

## **Possible improvements to emissions trading and the project-based mechanisms under the Kyoto Protocol with potentially significant implications for the ability of Annex I Parties to achieve mitigation objectives**

Note: For each element contained in this annex, there exists a 'status quo' option representing the maintenance of the current approaches and rules adopted by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP).

Note: Some Parties expressed the view that the elements in sections I.E, I.F, I.G, I.J, II.A, III.A, III.B, III.C, IV.C and IV.D below would require an amendment to the Kyoto Protocol and would not be within the mandate of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP). Some other Parties expressed the view that legal analysis is needed to determine which elements in this annex would require a decision of the CMP or an amendment to the Kyoto Protocol and that such amendments would be within the mandate of the AWG-KP.

### **I. Clean development mechanism**

#### **A. Include other land use, land-use change and forestry activities<sup>1</sup>**

*Note: The following activities have been proposed by Parties as candidates for inclusion:*

- *Reducing emissions from deforestation and degradation;*
- *Restoration of wetlands;*
- *Sustainable forest management and other sustainable land management activities.*

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Resolution of non-permanence and methodological issues;*
- *Modalities for inclusion of such land use, land-use change and forestry (LULUCF) activities.*

#### **B. Introduce a cap for newly eligible land use, land-use change and forestry activities<sup>2</sup>**

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Application of the limit to the issuance of certified emission reductions (CERs) or use of CERs for compliance;*
- *Establishment of a single overall limit or limits by individual LULUCF activity;*

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<sup>1</sup> Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

<sup>2</sup> Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

- *Determination of the limit or limits.*

### **C. Include carbon dioxide capture and storage<sup>3</sup>**

1. Option 1: Carbon dioxide capture and storage (CCS) activities are not eligible as clean development mechanism (CDM) project activities.

Option 2: Annex I Parties are to refrain from using CERs generated from CCS activities to meet their commitments under Article 3, paragraph 1.

Option 3: CCS activities may be registered under the CDM and Annex I Parties may use CERs issued for such project activities, on the basis of emission reductions during the second commitment period under the Kyoto Protocol, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Short- and long-term liability (e.g. in relation to leakage);*
- *Provisions for monitoring, reporting and verification, taking account of data availability;*
- *Possible environmental impacts;*
- *Definition of project boundaries;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes.*

### **D. Include nuclear activities**

2. Option 1: Activities relating to nuclear facilities are not eligible as CDM project activities.

Option 2: Activities relating to new nuclear facilities may be registered under the CDM and Annex I Parties may use CERs issued for such project activities, on the basis of emission reductions during the second commitment period under the Kyoto Protocol, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Specific criteria or requirements for eligible nuclear activities;*
- *Costs related to access to the technology;*
- *Direct contribution to emission reductions;*
- *Issues relating to non-proliferation;*
- *Issues relating to permanent disposal of nuclear waste;*
- *Safety, security and safeguards.*

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<sup>3</sup> This issue is being considered by the Subsidiary Body for Scientific and Technological Advice under its work on carbon dioxide capture and storage in geological formations as clean development mechanism project activities.

**E. Introduce sectoral clean development mechanism  
for emission reductions below a baseline defined at a sectoral level**

3. Activities defined at the sectoral level may be registered under the CDM and shall be subject to applicable modalities and procedures for the CDM adopted by the CMP and all applicable procedures and decisions issued by the CDM Executive Board.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Guidelines for the definition of sector boundaries relating to sectors, mitigation measures and geographical scope;*
- *Process for defining sector boundaries;*
- *Specific additionality provisions;*
- *Specific baseline provisions, including changes to the composition of the sector;*
- *Provisions to ensure participation of all activities within the sector boundary;*
- *Provisions for single project activities within the sector boundary;*
- *Specific registration provisions;*
- *Provisions for monitoring, reporting and verification of emission reductions, taking account of data availability;*
- *Incentives for private-sector participation.*

**F. Introduce sectoral crediting of emission reductions  
below a previously established no-lose target**

4. A non-Annex I Party may propose a no-lose target for emissions from a sector. Such targets shall be approved by {the CMP} {a body constituted by the CMP and operating under its guidance}. The Party may receive upfront financing, technology and credits for verified emission reductions below the target. There shall be no consequences for a Party that does not meet its approved target.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Guidelines for the definition of sector boundaries relating to sectors, mitigation measures and geographical scope;*
- *Process for determining sectoral no-lose targets;*
- *Institutional structure for the administration of sectoral crediting and issuance of credits;*
- *Provisions for monitoring, reporting and verification of cumulative emission reductions, taking account of data availability;*
- *Provisions for single CDM project activities within the sector boundary;*
- *Form of the credit;*
- *Incentives for private-sector participation.*

