GILBERT +TOBIN

BRIEFING REPORT ON THE ARTICLE 6 RULES AGREED AT COP 26

IMPLICATIONS FOR AUSTRALIA

CONTACT

Ilona Millar
Partner
+61 2 9263 4723
IMillar@gtlaw.com.au

20 MAY 2022

CONTENTS

Overview and Executive Summary

The Climate Change Authority (**CCA**) has asked us to prepare a briefing report on the rules governing the cooperative approaches under Article 6 of the Paris Agreement agreed at COP 26 in Glasgow (**Article 6 Rules**) and to consider the implications for Australia.

In this report, we set out:

(a) an introduction to Article 6 of the Paris Agreement and the Article 6 Rules (**Part 1**);

(b) a detailed analysis of the Article 6.2 Rules (**Part 2**);

(c) a detailed analysis of the Article 6.4 Rules (**Part 3**);

(d) a detailed analysis of the Article 6.8 work programme (**Part 4**);

(e) our analysis of the implications of Article 6 Rules for Australia and Australian entities, including:

(i) ways in which Australia can directly engage with the Article 6.2 cooperative approaches as either a host country for mitigation activities (**transferring** or **host Party**) or as a user of internationally transferred mitigation outcomes (**ITMOs**) (**receiving** or **using Party**) (**Part 5**);

(ii) steps that the Australian Government will need to take to enable domestic participation in each of the Article 6 mechanisms, including possible changes to organisational arrangements and registry infrastructure (**Part 5**);

(iii) areas for potential engagement and capacity building with Indo-Pacific Carbon Offsets Scheme (**IPCOS**) partner countries and countries in the Asia-Pacific region more generally to facilitate the development or regional cooperation on Article 6 (**Part 6**);

(iv) opportunities to facilitate private sector involvement in Article 6.2 and 6.4, with reference to the likely timing of full implementation of Article 6.2 and 6.4, as well as potential risks of such involvement (**Part 7**); and

(v) implications of the Article 6 Rules for the voluntary carbon market (**VCM**) in Australia, including risks relating to Australian companies implementing VCM projects and purchasing voluntary carbon units (**Part 8**).

The Article 6 Rules as currently agreed provide a platform for early cooperation to begin under Article 6.2 and the architecture for the Article 6.4 mechanism (as described in detail in Parts 2 and 3 of this Report). However, it is important to recognise that there are a number of steps that need to take place both within participating Parties and at an international institutional level before the approaches will be fully operational. Those key steps include:

(a) Parties to the Paris Agreement agreeing to the form of tables for reporting and infrastructure for recording and tracking ITMOs;

(b) participating Parties addressing each of the participation requirements for Article 6.2 – in particular, having arrangements in place for authorising the use, and tracking, of ITMOs and providing a national inventory report;

(c) the Supervisory Body for the Article 6.4 mechanism developing more detailed provisions for methodologies, validation, registration, verification, certification, issuance, first transfer, and voluntary cancellation of Article 6.4 emissions reductions (**A6.4ERs**); along with supporting guidelines and tools to support the implementation of the activity cycle;

(d) the development of processes for Clean Development Mechanism (**CDM**) transition by the Subsidiary Body for Scientific and Technological Advice (**SBSTA**); and

(e) Parties considering recommendations for the operation of the Article 6.4 mechanism registry and implementation of the share of proceeds.

Whilst a number of these steps are due to be completed and endorsed at COP 27, the ability of Parties, particularly developing country Parties, to fully engage with the cooperative approaches under Article 6.2 and the Article 6.4 mechanism will be dependent upon technical and financial resources and capacity. Therefore, programs such as IPCOS have a clear role in supporting regional engagement with Article 6.

In summary, we consider that engaging with Article 6 is likely to provide opportunities to Australia through:

(a) access to ITMOs for use towards Australia's nationally determined contribution (**NDC**) (if required);

(b) encouraging the development of emission reduction industries and providing financial benefits to Australia from the generation and export of Australian ITMOs to using Parties (if allowed);

(c) accelerating a clean energy and climate-friendly transition through contributions to overall mitigation in global emissions (**OMGE**);

(d) building and strengthening diplomatic relationships through ITMO trade, as well as capacity building in least developed countries (**LDCs**) and small island developing States (**SIDS**) through initiatives in areas such as education, technical support and carbon market infrastructure development;

(e) potentially enabling Australia to inform the Supervisory Body's development of Article 6.4 methodologies, which could use elements of Australia's domestic offset methodologies, while considering the extent to which those methodologies will also inform Australia's approach to eligible activities, such as under the Climate Active standard; and

(f) for public and private entities in particular, opportunities may arise in relation to:

(i) undertaking mitigation activities or providing services for such activities to create ITMOs;

(ii) acting as intermediaries for transactions involving ITMOs (where appropriate authorisations are in place from participating Parties); and

(iii) enabling compliance with various emissions trading schemes that they may participate in and more generally in sourcing emission reductions for use towards voluntary corporate commitments (where ITMOs or A6.4ERs may be accepted).

