EDF ENVIRONMENTAL DEFENSE FUND
Finding the ways that work

CLIMATE

Q&A on accounting for transfers from "outside" of NDCs under Article 6 of the Paris Agreement to avoid double counting

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Background

The scope of current emissions targets in countries' Nationally Determined Contributions (NDCs) under the Paris Agreement varies considerably. Some greenhouse gas (GHG) emission sources are not included within the scope of NDCs, while some NDCs target types are not expressed in metrics that are consistent with current mass-based accounting practices for carbon markets. This raises the questions of whether and how transfers of emission reductions that occur outside the scope of NDC targets, or within NDCs that are not quantifiable in terms of tons of CO2 equivalent, should avoid double counting.

The principle of avoiding double counting is simple.

- Suppose emissions reductions in country A — say, from replacing a coal-fired electric power plant with a wind farm — generate credits that are sold to emitters in country B and used to comply with their own emissions targets.
- The atmosphere doesn't care whether the emission reductions took place in country A or B, so long as emissions go down overall.
- Of course, in keeping track of emissions reductions, it's important not to count the same emissions reductions twice.
- If country B claims the credits against its own emissions, country A can't do the same.

If the Article 6 rulebook were to allow such double counting, total emissions could go up, not down. While Articles 4 and 6 of the Paris Agreement include text prohibiting double counting, their focus on each nation's NDC has led some to suggest that double claiming need not be a concern if emissions reductions originate outside NDCs or are used toward mitigation efforts other than NDCs.

This issue is relevant for both international emission reduction transfers among countries under Article 6 of the Paris Agreement, and transfers from host countries to airlines under the International Civil Aviation Organization's Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

1. How does the guidance on accounting for NDCs under Article 4 relate to guidance for Parties using ITMOs pursuant to Article 6?

An important distinction between accounting under Article 6 and Article 4 is that Article 6 guidance applies from the first NDC period, while application of the accounting guidance developed under Article 4.13 is voluntary for the first set of NDCs.

This distinction is consistent with Article 6's role as a tool to allow higher ambition, including ambition in reporting and accounting in those countries that voluntarily participate in Article 6 cooperation.

Article 6.2's requirement to Parties to ensure "robust accounting" for ITMO's can facilitate Parties' efforts under Article 4, including efforts under 4.8 to clarify and improve understanding of their NDCs, as well as Party efforts to expand NDC coverage over time under Article 4.4. However, "robust accounting" is a distinct requirement from Article 4, and must be achieved for all parties participating in cooperative approaches. Article 6 thus should be seen as a tool for catalyzing and enabling more ambitious accounting and reporting outcomes than may be possible by application of Article 4 alone.

Under Article 6, then, if a country voluntarily chooses to engage in ITMO transfers - whether the reductions undergirding the transfer occur inside or outside the country's NDC, and whether the ITMOs are being transferred to another country or to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) - it must "step up" to a higher level of quantified accounting and related transparency than may be required under Article 4 or Article 13 alone. In such a case, for example, a country could not claim reporting "flexibility" under Article 13 when reporting on Article 6 activities.

