁶² This could automatically lead to an underestimation of the extent of the emission reduction in question compared to the actual mitigation achieved. However, it must be taken into account and is

therefore the central point of criticism of such a solution that the respective host country could then continue to count the remaining achieved reduction towards its NDC.⁶³ This is the major difference to automatic cancellation.

Impact on the private sector

Similarly to the SOP, the resulting costs of a mandatory cancellation would act like a tax and therefore one could argue that it will discourage trade with respective units. This can however be countered by the idea that in order to stimulate demand, there needs to be a continuous increase in ambition, which could be achieved precisely through OMGEs.⁶⁴

Suggestions for the Paris Rulebook

Given the significance of the principle and with a view to the named positive effects on the demand side we opt for an effective implementation through cancellation, paired with robust rules to ensure transparency and predictability for the private sector.

As cancellation of credits does have the potential to effectively ensure an overall mitigation by ‘retiring’ mitigation outcomes, we recommend making cancellation mandatory. In order to balance out possible disadvantages for the private sector, it is very important in this context to have clear and robust rules. Cancellation rates must be predictable for the participant. It will be crucial for the Party to decide on the percentage of the emissions reductions units that will be directed to a cancellation account, with the rest of the units issued to the entities involved in the activity.

It is beneficial to the private sector, is to select a design that does not allow the cancellation to impact the supply side. This means that a cancellation should not take place at issuance but at transfer

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- 55 SBSTA 51, (2019) Draft CMA decision on guidance on cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement (third iteration), para.s 52 et seq., available at: <https://unfccc.int/sites/default/files/resource/DT.SBSTA51.i12a.3.pdf>
- 56 For the still differing views see: SBSTA, (2021) Chair’s summary, informal consultations/informal technical expert dialogue on Article 6 of the Paris Agreement (June 2021), Implementing overall mitigation in global emissions in the Article 6.4 mechanism, available at: <https://unfccc.int/sites/default/files/resource/IN.SBSTA2021.i15b.2.pdf>.
- 57 Evans, Gabbatiss, (2019) Carbon Brief, In-depth Q&A: How ‘Article 6’ carbon markets could ‘make or break’ the Paris Agreement, available at: <https://www.carbonbrief.org/in-depth-q-and-a-how-article-6-carbon-markets-could-make-or-break-the-paris-agreement>.
- 58 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement, para. 67 b, available at: <https://unfccc.int/sites/default/files/resource/DT.CMA2.i11a.v3.0.pdf>.
- 59 Michaelowa et al., (2019) Negotiating Cooperation under Article 6 of the Paris Agreement, p. 22, available at: https://www.perspectives.cc/fileadmin/Publications/Michaelowa_et_al.2019_-_Negotiating_cooperation_under_Article_6_of_the_PA.pdf.
- 60 Evans, Gabbatiss, (2019) Carbon Brief, In-depth Q&A: How ‘Article 6’ carbon markets could ‘make or break’ the Paris Agreement, available at: <https://www.carbonbrief.org/in-depth-q-and-a-how-article-6-carbon-markets-could-make-or-break-the-paris-agreement>, p. 26.
- 61 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (first iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement, para. ., available at: <https://unfccc.int/sites/default/files/resource/DT.CMA2.i11b.13Dec.pdf>.
- 62 Ibid., para. 81.
- 63 Michaelowa et al., (2019) Negotiating Cooperation under Article 6 of the Paris Agreement, p. 22 et seq., available at: https://www.perspectives.cc/fileadmin/Publications/Michaelowa_et_al.2019_-_Negotiating_cooperation_under_Article_6_of_the_PA.pdf.
- 64 Füssler et al., (2019) Incentives for Private Sector Participation in the Article 6.4 Mechanism, p. 8, available at: https://www.dehst.de/SharedDocs/downloads/EN/project-mechanisms/discussion-papers/climate-conference-2019_1.pdf?__blob=publicationFile&v=4.

or use against NDC or another purpose.⁶⁵ This option is technically easy to apply and can be applied to all types of activities.⁶⁶

Transparency highly depends on the implementing entity. Therefore, the cancellation should be administered on UN level as the implementing entity in this case can centralise relevant accounting tasks.⁶⁷ The Supervisory Body could issue emission reduction units first to an account under its control. At transfers a fixed percentage is set aside to a dedicated OMGE cancellation account. Through this oversight is ensured and the mainstreaming of standards and procedures is easier which in turn facilitates technical applicability.⁶⁸