In order to fully engage with Article 6 and avail itself of these opportunities, the Australian Government should consider the development and implementation of specific institutional and regulatory infrastructure to facilitate participation both in the public and private sector, including:

(a) nomination of a designated Australian Government body responsible for the oversight and coordination of Australia's Article 6 participation, in particular the tracking and authorising of ITMOs, as well as a designated national authority (**DNA**) for the purposes of Article 6.4 and determining participation under that mechanism (which could be the same entity);

(b) considering the potential for types of cooperative approaches to create Australian ITMOs for export under the Article 6.2 framework;

(c) considering the parameters Australia will use to govern the import of ITMOs (which might include units issued under VCM standards) or whether such imports will be assessed on a case-by-case basis;

(d) creating the infrastructure to track ITMOs and A6.4ERs, which infrastructure is likely to interface with existing registry systems (and the new system to be established by the UNFCCC), and may involve adaptation of the Australian National Registry of Emission Units (**ANREU**);

(e) developing rigorous accounting practices to reflect corresponding adjustments and the cancellation of units for OMGE;

(f) making policy decisions around the extent to which Australian carbon credit units (**ACCUs**) and other environmental products measured in non-GHG metrics might be recognised as ITMOs for export out of Australia;

(g) considering the extent to which any processes should be enshrined in, and amendments made to existing, legislation and regulation; and

(h) considering the extent to which private sector entities can participate in the creation and transfer of ITMOs and A6.4ERs.

There are some potential risks associated with Australia's engagement with Article 6, if that engagement is not properly managed and if other participating Parties fall short in their own engagement with the Article 6 mechanisms, such as:

(a) an inability to ensure the environmental integrity of mitigation outcomes transferred under Article 6;

(b) sovereign risk associated with the potential for policy change that impacts upon the transfer of mitigation outcomes between participating Parties (and private entities);

(c) the failure of participating Parties to continue to meet the participation requirements under Article 6.2 and/or Article 6.4 which may impact upon the ability to transfer ITMOs;

(d) certified emissions reductions (**CERs**) eligible for transition may become stranded if they are either not approved for transition to the new Article 6.4 mechanism, or national registry infrastructure precludes the movements of CERs to that mechanism; and

(e) the possibility of double counting, which will need to be carefully evaluated as frameworks and processes are developed, in particular in relation to the approaches to corresponding adjustment and labelling being adopted by VCM standards.

1 Introduction to Article 6 of the Paris Agreement and the Article 6 Rules

Article 6 of the Paris Agreement

1.1 Article 6 of the Paris Agreement enables Parties to voluntarily cooperate to implement their NDCs and pursue higher ambition through the use of three approaches:

(a) Cooperative approaches between country Parties that involve the creation, transfer and use of ITMOs under Article 6.2 (described in Part 2). **Cooperative approaches** are essentially bilateral or multilateral agreements between country Parties to cooperate on the achievement of mitigation outcomes in the host Party. Such cooperation could be through the mutual or one-way recognition of abatement achieved by a GHG emissions trading or offset scheme, or by the using Party financing a particular project or sectoral activity that leads to mitigation outcomes in the host Party, or even through the recognition of policy changes that result in emission reductions. The ITMOs created are then able to be transferred and used by a using Party either towards its NDC, or for "international mitigation purposes" or for "other purposes" (collectively referred to as "other international mitigation purposes").

(b) A new mechanism under Article 6.4, which establishes the framework for the creation, transfer and use of unitised mitigation outcomes known as A6.4ERs that can be traded on what is effectively an international carbon market through an international registry (described in Part 3). A6.4ERs may also be recognised as ITMOs and be authorised for use as part of a cooperative approach under Article 6.2.

(c) A framework for non-market approaches (**NMAs**) under Article 6.8 which provides for the recognition of cooperation that results in mitigation outcomes that are not in a tradeable, unitised form (set out in Part 4).

1.2 Pursuant to Article 6.1, the primary purpose of Article 6 is to **raise ambition**, through enabling countries to achieve higher ambition in their mitigation and adaptation actions, and to promote **sustainable development and environmental integrity**.[1]

1.3 For each of the three approaches under Article 6, Parties to the Paris Agreement were tasked with reaching agreement on (a) guidance for Article 6.2 (**Article 6.2 Rules**), (b) rules, modalities and procedures for the Article 6.4 mechanism (**Article 6.4 Rules**), and (c) a work programme for Article 6.8. These are collectively referred to as the "**Article 6 Rules**".