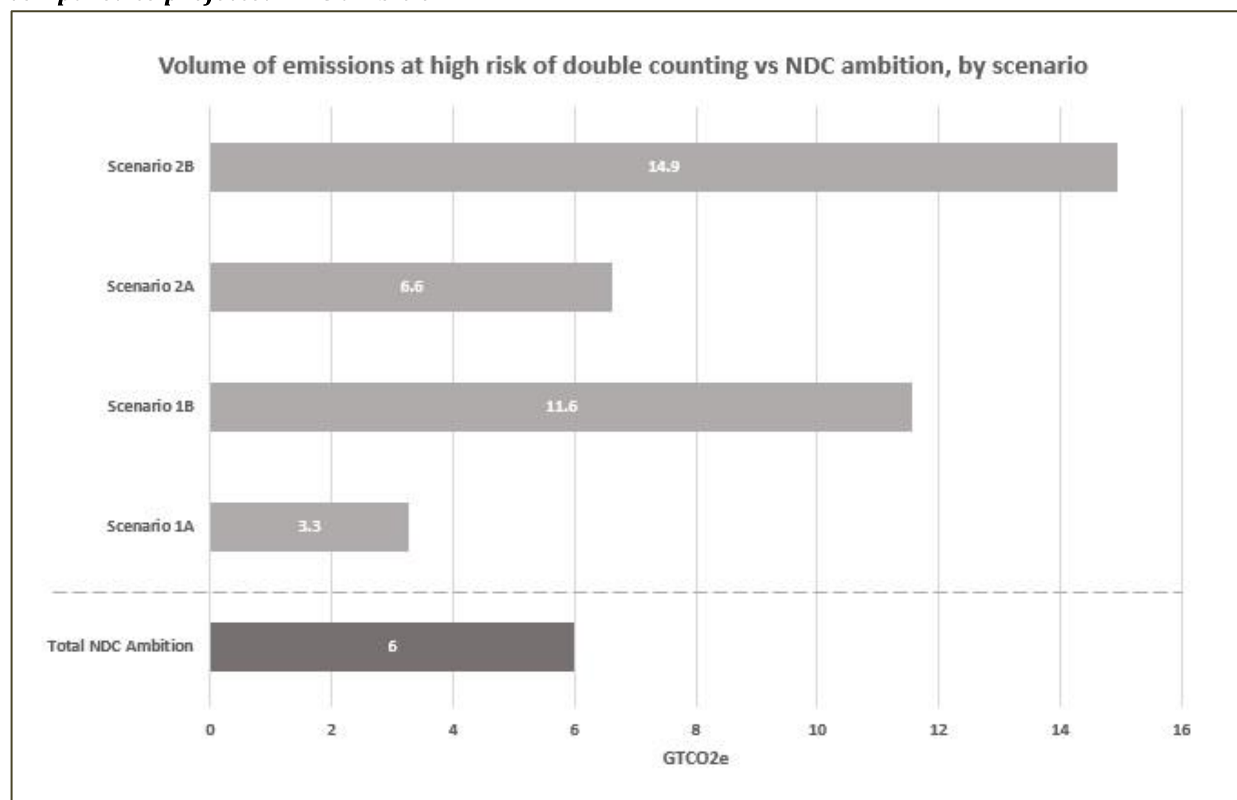
Introducing Article 13 "flexibility" into Article 6 could jeopardize the environmental integrity of the cooperative approach and weaken the ability of parties to assess whether the country is actually following the binding "shalls" of Article 6 (including the need to ensure "robust accounting", environmental integrity, and sustainable development).

In other words, no flexibility is needed or available under Article 6 accounting and reporting rules, because flexibility is already embedded in a Party's choice to participate in Article 6 cooperation.

2. How material is the issue of double counting outside NDCs?

Schneider et al. (2017) estimate that about 12-14% of projected global GHG emissions in 2030 will not be covered by current NDC targets (assuming that the United States is part of the Paris Agreement). More recent EDF analysis concluded that the total volume of emissions at high risk of double counting because they are outside of NDCs, or originate in countries without clear GHG targets expressed in absolute terms, is potentially equivalent to a third of global emissions, depending on how NDC GHG targets are interpreted. To put such numbers in context, three out of four emissions coverage scenarios analyzed by EDF indicate that the total volume of emissions at high risk of double counting exceeds the magnitude of the entire ambition of current NDCs relative to a 2030 current-policy baseline estimate. See **Figure 1 below**. In other words, all the emissions reductions estimated in current NDCs could be wiped out if double counting is not avoided.