Elements for Article 6.4 Rulebook

- Mandatory cancellation
- Agreeing on the percentage of cancellation units
- Implementation via UN – Body

3.3. Broadening the playing field for the private sector

3.3.1. Allowing for activities outside the NDC and accounting

A further issue relevant to both Art. 6.2 PA and Art. 6.4 PA, which has yet to be fully clarified, is whether mitigations achieved outside of the scope of the country's NDC can be transferred outside of a country and whether such a transfer triggers a corresponding adjustment. Difficulties on deciding this issue during the negotiations stems i.a. from the lack of agreement between Parties on what 'outside' the NDC or 'not covered' by the NDC means. The prevailing opinion (so far) defines mitigation 'outside' the respective NDC as mitigations in sectors or regarding gases that are not considered in the NDC (e.g. a country's NDC only contains energy sector). Others understand 'outside' as any action going beyond the actions required to meet the GHG emission targets.⁶⁹ While some Parties are in favor of allowing mitigations 'outside' the NDC without any further requirements, others demand corresponding adjustments and again others argue that respective mitigations

should not be counted as emission reductions at all.⁷⁰ The first option is mainly supported by the argument that because the mitigation comes from 'outside' the NDC it already increases the ambition to mitigate as it was not foreseen in the NDC. Furthermore, respective measures would build capacities in a non-addressed sector so that it could be implemented in future NDCs. The main argument against a transfer without any requirements is that it would provide an incentive not to include a certain sector in the NDC.

In the context of Art.6.2 PA guidance, merely a reference to 'sectors and gases not included in the NDC' was retained in the third Presidency Draft. The Draft also envisions the possibility to transfer mitigations 'outside' the NDC as far as a corresponding adjustment is made.⁷¹

With regard to the rules, modalities and procedures to be decided on under Art. 6.4 PA the issue was treated slightly differently in the negotiations. This is because some argue that units generated under Art. 6.4 PA (A6.4ERs) are different from mitigation outcomes traded under Art. 6.2 PA as they will have to adhere to international rules regarding the setting of baselines and proof of additionality. As a consequence, according to some no corresponding adjustment is needed and the danger of a perverse incentive to not expand the scope of the NDCs can be prevented. This resonates with the interpretation of 'outside the NDC' as going beyond NDC targets.

The positions lastly put forward in the Presidency text includes the need for corresponding adjustments for all A6.4 ERs at first transfer as well as an opt out period, during which a host country that first transfers A6.4 ERs from sectors and greenhouse gases (among others) not covered by its NDC is not required to apply a corresponding adjustment.

Impact on the private sector

The private sector would certainly favour to have access to mitigation activities outside the NDC, and the attractiveness of the mechanism would be further enhanced if a corresponding adjustment was not needed, as the implementation of activities would be more attractive, especially for the host country. However, it is again ne-

65 Michaelowa et al., (2019) Opportunities for mobilizing private climate finance through Article 6, p.30., available at: https://www.perspectives.cc/fileadmin/Publications/Private_finance_through_Art_6_2019.pdf

66 Wang-Helmreich et al., (2019) Achieving Overall Mitigation of Global Emissions under the Paris Article 6.4 Mechanism, p. 20, available at: https://epub.wupperinst.org/frontdoor/deliver/index/docId/7394/file/7394_Overall_Mitigation.pdf.

67 Ibid p. 19.

68 Again, this suggestion does not entail the recommendation of applying the rules regarding operationalization and level of payment under Art. 6.4 PA to Art. 6.2. PA in an identical manor, as a voluntary implementation of OMGE under Art. 6.2 PA could help balance out conflicting interests.

69 The last draft at COP.25 favors the former understanding, cf. para. 15 UNFCCC Draft CMA decision on guidance on cooperative approaches referred to in Article 6 paragraph 2, of the Paris Agreement (third iteration, 15th Dec 2019), available at: https://unfccc.int/sites/default/files/resource/DT.CMA2_i11a.v3_0.pdf.

70 Michaelowa et al., (2019) Negotiating Cooperation under Article 6 of the Paris Agreement, p. 18, available at: https://www.perspectives.cc/fileadmin/Publications/Michaelowa_et_al_2019_-_Negotiating_cooperation_under_Article_6_of_the_PA.pdf.