1.4 **Article 6.2** at its core operates as an accounting framework that applies to country-to-country transfers of ITMOs. It enables ITMOs generated in a host Party to be transferred to a using Party, and ensures that such ITMOs are only counted towards the using Party's NDC (unless authorised for another use). Article 6.2 transfers are not governed by a centralised UN body, and key details of the transactions (e.g. the methodology for quantifying mitigation outcomes achieved) are decided bilaterally between the Parties. However, participating Parties are required to put in place recording systems for ITMO creation, transfer and cancellation; apply corresponding adjustments for each ITMO transfer; and provide a series of reports to enable ITMO transfers to be transparently recorded and reviewed. Whilst public and private entities (**non-State actors**) may participate in the cooperative approaches (for example, undertaking activities that generate ITMOs or acting as intermediaries in the transfer of ITMOs), the Article 6.2 Rules require the making of corresponding adjustments through international GHG inventories and accounting frameworks, which only apply to Parties. As such, participating Parties may authorise non-State actors to perform certain functions, and ITMOs could

[1] Environmental integrity has not been explicitly defined by the Parties. However, in the context of the negotiations of Article 6, environmental integrity commonly refers to ensuring that global GHG emissions are no higher as a result of international cooperation (i.e., transfers of mitigation outcomes) than they would have been without such cooperation (see Lambert Schneider and Stephanie La Hoz Theuer, 'Environmental integrity of international carbon market mechanisms under the Paris Agreement' (2019) 19(3) *Climate Policy* 386).

technically be held and used by those actors. However, if the mitigation outcome is to be used for one of the purposes authorised by Article 6.2, national level accounting and reporting will need to be undertaken by the participating Parties.

1.5 **Article 6.4** sets out principles for the establishment of a centralised UN mechanism which is to be governed by a Supervisory Body. The aims of the Article 6.4 mechanism include:

(a) contributing to the mitigation of GHG emissions and supporting sustainable development;

(b) incentivising and facilitating public and private sector participation;

(c) contributing to emissions reductions in host Parties that can also be used by a using Party to fulfil its NDC (in which case the prohibition against double counting applies and the host Party must correspondingly adjust its emissions upwards as the using Party adjusts its emissions downwards (see 1.8 below)); and

(d) delivering OMGE.

1.6 The Article 6.4 mechanism will enable mitigation outcomes to be generated (in a unitised form known as A6.4ERs) pursuant to methodologies approved by the Supervisory Body, and such mitigation outcomes are to be recorded and tracked by a centralised UN registry.

1.7 The Article 6.4 mechanism aims to deliver an **overall mitigation in global emissions** (**OMGE**). The concept of OMGE was introduced to ensure that the new mechanism under Article 6.4 will move beyond offsetting. That is, it ensures a net *reduction* in emissions, rather than being limited to net offsetting of emissions (CO_2 released in one country with savings elsewhere). The Article 6.4 Rules require a levy of 2% of A6.4ERs at issuance be cancelled to ensure OMGE.

1.8 Article 6.5 establishes that there can be no double counting under Article 6.4. Double counting is not defined by the Paris Agreement, however it is widely understood to mean a situation in which a single GHG emission reduction or removal is used more than once to demonstrate compliance with mitigation targets or commitments.[2] To avoid the potential for double counting, the Article 6.4 Rules require **corresponding adjustments** to be made where A6.4ERs go towards a using Party's NDC or are authorised for other international mitigation purposes. In this regard, the Article 6.4 Rules refer to the Article 6.2 Rules on setting out the requirements for corresponding adjustments, which must occur in a manner that ensures "transparency, accuracy, completeness, comparability and consistency", avoids a net increase in emissions and reflects the participating Party's NDC implementation and achievement.[3]

1.9 Article 6.6 requires the Conference of the Parties serving as the Meeting of the Parties to the Paris Agreement (**CMA**) to ensure that a **share of the proceeds** from activities under the Article 6.4 mechanism is used to cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. This is achieved via a levy of 5% of A6.4ERs at issuance into the Adaptation Fund, as well as a monetary contribution related to the scale of the Article 6.4 activity or the number of A6.4ERs issued (to be set by the Supervisory Body).

1.10 **Article 6.8** provides for the development of a framework for NMAs which are intended to capture actions that represent cost-effective mitigation and adaptation without relying on market-based approaches or mechanisms that use tradeable units. Whilst there is limited guidance on what may

[2] Double counting can take the form of (i) double claiming, where two or more Parties claim the same emission reduction to comply with their NDC mitigation targets; and (ii) double issuance, where more than one emission reduction unit is registered for the same mitigation outcome under different mitigation approaches.

[3] 2/CMA.3, para 7.

constitute an NMA, this could arguably include results-based payments or other forms of mitigation and adaptation finance.

1.11 Parties agreed to a work programme being initiated in 2022 and implemented by the Glasgow Committee on Non-market Approaches. The initial focus areas of the work programme activities include (but are not limited to): (i) adaptation, resilience and sustainability; (ii) mitigation measures to address climate change and contribute to sustainable development; and (iii) development of clean energy sources.