**G. Introduce crediting on the basis of nationally appropriate mitigation actions**

5. A non-Annex I Party may propose nationally appropriate mitigation actions (NAMAs). Credits could be issued for the verifiable mitigation generated by NAMAs. Such mitigation shall be verified by methodologies established by the Parties.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Nature of participation of Parties;*
- *Guidelines for the determination of NAMAs;*

- *Provisions relating to additionality;*
- *Process for the approval of NAMAs;*
- *Changes to NAMAs;*
- *Institutional requirements;*
- *Provisions for monitoring, reporting and verification of emission reductions, taking account of data availability;*
- *Provisions for CDM project activities within the boundary of the NAMA;*
- *Form of the credit;*
- *Consequences if the emission reduction goal is not achieved;*
- *Incentives for private-sector participation;*
- *Improving the commercial viability of mitigation investment;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes.*

#### **H. Ensure environmental integrity and assess additionality through the development of standardized, multi-project baselines**

6. The CDM Executive Board shall define standardized baselines for specific types of project activities under the CDM by pre-approving parameters and procedures for use in baseline methodologies. The Executive Board may define such standardized baselines for types of project activities meeting the following criteria: { ... }

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Criteria for eligible project activities;*
- *Criteria for the definition of parameters, including use of conservative estimates;*
- *Provisions for single CDM project activities if an applicable standardized baseline exists for this specific project activity type;*
- *Provisions for periodic review;*
- *Treatment of existing project activities if a standardized baseline is subsequently approved.*

#### **I. Ensure environmental integrity and assess additionality through the development of positive or negative lists of project activity types**

7. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by project activities in categories meeting the following criteria are deemed to be additional to any that would occur in the absence of the project activities: { ... }

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Criteria for categories of project activities for inclusion on a positive list;*
- *Process for determining positive lists;*
- *Body responsible for determining positive lists;*
- *Provisions for periodic review;*
- *Consequences for project activities where the project type is removed from the positive list;*
- *Issues concerning national circumstances.*

8. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by project activities in categories meeting the following criteria are deemed not to be additional to any that would occur in the absence of the project activities, and the project activities are not eligible to be project activities under the CDM: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Criteria for categories of project activities for inclusion on a negative list;*
- *Process for determining negative lists;*
- *Body responsible for determining negative lists;*
- *Provisions for periodic review;*
- *Provisions for addressing registered project activities in categories which are subsequently covered by a negative list;*
- *Issues concerning national circumstances.*

#### **J. Differentiate the eligibility of Parties through the use of indicators**

9. Non-Annex I Parties meeting the following criteria shall {not} be eligible to host {particular types of} project activities under the CDM: {...}

10. Annex I Parties meeting the following criteria shall {not} be eligible to use CERs issued for {particular types of} project activities under the CDM for the purpose of compliance with commitments under Article 3, paragraph 1, of the Kyoto Protocol: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Appropriate indicators and thresholds, taking account of differing national circumstances;*
- *Project activity categories affected by the eligibility determination;*
- *Transition issues.*

#### **K. Improve access to clean development mechanism project activities by specified host Parties**

11. For {specified host Parties} {least developed countries and small island developing States} the following provisions shall apply:

- (a) The definition of a small-scale project activity is {...};
- (b) Project activities that meet the requirements of small-scale project activities are exempt from the requirement to demonstrate additionality;
- (c) The validation, verification and certification of project activities shall be funded through the {budget of the CDM} {financial mechanism of the Convention}.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of the host Parties for which provisions are applicable or definition of criteria for subsequently determining the host Parties;*
- *Identification of further measures to improve access;*
- *Enabling environment.*

## **L. Include co-benefits as criteria for the registration of project activities**

12. Option 1: Project activities that demonstrate specific co-benefits, as {defined and confirmed by the designated national authority} {validated by a designated operational entity (DOE)}, shall be entitled to the following preferential treatment: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of which co-benefits to consider, including:*
  - *Specific sustainable development benefits;*
  - *Energy efficiency;*
  - *Technology transfer;*
  - *Environmental services such as conservation of biodiversity, hydrological resources management and air quality;*
  - *Poverty alleviation;*
  - *Economic growth;*
  - *Social benefits;*
- *Determination of the preferential treatment (e.g. reduced fee, financial support and faster processing times);*
- *Provisions to ensure that preferential treatment is consistent with CDM rules;*
- *Provisions for the measurement of co-benefits;*
- *Definition of a sufficient level of co-benefits to qualify for the preferential treatment;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes;*
- *Contribution to minimization of negative spillover effects.*