71 UNFCCC, (2019) Draft text on matters relating to Article 6 of the Paris Agreement, Proposal by the President (third iteration): Draft CMA decision on rules, modalities and procedures for the mechanism established by Art. 6 paragraph 4 of the Paris Agreement, para. 15, available at: https://unfccc.int/sites/default/files/resource/DT.CMA2_i11a.v3_0.pdf.

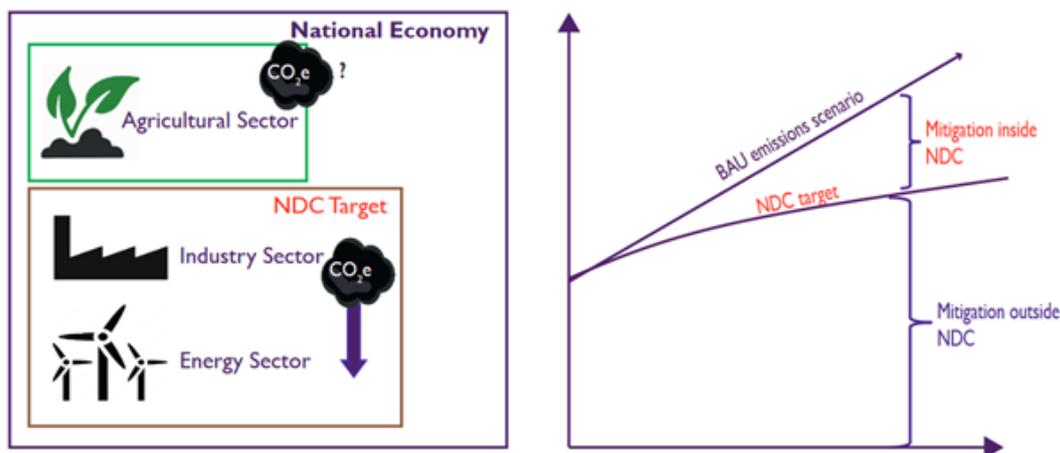


Figure 1: Different understandings of ‘outside NDC’. Source: Michaelowa et al. (2020): 2020 Update; Negotiating cooperation under Article 6 of the Paris Agreement

cessary to strike a balance between market interests and environmental integrity. The danger of de-incentivising the expansion of ambitious NDCs by allowing for generous exemptions from double counting constitutes a danger to the overall success of the Paris Agreement⁷² as well as to the amount of mitigation.

Suggestions for the Paris Rulebook

Mitigation activity outside the NDC should certainly be eligible under Art. 6.4 PA. In order to not risk environmental integrity, however, no accounting at all for activities under Art. 6.4 outside an NDC is not a feasible option: International oversight surely can provide more confidence in the quality of mitigation outcomes versus a scenario where there is none. However, stronger incentives for ensuring quality may be provided if mitigation outcomes occur within the scope of ambitious NDCs – in order to reach that goal, a transition within that scope is needed.⁷³ If there are to be exceptions for units generated under Art. 6.4 PA, they then must be limited: By not immediately undertaking corresponding adjustments as foreseen in the Presidency Draft, environmental integrity could possibly be safeguarded without rendering the mechanism unattractive for the participants.

We support the approach that the engagement in outside-scope mitigation outcomes without corresponding adjustments could be limited to a certain time period. This means that until a certain date the scope of activities also includes emission reductions outside the NDC without corresponding adjustments, while after that

date safeguards such as corresponding adjustments apply. Countries then have the opportunity to build capacities to expand their NDC scope. This solution could very well be politically feasible as well:

New developments around the informal technical expert dialogues on Art. 6 PA in 2021 in preparation of SBSTA 52 and COP.26 could indicate the success of further negotiations. While Egypt on behalf of the Arab Group insists on their prior statements,⁷⁴ Brazil as one of its prior main opponents showed willingness to discuss corresponding adjustments for emission reductions outside the scope of the NDC after a transition period for all countries.⁷⁵ We suggest making corresponding adjustments applicable from the second NDC implementation period onward (2025). Parties will also have to agree on whether they would follow the guidance of Art. 6.2 PA or apply specifically designed accounting rules.⁷⁶

Elements for the Article 6.4 Rulebook

- Transition Period without corresponding adjustments

3.3.2. Enhancing private sector demand beyond NDCs

As has been stated before, market demand for generated units will mostly depend on the ambition of national programmes and policies. The negotiations of the Rulebook for Art. 6 PA could howe-

72 Due to the limited scope of this paper technical aspects of accounting options will not be explored in the following section.