Figure 1: Simplified visualization of the share of the world's emissions considered at "high risk" of double counting compared to projected NDC ambition



Note: In order to attain scenario estimates, four scenarios were crafted to explore the impact of a range of differing assumptions on what constitutes double counting "risk." Estimates were based on sector and greenhouse gas coverage status, as well as GHG mitigation target type within each nation's Nationally Determined Contribution (NDC). Interpretations of China and India's NDC contributes much of the uncertainty range within the results. Scenario volumes are not intended to show predicted emissions trajectories through 2030, but rather are intended to compare the magnitude of emissions at risk of double counting with the total predicted climate gains from full implementation of both conditional and unconditional NDCs. Median estimates of total annual GHG emissions under "current policy trajectory" and "NDC implementation" scenarios are taken from the UNEP Emissions Gap Report 2017.

This analysis suggests that double counting risk is not supply-limited, but rather demand-limited. Assuming that altering the supply of emissions at high-risk of double counting (i.e. increasing the sectoral scope of NDCs or stringency of GHG target types, or restricting transfers to NDCs only) is politically challenging, applying corresponding adjustments to all transfers - regardless of whether they originate in sectors/gases inside or outside of NDCs, or are used toward other mitigation efforts, like CORSIA - can effectively constrain the supply of emissions at high-risk of double counting and prevent total emissions from rising.

3. Are activities that are outside the scope of the NDCs eligible for markets?

There is a legal basis in the Paris Agreement for the view that emission reductions originating "outside" of NDCs can be eligible for market transfers towards NDCs, provided that certain safeguards for transparency, environmental integrity, and avoiding double-claiming are met. For example, Article 6 guidance applies when mitigation outcomes are transferred internationally and used "towards NDCs": thus, a non-NDC ITMO used "towards" another country's NDC would fall under Article 6 guidance requiring a "corresponding adjustment" to avoid double counting. Further, there is no requirement that ITMO transfers be made only towards NDCs. For example, any transfer to CORSIA (or any other entity) that assists a host Party to achieve its NDC (e.g. through reduced host country emissions, or via achievement of a conditional NDC) would be a use "towards" an NDC and fall within the scope of Article 6.2 guidance. In sum, if any Party to the transaction will use the

mitigation outcome towards an NDC, the guidance of Article 6.2 would apply. The nature of a corresponding adjustment in this case is the next question.

4. What type of corresponding adjustment is required for transfers from outside an NDC?

As stated above, reductions originating outside-of-NDCs may be used "toward NDCs" and toward CORSIA, as long as the host country reports the overall emissions of the relevant sector, reports the transfer, adds a corresponding amount of emissions to an account based on its NDC inventory, and satisfies the other relevant provisions of 6.2/6.4 (including those related to environmental integrity and sustainable development). Alternatively, if the host country only reports the overall emissions of the relevant sector, and reports the transfer, but does not correspondingly adjust at the time of the transfer, the buyer might purchase them as "locked," to be "unlocked" at the time in the future when the host country makes the adjustment to its NDC - but the buyer takes a risk.

5. Isn't the issue of accounting for transfers from a Party's non-NDC to another Party's NDC really just a question of inspecting the inventories?

Strong annual inventory reporting, strong centralized tracking of transfers, and a strong watchdog reviewing each country's inventory against their transfers, will theoretically allow "backing out" from the inventories and registries what is actually happening in terms of global emissions. For example, if a country claims that significant non-NDC sector reductions show it is doing "good for the climate," even though it did not meet its NDC, and if it sells those reductions for use in offsetting emissions in (a) other Parties' NDCs, or (b) CORSIA, then theoretically the global community should be able to rely on country inventories and tracking to spotlight that country's double-counting.

But the Paris Agreement only requires inventories every two years; the quality of those inventories in many developing countries is limited, especially in their outside-of-NDC emissions areas; and there is unlikely to be a single central transaction log to track transfers. Instead, there are likely to be multiple registries, some of which may not be public. So it may be very difficult to back out actual results from the inventory. Moreover, failing to require accounting for transfers from outside NDCs perpetuates the rule that developing countries (which are the only countries without economy-wide NDCs) don't have to carefully consider, in atmospheric terms, what they sell from their non-NDC sectors – it perpetuates the divisions that crippled the Kyoto Protocol from fully addressing the climate challenge.