1.12 The Article 6.8 work programme is tasked with identifying possible NMAs and spreading information on, and awareness of, such approaches within the global community. The Article 6.8 work programme builds in scope for participating Parties to identify what they consider to be an NMA, so it is open to Parties to identify different forms of cooperation that could include financing of capacity building programs as an NMA.

1.13 Whilst there is still work to be done to fully operationalise Article 6, the Article 6.2 and 6.4 Rules established in Glasgow provide a rigorous framework for ITMOs under the Paris Agreement. They represent a balanced outcome between a high level of environmental integrity and heightened ambition in the medium to long term, with a pragmatic approach to manage short term transition of projects and programmes of activity under the CDM (as well as CERs generated under the CDM).

2 Detailed analysis of Article 6.2

2.1 The Article 6.2 Rules set out many of the key operational aspects of cooperative approaches under Article 6.2, including the characterisation of ITMOs, participation requirements, requirements relating to the application of corresponding adjustments, reporting, technical expert review of such reports, and recording and tracking (for both single versus multi-year NDCs). Some issues were deferred to be decided at CMA 4 (which runs parallel to COP 27 in November 2022), and additional work is required by the Secretariat to fully implement Article 6.2.

2.2 Below, we set out the key elements of the Article 6.2 Rules, in order to identify the types of cooperative approaches that may be carried out under Article 6.2, the form of such cooperative approaches and the steps that must be satisfied by governments in order to participate in such cooperative approaches.

Definition of ITMOs

2.3 **Mitigation outcomes** are not expressly defined in the Paris Agreement or supporting decisions of the CMA, however it is generally understood that they include emission reductions and emission removals, referred to as ITMOs when internationally transferred. Neither the Paris Agreement nor the Article 6 Rules define what constitutes an emission reduction or an emission removal. However, these terms are well understood in carbon markets generally. In the case of emission reductions this refers to the reduction in the amount of GHG emissions that would otherwise have been emitted referable to a baseline scenario (e.g. changing plant and equipment or processes to reduce emissions) and, in the case of removals, the undertaking of activities that remove GHG emissions from the atmosphere and sequester them for permanent storage – either biologically or technologically. There is a third category of activities, which has been excluded from Article 6 for the time being, namely emissions avoidance activities which prevent GHG emissions that would otherwise have been released into the atmosphere (e.g. “avoided deforestation” projects avoid GHG emissions that would otherwise have resulted from forest clearing).

2.4 The Article 6.2 Rules provide for the following characteristics of ITMOs:

(a) ITMOs must be real, verified and additional;

(b) ITMOs may include emissions reduction and removals (including their co-benefits) but not the avoidance of emissions. In 2022, SBSTA will consider whether ITMOs could include emission avoidance (for adoption in a subsequent CMA decision); and

(c) ITMOs must have been generated in respect of mitigation from 2021-onwards, which precludes the use of mitigation outcomes generated (i.e. emission reductions or removals occurring) pre-2021 in transfers under Article 6.2. This does not preclude the carryover of pre-2021 CERs generated under the CDM to the Article 6.4 mechanism, however pre-2021 CERs will not be “ITMOs”. Pre-2021 CERs can nevertheless go towards a using Party’s NDC, provided certain requirements are met (see paragraph 3.33).

2.5 ITMOs may represent emission reductions in either tonnes of carbon dioxide equivalent (**tCO_2e**) or other non-GHG metrics. Non-GHG metrics are to be determined by participating Parties and must be consistent with both the host and using Party’s NDCs (e.g. kilowatt hours of renewable electricity).[4]

2.6 ITMOs may include:

[4] In practical terms, there may be a more limited market for ITMOs that are expressed in non-GHG metrics, as some prospective buyer countries are likely to only purchase ITMOs that can be expressed in GHG metrics.

(a) mitigation outcomes generated from cooperative approaches under bilateral / multilateral agreements pursuant to Article 6.2 that involve their international transfer authorised for use towards an NDC;

(b) mitigation outcomes authorised by a participating Party for use for "international mitigation purposes" other than achievement of an NDC (e.g. for international schemes such as the Carbon Offsetting and Reduction Scheme for International Aviation (**CORSIA**));

(c) mitigation outcomes authorised for "other purposes" as determined by the first transferring participating Party; and

(d) A6.4ERs issued under the Article 6.4 mechanism, where the A6.4ERs are authorised by the host Party for use towards the achievement of an NDC or "other international mitigation purposes".

2.7 "International mitigation purposes" and "other purposes" are undefined and have been left deliberately vague, so that it is left to individual Parties to determine what activities and transactions constitute "other international mitigation purposes" (this term being the term used in the Article 6.2 Rules to cover both international mitigation purposes and other purposes). As noted above, most commentators understand "international mitigation purposes" to reference schemes such as CORSIA and "other purposes" to reference the VCM. However, as discussed in section 8 below, the approach to emission reductions and removals generated by, and carbon offsets issued on, the VCM being treated as ITMOs will be dependent upon the authorisations provided by participating Parties and the proposed use and claims being made by the entity seeking to claim the benefit of the emission reductions or removals.