73 Schneider et al., (2020) Outside in? Using international carbon market for mitigation not covered by nationally determined contributions (NDCs) under the Paris Agreement, available at: <https://www.tandfonline.com/doi/epub/10.1080/14693062.2019.1674628?needAccess=true>

74 Informal Submission by Egypt on behalf of the Arap Group on avoiding double use for outside the NDC for Article 6.4, p. 1, available at: <https://www4.unfccc.int/sites/SubmissionsStaging/Documents/202104161824---Informal%20Submission%20by%20Egypt%20on%20behalf%20of%20Arab%20Group%20on%20Avoiding%20double%20counting%2064.pdf>.

75 Views of Brazil on the Rules, Modalities and Procedures for the Mechanism established by Article 6, paragraph 4 of the Paris Agreement, para. 13, 16, 17, available at: <https://www4.unfccc.int/sites/SubmissionsStaging/Documents/202104012104---BR%20-%20Submission%20-%20Article%206.pdf>.

76 Due to the scope of this paper, a detailed look at possible accounting rules is not part of this paper.

ver also influence the demand from other sources.⁷⁷ Such demand could stem from private sector entities not covered by the NDC, or non-UNFCCC mechanisms such as CORSIA. A source of demand for emission reductions issued under Art. 6 could be the voluntary carbon market. The voluntary carbon market enables private organisations such as businesses, non-governmental organisations or churches as well as public organisations or even individuals to reduce their carbon footprint voluntarily. For example, businesses use the voluntary carbon market to claim ‘carbon neutrality’ by buying and cancelling credits. It is largely driven by corporate or consumer wishes to offset their emissions and operates outside of the UNFCCC or country-level regulation.⁷⁸

Regarding the consideration of voluntary market activities, important groundwork was laid at COP.25 to help guide the implementation of voluntary market activities through the use of Art. 6.4 PA mechanism or Art. 6.2 PA guidance. The last draft of negotiation text for Art. 6.2 PA on guidance for the transfer of ITMOs refers to allow for ‘other purposes’ than trade between Parties with the purpose to use it against their NDCs and calls for corresponding adjustments with regards to those purposes. While ‘other purposes’ are set to definitely include non-UNFCCC compliance schemes such as CORSIA, the inclusion of the voluntary market is also on the table. As the ITMO definition in Art. 6.2 PA on the other hand will likely include Art. 6.4 PA emission reduction units if they are transferred, decisions on the scope of ITMOs are crucial for the use of units issued under Art. 6.4 PA towards other purposes too.

Impact on the private sector

It is becoming increasingly difficult to give a clear definition of the ‘voluntary market’: In its most common usage the term refers to the named situation, in which e.g. a company buys ITMOs issued by private sector certification schemes to voluntarily reduce their footprint. However, private certification standards are also being used in compliance markets and voluntary buyers also use internationally governed market standards for voluntary offsetting.⁷⁹ In any case, corporate and private demand for certificates to compensate or ‘offset’ emissions is increasing. This has given rise to a number of initiatives that are working to support and guide co-operations in their engagement, such as the ‘Science Based target Initiative’ (SBTi) and the ‘Task Force on Scaling Voluntary Carbon

Markets’ (TSVCM). While mandatory markets still operate at a significantly larger scale compared to the voluntary carbon market, the latter has seen a considerable increase in volume and value in the last years. According to a report by ecosystem market place, as of August 2021, USD 748 million have been posted in sales for 239.3 million credits. This represents 58% year to date jump in value and growth in credit volume of 27% over 2020 performance⁸⁰.

Enabling the transfer of ITMOs onto the voluntary market could broaden the market for private investors. Additionally, rules on the international level will heavily influence the voluntary market that is in itself not governed by the Paris Agreement.⁸¹ This has the potential to indirectly strengthen the voluntary market as a whole, by finding robust rules that will be applied by independent standards. A strong voluntary carbon market opens new possibilities for private sector engagement in its playing field.