6. Why is a corresponding adjustment needed/valuable?

1. To ensure "robust accounting" as required under Article 6 of the Paris Agreement, including the need to avoid double counting: Without a corresponding adjustment for all transfers, a single mitigation outcome may be counted towards two different mitigation efforts. EDF's preliminary analysis concludes that double counting even 1/3 of available transfers from "outside" NDCs could wipe out the estimated global effect of NDC ambition and cause global emissions to rise, rather than fall.

2. To provide market value: a corresponding adjustment gives reductions significant environmental and carbon market value, for the seller and buyer. A corresponding adjustment is a host country's strongest "stamp of approval" on a mitigation outcome, providing a buyer with confidence in the full

value of the emissions reduction asset transferred.[1] Those emissions reductions that clearly and transparently avoid double counting are likely to command a price premium. In order for these reductions to have maximum value, it is important that the seller complies with its NDC and that the purchased reductions are additional to those needed to meet the seller's NDC (or otherwise contribute to global mitigation). To assist with host country NDC achievement, revenues generated from "outside" NDC transfers could be used to fund "inside" NDC reductions, or some portion of "outside" NDC reductions could be retained for use by the host country.

3. To minimize transaction costs: In some cases, it is somewhat artificial to distinguish between NDC and non-NDC reductions: some projects and programs may generate reductions both inside and outside of NDCs. Requiring "apportionment" of those reductions because of two different accounting rules would add unnecessary burden and additional transaction costs with no environmental benefit. It would be simpler and more environmentally effective to have one rule with integrity requiring that all transfers should be adjusted in a country's NDC emissions account, regardless of whether the reductions may wholly or partially originate "inside" or "outside" an NDC.

4. To facilitate host country efforts to preserve environmental integrity: A corresponding adjustment can help a country manage the risk of low-quality reductions being generated from "outside" NDC sectors, since it creates a jurisdictional responsibility to ensure the mitigation value of transferred outcomes. (A jurisdiction that is properly "adding back" transferred emissions to its emissions balance will want to ensure each ton it transfers represents at least one ton of actual domestic reductions, to ensure its emissions do not rise as a result of the transfer). Without the need to compensate via a corresponding adjustment for exported mitigation outcomes outside its NDC, a host country may find it difficult to expand the scope of its NDC, and may overestimate emission reductions.

5. To ease the expansion of NDCs over time: A consistent accounting approach for all transfers from inside or outside of NDCs would avoid penalizing countries that expand the scope and coverage of their NDCs. Requiring corresponding adjustments for all transfers would thus support the increased global ambition needed to meet the objectives of the Paris Agreement, while increasing confidence in the integrity of carbon market cooperation under the Paris Agreement. (Non-NDC sector transfers that bypass accounting rules could in effect constitute an unfair subsidy to non-NDC sector activities.)

6. To avoid a return to bifurcation: If all reductions transferred must comply with Art 6.2 accounting guidance requiring a "corresponding adjustment," Parties can avoid resurrecting the sharp polarization between developed and developing countries that existed under the KP. Consistent corresponding adjustments would ensure that the CDM's bifurcation is not copied post-2020.

7. To promote public understanding and confidence in carbon markets: From common practice, individuals and the public expect that when an asset is voluntarily transferred, whether from a bank account or a carbon account, the original holder no longer owns it. Carbon market guidance under the Paris Agreement should follow common accounting practices that facilitate public understanding of the value and integrity of carbon markets and build market confidence.