Participation responsibilities

2.8 Each Party that wants to participate in cooperative approaches under Article 6.2 is required to satisfy a number of "participation responsibilities", and report on their satisfaction of such responsibilities to the "Article 6 technical expert review team". These responsibilities must be fulfilled by Parties (rather than by non-State actors). This structure does not necessarily preclude non-State actors participating in cooperative approaches and even holding ITMOs (or at least the units representing the emission reductions or removals) in their own registry accounts (should these be available). However, if a host Party has expressly authorised the transfer of the ITMO, corresponding adjustments will need to be made upon first transfer and if used towards another country's NDC, at the point of use (see below).

2.9 The participation responsibilities are generally not controversial, and include requirements that participating Parties (being both host and using Parties) must:

(a) be a Party to the Paris Agreement;

(b) have prepared, communicated and be maintaining an NDC;

(c) have arrangements in place for authorising the use of ITMOs towards the achievement of NDCs;

(d) have arrangements in place for tracking ITMOs (i.e. via a national registry or the international registry to be established by the UNFCCC Secretariat);

(e) have provided their most recent national inventory report; and

(f) ensure that their participation contributes to the implementation of their NDC and long-term low-emission development strategy (if applicable), and the long-term goals of the Paris Agreement.

Each participating Party is required to ensure that its participation in cooperative approaches under Article 6.2 is consistent with the Article 6.2 guidance.

2.10 Article 6.2 does not have a governing body that assesses whether individual Parties meet these requirements or grants approval for Parties to participate. However, Parties are required to report on

their fulfilment of these requirements to the Article 6 technical expert review team, and elements of these responsibilities will also be considered by the Paris Agreement's compliance committee (e.g. whether a Party has prepared, communicated and is maintaining an NDC).

Authorisation and application of corresponding adjustments

2.11 Article 6.3 states that the use of ITMOs by Parties to achieve NDCs shall be:

(a) voluntary (that is, it is completely at the discretion of a Party to participate in any of the Article 6 approaches); and

(b) authorised by participating Parties (being both the host and using Parties).

2.12 One of the key participation requirements is that Parties must have arrangements in place for authorising the use of ITMOs towards the achievement of NDCs. A copy of the authorisation for each cooperative approach must be provided in the "initial report" required under the Article 6.2 Rules, as considered in further detail below (see paragraph 2.23 to 2.26).

2.13 At a minimum, one host party authorisation must apply to each cooperative approach, however it is also possible that multiple authorisations may be issued in relation to a single cooperative approach (e.g. if the initial authorisation applies to a specified quantity of mitigation outcomes or for a specified period, and subsequent authorisations may apply to additional quantities and/or periods). Whilst not expressly stated, it would be expected that the authorisations also set out the purpose for which the mitigation outcomes are authorised to be used (i.e. towards another Party's NDC, and/or for a specified "other international mitigation purpose").

2.14 Article 6.2 states that Parties shall apply robust accounting to ensure the avoidance of double counting, consistent with guidance adopted by the CMA. Double counting is not formally defined (other than by reference to the need for a corresponding adjustment). Under the Paris Agreement, as noted above, double counting would arise where more than one Party claimed the same emission reduction or removal towards its NDC. We also set out below the definitions provided by Gold Standard and Verra to provide some context for how double counting can arise in carbon markets generally.

(a) Gold Standard defines double counting as situations in which "*the benefit of a single GHG Emission Reduction (ER) unit is used on more than one occasion to:*

(i) sell to third parties for the purpose of financial gain, VER offsetting or to achieve regulated targets; or

(ii) *be included in an account or inventory to avoid the requirement to purchase ER units under a regulated system.*"[5]

(b) Verra defines double counting as "*double monetization or double selling of GHG credits and GHG emission reductions and removals – but not double claiming*",[6] where:

(i) double monetisation occurs "*when a singular GHG emission reduction or removal is monetized once as a GHG credit and a second time as a GHG allowance*";

(ii) double selling occurs "*when a single GHG emission reduction or removal is sold to multiple buyers*"; and

[5] Gold Standard, *Double Counting Guideline* (November 2015).

[6] Verra, *Double Counting: Clarification of Rules* (1 February 2012).

(iii) double claiming occurs "*when the environmental benefit of a singular GHG emission reduction or removal is claimed by two different entities*."

2.15 Decision 1/CP.21 required the CMA to develop guidance that ensures that "double counting is avoided on the basis of a **corresponding adjustment** by Parties for both anthropogenic emissions by sources and removals by sinks covered by their nationally determined contributions under the Agreement."[7]

2.16 Corresponding adjustments have been described as a form of "double entry bookkeeping"[8], under which both the country transferring mitigation outcomes and the country receiving mitigation outcomes must make an adjustment to their GHG emissions inventory to reflect the transfer. For example, if Country A exports a mitigation outcome to Country B representing a reduction of 10 tCO_2e, both Country A and Country B need to make accounting adjustments so that Country A does not count the emission reductions towards achievement of its NDC, and Country B can count the emission reduction towards achievement of its NDC without resulting in double counting (see diagrammatic examples below).