Suggestions for the Paris Rulebook

In order to enable the use of mitigation outcomes in these markets and schemes, negotiators must necessarily agree on the use of those units for other purposes and the inclusion of the voluntary market. Given the status quo of negotiations, this seems likely in principle. Differing from the issue whether mitigation outcomes can be used for other purposes than towards an NDC, one of the crucial issues again concerns the question of accounting under the Paris regime: The challenge is how to embed, account for and transfer climate activities outcomes to be used for the voluntary carbon market from countries which now have their own mitigation targets.

Under the PA, if a country sells a reduction to another country, it should adjust its own levels of emissions to account for the fact that some of the achieved reductions have been used by another country. But should this also apply when the reduction is sold to a company?

Emission reductions achieved through international voluntary carbon markets are used on an entity level by primarily private sector buyers. Voluntary market offsets purchased by entities are not reflected by the country in its national accounting. The voluntary market purchase therefore has no impact on the NDC achievements of the country in which the buyer entity is based.⁸² Mitigation action within the capped environment of the host country,

77 Michaelowa et al., (2019) Opportunities for mobilizing private climate finance through Article 6, p.30, available at: https://www.perspectives.cc/fileadmin/Publications/Private_finance_through_Art._6_2019.pdf

78 Bürgi et al., (2017) Operationalising Article 6 of the Paris Agreement; Perspectives of developers and investors on scaling-up private sector investment, p. 17, available at: https://www.ieta.org/resources/International_WG/Article6/Portal/operationalising-article-6-of-the-paris-agreement.pdf.

79 Kreibich, Obergassel, (2019) The voluntary Carbon Market: What may be its future role and potential contributions to Ambition raising?, p. 12, available at: https://epub.wupperinst.org/frontdoor/deliver/index/docId/7396/file/7396_Carbon_Market.pdf

80 Donofrio et al., (2021) Markets in Motion: State of the Voluntary Carbon Markets 2021 Installment 1,p12, available at: <https://app.hubspot.com/documents/3298623/view/251152947?accessId=fd91dd>.

81 Espelage et al., (2021) Leitfaden: Vermeidung von Doppelzählung und Unterstützung der Gaststaaten im freiwilligen Markt, p.4, available at: <https://allianz-entwicklung-klima.de/wp-content/uploads/2021/02/leitfaden2021-vermeidung-von-doppelzaehlung-freiwilliger-markt.pdf>

82 World Bank, (2021) Country Perspectives: Opportunities and Challenges for International Voluntary Carbon Markets in the context of the Paris Agreement, p.19, available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/35538/Country-Perspectives-Opportunities-and-Challenges-for-International-Voluntary-Carbon-Markets-in-the-Context-of-the-Paris-Agreement.pdf?sequence=1&isAllowed=y>