Option 2: Each project activity shall demonstrate specific co-benefits. Prior to the registration of the project activity, a DOE shall validate {that the proposed project activity demonstrates the respective co-benefits} {that the designated national authority of the host Party has confirmed that the respective co-benefits are demonstrated by the project activity}.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of which co-benefits to consider, including:*
  - *Specific sustainable development benefits;*
  - *Energy efficiency;*
  - *Technology transfer;*
  - *Environmental services such as conservation of biodiversity, hydrological resources management and air quality;*
  - *Poverty alleviation;*
  - *Economic growth;*
  - *Social benefits;*
- *Provisions for the measurement of co-benefits;*
- *Definition of sufficient level and type of co-benefits to allow registration of project activities;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes;*
- *Contribution to minimization of negative spillover effects.*

**M. Introduce multiplication factors to increase or decrease  
the certified emission reductions issued for specific project activity types**

13. A CDM project activity shall receive CERs equal to the emission reductions that are certified by the DOE multiplied by factors based on the {project activity types} {technologies} {sustainability components}. Multiplication factors may be greater or less than one.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of multiplication factors for project activity types;*
- *Basis for determination of multiplication factors;*
- *Provisions to ensure that the total number of CERs issued is not higher than the aggregate quantity of emission reductions achieved;*
- *Provisions to ensure environmental integrity;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes;*
- *Improving the commercial viability of investment for renewable energy projects.*

**II. Joint implementation**

**A. Introduce modalities for treatment of clean development mechanism  
project activities upon graduation of host Parties**

14. Option 1: Where a Party becomes eligible to host joint implementation (JI) projects, any registered CDM project activities hosted by that Party shall continue as CDM project activities until the end of their crediting periods and a quantity of assigned amount units equal to the CERs issued from this time onwards shall be cancelled.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Specific provisions for CDM afforestation and reforestation project activities;*
- *Provisions for cancellation.*

Option 2: Where a Party becomes eligible to host JI projects, any registered CDM project activities hosted by that Party shall be converted to JI projects and shall be subject to JI rules.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Specific provisions for CDM afforestation and reforestation project activities;*
- *Provisions relating to the crediting period;*
- *Transition issues;*
- *Ability to select Track 1 procedure if the relevant eligibility requirements are met by the host Party.*

**B. Include nuclear activities**

15. Option 1: Activities relating to nuclear facilities are not eligible as JI projects.

Option 2: Activities relating to new nuclear facilities are eligible as JI projects and Annex I Parties may use emission reduction units issued for such projects, on the

basis of emission reductions during the second commitment period under the Kyoto Protocol, to meet their emission commitments under Article 3, paragraph 1, for the second commitment period.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Specific criteria or requirements for eligible nuclear activities;*
- *Costs related to access to the technology;*
- *Direct contribution to emission reductions;*
- *Issues relating to non-proliferation;*
- *Issues relating to permanent disposal of nuclear waste;*
- *Safety, security and safeguards.*

**C. Include projects that reduce greenhouse gas emissions  
from deforestation and degradation<sup>4</sup>**

**D. Ensure environmental integrity and assess additionality  
through the development of positive or negative lists of project types**

16. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by projects in categories meeting the following criteria are deemed to be additional to any that would occur in the absence of the projects: { ... }

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Applicability to Track I projects;*
- *Criteria for inclusion of project categories on a positive list;*
- *Process for determining positive lists;*
- *Body responsible for determining positive lists;*
- *Provisions for periodic review;*
- *Consequences for projects whose project type is removed from the positive list;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes.*

17. Reductions in anthropogenic emissions by sources or enhancements of anthropogenic removals by sinks achieved by projects in categories meeting the following criteria are deemed not to be additional to any that would occur in the absence of the projects, and the projects are not eligible to be projects under II:

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Applicability to Track I projects;*
- *Criteria for inclusion of project categories on a negative list;*
- *Process for determining negative lists;*
- *Body responsible for determining negative lists;*
- *Provisions for periodic review;*
- *Provisions for addressing projects which have received a final positive determination but which are subsequently covered by a negative list;*
- *Cost-effectiveness;*

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<sup>4</sup> Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.