2.17 Under the Article 6.2 Rules, corresponding adjustments are required by each participating Party for all ITMOs. In general terms, Parties must apply corresponding adjustments in a manner that ensures transparency, accuracy, completeness, comparability and consistency in tracking progress and achievement of NDCs, and ensures that cooperative approaches do not lead to a net increase in emissions within and between NDC implementation periods or across participating Parties. Corresponding adjustments must also be consistent with the implementation and achievement of the participating Parties' NDCs.

2.18 Different guidance for applying corresponding adjustments applies depending on whether Parties have a single-year or multi-year NDC:

(a) Parties with a single-year NDC must provide an indicative multi-year emissions trajectory for their NDC implementation period that is consistent with implementation and achievement of their NDC, and *annually apply corresponding adjustments* for the *total amount of ITMOs first transferred and used* for each year in the NDC implementation period (image 1 below).

(b) Alternatively, Parties with a single-year NDC may calculate *the average annual amount of ITMOs first transferred and used over the NDC implementation period* (by taking the cumulative amount of ITMOs and dividing by the number of elapsed years in the NDC implementation period) and annually applying indicative corresponding adjustments equal to this average amount for each year in the NDC implementation period (and *applying corresponding adjustments equal to this average amount in the NDC year*) (image 2 below).

(c) Parties with a multi-year NDC must calculate a multi-year emissions trajectory for their NDC implementation period that is consistent with the NDC, and *annually apply corresponding adjustments for the total amount of ITMOs first transferred and used each year in the NDC implementation period and cumulatively at the end of the NDC implementation period* (image 3 below).

2.19 In circumstances where a mitigation outcome is authorised by a participating Party for use towards the achievement of an NDC, first transfer is defined as the first international transfer of a mitigation outcome. In circumstances where a mitigation outcome is authorised for use for other international mitigation purposes, the participating Party (or first transferring Party in the case of other purposes) may specify whether first transfer is at the point of authorisation, issuance or use/cancellation of the mitigation outcome.

---

[7] Decision 1/CP.21, paragraph 36.

[8] Simon Evans and Josh Gabbatiss (Carbon Brief), *In-depth Q&A: How 'Article 6' carbon markets could 'make or break' the Paris Agreement* (Web Page, 29 November 2019) https://www.carbonbrief.org/in-depth-q-and-a-how-article-6-carbon-markets-could-make-or-break-the-paris-agreement/.