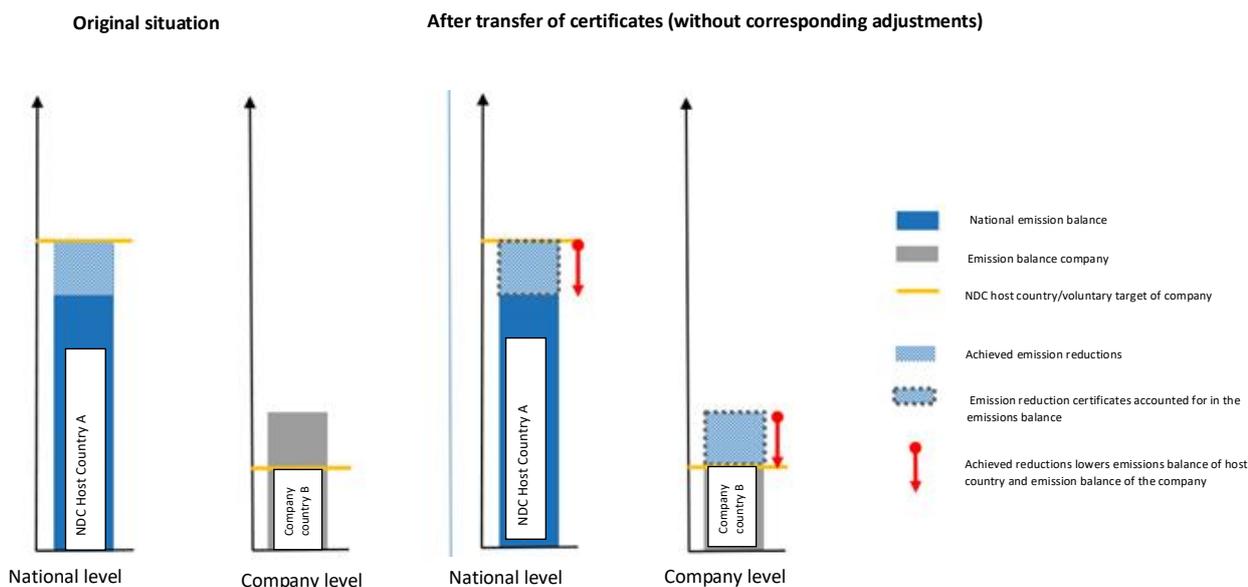


Figure 2: Risk of 'double counting' between NDCs and the voluntary carbon market. Source: Espelage et al (2021), Vermeidung von Doppelzählung und Unterstützung der Gasstaaten im freiwilligen Markt.

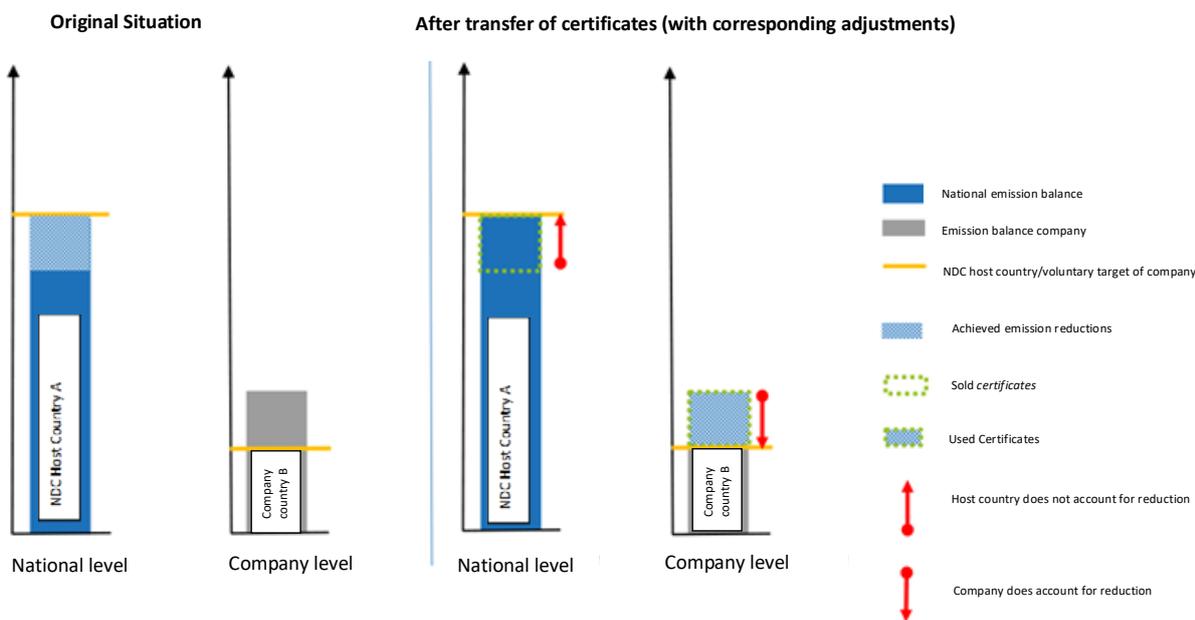


Figure 3: The principle of corresponding adjustments. Source: Espelage et al (2021), Vermeidung von Doppelzählung und Unterstützung der Gasstaaten im freiwilligen Markt.

however, contributes towards the achievement of the host Party's NDC and would be claimed against an international target. Some carbon offset providers argue in favour of voluntary emission reductions being used to make carbon neutrality claims without corresponding adjustments having been implemented: Mitigation

outcomes are only counted once on UN level as they are not exported from the host country to the jurisdiction in which the corporate buyer is based. Only the host country reports the reduction to the UNFCCC, while corporate GHG accounts are not reported and aggregated to a country level.⁸³

83 ICROA, (2020) ICROAs position on scaling private sector voluntary action post-2020, available at: https://www.icroa.org/resources/Documents/ICROA_Voluntary_Action_Post_2020_Position_Paper_March_2020.pdf