7. How might "robust accounting" be achieved for transfers from outside NDCs?

One practical way of ensuring the above market value and environmental safeguards can be met would be to consider ITMO transfers as actions which occur at the end of each emitting year, as a means of balancing accounts among Parties; while private actors - if the host country so authorizes - transfer emissions units in

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[1] Project developers, for example, believe units that are backed by host country corresponding adjustments "represent the currently available "best in class" host country-approved… carbon credits." See "First-of-its-kind REDD+ carbon credit integrated into Peru's plan to achieve Paris targets," available at https://althelia.com/2018/05/21/world-first-peru-moves-to-integrate-redd-forest-conservation-projects-into-paris-climate-plan/

and out during the course of the year. To meet their Paris obligations, Parties would want to ensure that their accounts are in balance, as follows:

- Transacting Parties would need to report their emissions (NDC and non-NDC) annually; refrain from ITMO transfers the first year; and if at the end of the first year, any Party has a positive balance in its ITMO account (i.e., its emissions within the scope of its NDC are less than its emissions trajectory under its NDC pledge), that Party can transfer from its ITMO account.
- During year 2, transfers could occur at any time provided they are accounted for and reported and adjusted as above. At the end of year 2, each Party's ITMO account is checked against its total emissions. If the ITMO balance is positive (i.e., the Party's emissions within the scope of its NDC are less than its NDC emissions trajectory, after accounting for all transfers, whether from NDC or non-NDC sectors), then the Party can sell more. If the ITMO balance is negative, the Party must wait until its account is back in balance before selling more ITMOs. Another alternative would be for host countries to pre-define a "set aside" buffer of ITMOs available for transfer.

8. How might "robust accounting" facilitate Parties' efforts to expand and clarify the scope and coverage of their NDCs?

Parties may wish to consider accounting guidance that requires Parties to clarify the scope and coverage of their NDCs in order to participate in Article 6 transfers. Such guidance would be consistent with the goals of the Paris Agreement's enhanced transparency framework, while providing additional options for international cooperation to Parties' that enhance the clarity, transparency, and understanding of their NDCs.

9. Is reporting required for non-NDC transfers?

Reporting of non-NDC transfers is needed to satisfy the following mandates under the Paris Agreement:

i) Ensuring "robust accounting" under Article 6;
ii) The purpose of the enhanced transparency framework under Article 13.5 (to provide "a clear understanding of climate change action in the light of the objective of the Convention");
iii) Requirements under Paragraph 13.7 of the Paris Agreement and paragraph 90 of Decision 1/CP.21 for Parties to provide "information necessary to track progress" to NDCs at least every two years; and
iv) CMA's guidance under paragraph 92 of Decision 1/CP.21, to ensure environmental integrity, transparency, accuracy, completeness, and avoid double counting.

10. Can markets be used in implementing conditional NDCs?

It should be up to each Party with a conditional target to determine the answer to this question for itself. Transfers would be possible provided the above accounting and reporting steps and safeguards are observed. This could enable the host country to use the additional revenue from the transferred reductions to help finance further reductions to help it meet – and beat – its unconditional NDC pledge. To preserve both the environmental integrity and market value of this approach, it is essential that the above accounting process be followed, and that the "ITMO balance" be measured by comparing the NDC commitment level to the actual emissions of the country overall, adjusted by adding to the NDC portion of the country's inventory-based emissions account, the volume of NDC and non-NDC reductions transferred.

Including "outside" NDC sectors in a country's conditional NDC may be an important stepping stone to full NDC coverage, providing confidence to developing countries that market and other financing tools are available to them as they move to more comprehensive NDCs.

11. How about private sector projects that are part of the conditional NDC but rely on carbon finance?

See #2 above.

12. Will the host countries need to build registries?

For the transfer of ITMOs, a registry is needed. Registries may be created via an account of the host country in a common international transaction log, or an account in the registry of the host country, or in another country or programme, as long as double counting is avoided, by linking the registries. What will also be essential is for the country either to build a registry account so that it can track transfers in and out of the country throughout the year, or to designate a single registry operating in its country as its official registry, through which all transfers must go, and require host government approval before any transfers. Otherwise, a private investor or project developer could transfer "too much," in effect undermining the country's baseline and putting its ITMO account into deficit. Establishing such capacity in the host country brings important and positive governance benefits, as it allows host countries to exercise a measure of authority over the selection of project locations and types, to ensure they are consonant with national sustainable development priorities.