- *Administrative complexity;*
- *Potential for perverse outcomes.*

### **E. Include co-benefits as criteria for the final determination for projects**

18. Option 1: Projects that demonstrate specific co-benefits, as determined by an accredited independent entity (AIE), shall be entitled to the following preferential treatment: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Applicability to Track I projects;*
- *Determination of which co-benefits to consider, including:*
- *Technology transfer;*
- *Environmental services such as conservation of biodiversity, hydrological resources management and air quality;*
- *Determination of the preferential treatment;*
- *Provisions for the measurement of co-benefits;*
- *Definition of a sufficient level of co-benefits to qualify for the preferential treatment;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes.*

Option 2: Each project shall demonstrate specific co-benefits. The AIE shall determine whether {the proposed project demonstrates the required co-benefits} {the designated focal point of the host Party has confirmed that the required co-benefits are demonstrated by the project}: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Applicability to Track I projects;*
- *Determination of which co-benefits to consider, including:*
- *Technology transfer;*
- *Environmental services such as conservation of biodiversity, hydrological resources management and air quality;*
- *Provisions for the measurement of co-benefits;*
- *Definition of a sufficient level of co-benefits required to allow a final positive determination for projects;*
- *Cost-effectiveness;*
- *Administrative complexity;*
- *Potential for perverse outcomes.*

## **III. Emissions trading**

### **A. Introduce emissions trading based on sectoral targets**

19. International emissions trading may occur at the level of sectors across groups of Parties.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of targets and boundaries for each sector and avoidance of double counting;*
- *Participation of non-Annex I Parties;*
- *Allowance of trading across sectoral agreements;*
- *Relationship of sectoral targets to national emission commitments of Annex I Parties;*
- *Potential use of emission allowances of non-Annex I Parties for compliance with commitments of Annex I Parties;*
- *Provisions for monitoring, reporting and verification, taking account of data availability;*
- *Institutional structure;*
- *Determination of the tradable unit;*
- *Differences in implementation if the sectoral agreements are administered by national governments or other organizations.*

## **B. Introduce emissions trading on the basis of nationally appropriate mitigation actions**

20. Credits that are generated on the basis of a reduction in emissions below a goal set in the context of approved NAMAs in non-Annex I Parties may be traded under international emissions trading.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Determination of targets and boundaries for each NAMA and avoidance of double counting;*
- *Process for negotiating and recognizing NAMAs;*
- *Provisions for monitoring, reporting and verification, taking account of data availability;*
- *Institutional structure for the administration of NAMAs and issuance of credits;*
- *Definition of the tradable unit;*
- *Implications of changes to NAMAs;*
- *Provisions for single CDM project activities within the boundary of the NAMA.*

## **C. Introduce the linking of emissions trading schemes in Annex I Parties to voluntary emissions trading schemes in non-Annex I Parties**

21. Emissions trading schemes in Annex I Parties may be linked to trading schemes implemented on a voluntary basis by non-Annex I Parties at a national, regional or sectoral level.

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *Guidance on minimum provisions for linking;*
- *Potential use of emission allowances of non-Annex I Parties for compliance with commitments of Annex I Parties;*
- *Eligibility criteria for non-Annex I Party trading schemes to allow their emission allowances to be used by Annex I Parties for compliance with emission commitments.*

## **IV. Cross-cutting issues**

### **A. Relax or eliminate carry-over (banking) restrictions on Kyoto units**

22. Option 1: There shall be no restrictions on the carry-over of Kyoto units to a subsequent commitment period.

Option 2: Limits on the carry-over of specific Kyoto units to a subsequent commitment period shall be as follows: {...}

*Note: The following issue, inter alia, may be relevant to consideration of this element:*

- *Proposed limits on carry-over, by Kyoto unit type.*

### **B. Change the limit on the retirement of temporary certified emission reductions and long-term certified emission reductions<sup>5</sup>**

### **C. Introduce borrowing of assigned amount from future commitment periods**

23. An Annex I Party shall be permitted to borrow assigned amount from the subsequent commitment period and use it for the purpose of compliance with its commitment in the current commitment period in accordance with the following provisions: {...}

*Note: The following issues, inter alia, may be relevant to consideration of this element:*

- *- Timing of the 'repayment' of the assigned amount;*
- *- Limits on borrowing;*
- *Cost of borrowing, including through an 'interest rate';*
- *Consequences for non-compliance in the subsequent commitment period;*
- *Implications for the environmental integrity of the Kyoto Protocol.*

### **D. Extend the share of proceeds<sup>6</sup>**

*Note The following issue, inter alia, may be relevant to consideration of this element:*

- *Pros and cons of keeping the current provisions and extending the share of proceeds to JI and emissions trading under Article 17 or to the issuance of assigned amount units and removal units.*

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<sup>5</sup> Discussion to be informed by outcomes from the consideration of non-permanence and other methodological issues.

<sup>6</sup> This issue is being considered by the CMP under its work on the second review of the Kyoto Protocol pursuant to its Article 9.