Image 1

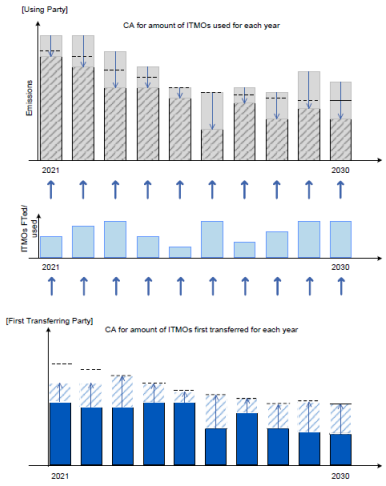


Image 2

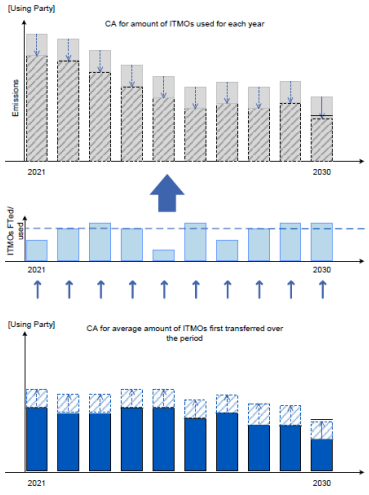


Image 3

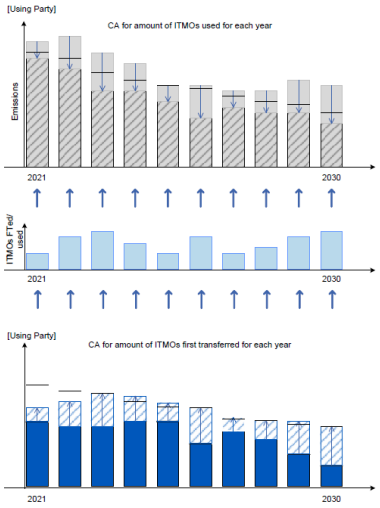
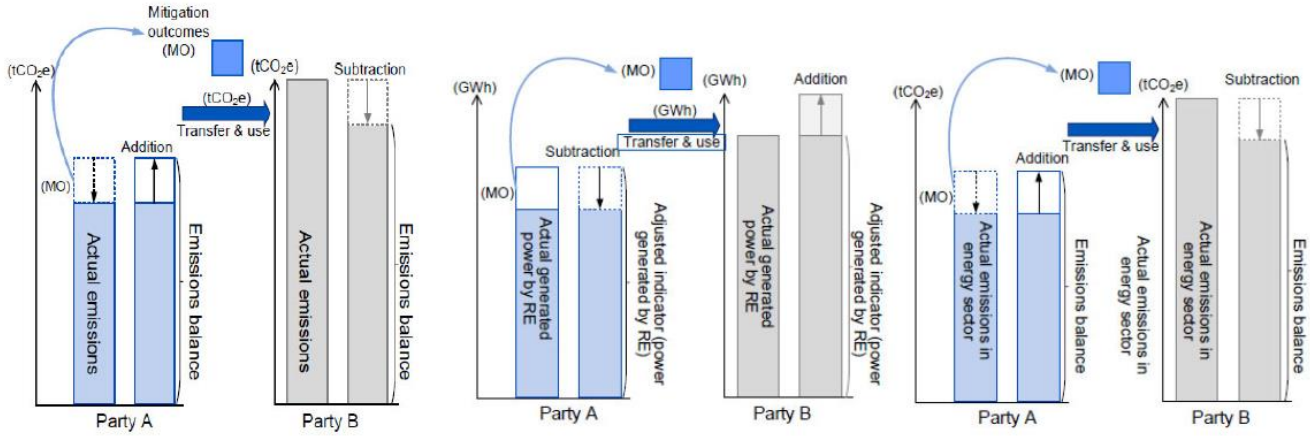


Image 4



Legend

2.20 There are also differences in how corresponding adjustments are to be applied depending on whether a Party's NDC is measured in tCO_2e, contains non-GHG metrics, or consists of policies and measures that are not quantified (image 4 below):

(a) For Parties with NDCs measured in tCO_2e, the transferring Party is required to apply a corresponding adjustment by adding the quantity of ITMOs authorised and first transferred for the calendar year in which the mitigation outcomes occurred, and the receiving Party is required to apply a corresponding adjustment by subtracting the quantity of ITMOs used for the calendar year in which the mitigation outcomes are used towards implementation and achievement of its NDC. For both Parties, this results in an emissions balance (i.e. the participating Parties add or subtract, as required, the quantity of ITMOs from their national inventory of emissions and removals from sectors and GHGs covered by their NDC). Mitigation outcomes must be used

within the same NDC implementation period as they occurred. This effectively prevents the banking of ITMOs across NDC implementation periods.[9]

(b) Parties with NDCs containing non-GHG metrics (and that trade ITMOs in non-GHG metrics) must apply corresponding adjustments in an equivalent manner, i.e. the transferring Party must subtract the quantity of ITMOs authorised and first transferred for the calendar year in which the mitigation outcomes occurred, and the receiving Party must add the quantity of ITMOs used for the calendar year in which the mitigation outcomes are used towards implementation and achievement of the NDC. ITMOs shall be recorded in a metric-specific registry account, and both Parties are to calculate an "annual adjusted indicator" (rather than an emissions balance) based on applying the corresponding adjustments to the annual level of the relevant non-GHG indicator that is being used by the Party to track progress towards the implementation and achievement of its NDC.

(c) Parties with a first or first-updated NDC consisting of policies and measures that are not quantified must also apply corresponding adjustments in an equivalent manner, i.e. the transferring Party must add the quantity of ITMOs authorised and first transferred and the receiving Party must subtract the quantity of ITMOs used. For both Parties, this results in an emissions balance (i.e. the participating Parties add or subtract, as required, the quantity of ITMOs from their national record of emissions and removals for those emission or removal categories affected by the implementation of the cooperative approach and by those policies and measures that include the implementation of the cooperative approach).

2.21 While all developed countries are required to have economy-wide emission reduction targets, developing countries may have emission reduction or limitation targets that only cover specified sectors and/or GHGs. Importantly, the Article 6.2 Rules specify that Parties that first transfer ITMOs from *emission reductions and removals either covered or not covered* by its NDC are required to apply corresponding adjustments. The decision to apply corresponding adjustments for all ITMOs, regardless of whether within or outside the scope of the NDC, was to encourage ambition over time and avoid perverse incentives to exclude sectors from an NDC. Parties are therefore required to apply corresponding adjustments for ITMOs regardless of whether or not the mitigation activity is in a sector (or achieves emission reductions of a GHG) that is within the scope of their NDC. Non-ITMO transfers from activities outside of a country's NDC, for example emission reductions or removals being exported solely for use in voluntary markets and for which no corresponding adjustments are being made, will sit outside of the Article 6 framework (this voluntary use is discussed further in Part 8).