However, this view does not thoroughly address the problem. The relevant risk to address here is not the double counting of emission reductions towards NDCs, as indeed the outcome would be accounted towards different systems and different mitigation objectives. Yet, the outcome could be considered as ‘double claiming’, regardless of the different systems. Allowing for both claims may create a false impression of how much mitigation is actually achieved. Additionally, it may also weaken the mitigation effort in the host country because these ‘windfall’ reductions in its inventory may prompt it to slow or halt its mitigation action. The windfall reductions could displace the need for other mitigation effort that would have occurred to achieve the NDC. Regarding these consequences, corresponding adjustments are necessary.⁸⁴ Implementing the necessity for corresponding adjustments should not be left to the voluntary market itself. At the international level, policy-makers must make sure that the accounting framework for Art. 6 PA enables corresponding adjustments for voluntary purposes and that it can be easily used by the countries hosting voluntary market activities. Clear provisions regarding this issue must therefore become part of the rulebook.

The corresponding adjustment could be implemented at the moment of transfer, regardless of the ultimate use of the mitigation outcome. This would prevent any double claiming of mitigation outcomes between different regimes, if the other international mitigation regimes have the necessary modalities to ensure that mitigation outcomes are not circulated further in the international market.⁸⁵

While in our view the implementation of corresponding adjustments for the voluntary market is crucial in principle, one also needs to acknowledge that it will take extensive capacity building for some countries to approve and apply these procedures. To this end, a staggered introduction of the requirements based on countries’ development status could provide a feasible solution.

Elements for Article 6.4 of the Rulebook

- allow use for ‘other purposes’; explicitly include the voluntary market
- ensure applicability of corresponding adjustments in these circumstances

84 In accordance with chapter 3.3.1 a temporary opt out period could be implemented for units transferred from ‘outside’ the NDC.

85 Greiner et al., (2019) Article 6 Corresponding Adjustments - Key Accounting challenges for Article 6 transfer of mitigation outcomes, p. 28, available at: https://www.carbon-mechanisms.de/fileadmin/media/dokumente/Publikationen/Studie/2019_ClimateFocus_Perspectives_Corresponding_Adjustments_Art6.pdf

4. Conclusion

Parties to the Paris Agreement acknowledge the importance of the private sector to reach the goals of the Paris Agreements. The private sector can serve as a provider of financial flows and innovative technology. One important way to leverage the potential of the private sector to unlock greater ambition and achieve cost-effective emission reductions is through the market mechanisms enshrined in Art. 6 of the Paris Agreement. Here the crediting mechanism of Art. 6.4 of the Paris Agreement explicitly calls for the engagement of the private sector.

To do so, the upcoming negotiations for the rulebook must find provisions that provide investment opportunities for the private sector through robust, but flexible rules that also strike a balance between market incentives and environmental integrity.

First of all, Parties have to take into account, the complex, policy driven markets of the international market mechanisms of the Paris Agreement are based on trust. Keeping the trust of the private sector requires rules, modalities and procedures that do not completely undermine the credibility of past investments without risking environmental integrity. This is why we suggest to allow for a limited transition of CERs from activities under the CDM. Trust in the mechanism will also depend on the predictability of the outcomes. For this it is important, that rules for baselines and additionality setting are clear and standardized where possible.

Furthermore, it is important that the costs associated with implementing activities are set on a level that does not serve as a deterrent for private sector engagement. Therefore, rules on 'taxes' that come with the use of the mechanism through the share of proceeds as well as through the concept of 'overall mitigation in global emissions' must be considered and balanced out accordingly.

Lastly it is important that the playing field for the private sector is not curtailed, but possibly enhanced and strengthened through the Rulebook for Art. 6.4 PA. This means allowing for activities outside the scope of an NDC. Given its potential for ambition raising it is also crucial that the demand beyond Parties NDC is made possible and robust accounting in this instances is provided for.

The outlined issues are by far not the only crunch issues awaiting the negotiators at COP.26 with regard to Art. 6 PA. All of the remaining political and technical issues need to be resolved in order to successfully implement the new market mechanisms. It is crucial however that the Parties keep in mind that reaching the overarching goal of the Paris agreement calls for 'all hands on deck'. For this common effort, the private sector is indispensable and its importance needs to be reflected through the Paris Rulebook.

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