Reporting and technical expert review

2.22 The Article 6.2 Rules mandate three kinds of reporting – an initial report, annual information and regular information. These interplay with the requirement to submit biennial transparency reports under Article 13 (the Transparency Framework).

Initial Report (from 2022)

2.23 The **initial report** is required no later than the authorisation of ITMOs from a cooperative approach or, where practical, in conjunction with the next biennial transparency report due under the Transparency Framework. Biennial transparency reports are to be submitted no later than 31 December in the relevant year. For subsequent cooperative approaches, Parties are required to update the initial report with information relating to that cooperative approach, and submit it with the next biennial transparency report that is due.

2.24 The initial report must contain information with respect to a Party's fulfilment of the participation responsibilities, ITMO metrics and the method for applying corresponding adjustments, quantification

[9] See Decision 2/CMA.3 Annex Part III D which notes the CMA may provide further guidance on safeguards and limits to the transfer and use of ITMOs.

of the Party's mitigation information in its NDC in tCO_2e (or a non-GHG metric, or the emissions level results from policies and measures, as applicable), a copy of authorisations for each cooperative approach, and a description of each cooperative approach (including information relating to duration, expected mitigation achieved annually, Parties and entities involved, and how it ensures environmental integrity).

2.25 In respect to environmental integrity, a Party must describe how each cooperative approach ensures there will be no net increase in emissions within an NDC implementation period; the governance and quality of mitigation outcomes (e.g. through conservative baselines and reference levels); and how it minimises risks of non-permanence.

2.26 Parties must also provide details of how negative environmental, economic and social impacts will be minimised and avoided; how there has been consideration of human rights and the rights of indigenous peoples and other vulnerable and affected classes of persons; how each cooperative approach is consistent with sustainable development objectives; how safeguards and limits have been applied; and how activities are contributing to adaptation and OMGE.

Annual Information (from 2023)

2.27 **Annual information** on ITMOs must be provided no later than 15 April of the year following specified actions. It is assumed that this will be submitted together with a Party's national inventory. The information includes both quantitative information on ITMOs, including the authorisation of ITMOs (for use towards NDCs or other international mitigation purposes); first transfer, transfer, acquisition, holdings, cancellation and voluntary cancellation; and use for OMGE. Additional background information is also to be provided as soon as it is known, including the year in which the mitigation occurred, the sector(s) and activity type(s), and the unique identifiers.

Regular Information (from 2024)

2.28 **Regular information** must be submitted no later than 31 December of the relevant year as an annex to biennial transparency reports. Regular information must contain (and update, on a cumulative basis) similar information to that required for initial reports and annual information. In addition, it must include:

(a) information on how participation responsibilities are being fulfilled;

(b) authorisations and information on the Party's authorisation(s) of use of ITMOs towards achievement of NDCs and for use for other international mitigation purposes, including changes to earlier authorisations;

(c) information on how corresponding adjustments have been undertaken to ensure there is no double counting and no net increase in emissions across participating Parties and within and between NDC periods, including how the Party has ensured that ITMOs used will not be further transferred, used or otherwise cancelled;

(d) information on how each cooperative approach implemented contributes towards NDC implementation and mitigation; ensures environmental integrity (with reference to minimising risk of non-permanence among other things); provides for mitigation outcomes to be measured in accordance with IPCC methodologies where measured in tCO_2e (or applies appropriate conversion approaches for converting non-GHG metrics into tCO_2e); addresses co-benefits; and respects vulnerable and affected classes of people, among others;

(e) information on how each cooperative approach contributes to the sustainable development objectives of the Party, including applying safeguards, contribution of resources and delivery of OMGE; and

(f) detailed annual information on the emissions and removals covered by the relevant Party's NDC; annual quantities of ITMOs first transferred; the quantity of mitigation outcomes authorised for use as other international mitigation purposes and entities authorised to use such

mitigation outcomes; the annual quantity of ITMOs used towards achievement of the Party's NDC; net ITMOs; total quantitative corresponding adjustments; the annual level of non-GHG indicators being used to track NDC progress; and the annual emissions balance (or annual adjusted indicator).

2.29 When the cumulative "annual information" included in the "regular information" is tracked against the emissions and removals that are covered by the relevant Party's NDC, it should be possible to determine whether participating Parties are on track to achieve their NDCs.

Review

2.30 Information reported by Parties in accordance with the Article 6 reporting requirements will be subject to **technical expert review** by the Article 6 technical expert review team from 2025.

2.31 Technical expert review is a centralised review of whether the information submitted is consistent. The team will be required to prepare Party-specific reports on its review, and may include recommendations on how the participating Party may improve consistency with the Article 6 Rules and other relevant decisions (and address inconsistencies). These reports are made publicly available and also forwarded to the technical expert review team serving the Transparency Framework.

Recording and tracking

2.32 In order to track mitigation outcomes, each participating Party is required to have (or have access to) a registry that is capable of recording unique identifiers, participating Party's authorisations, first and subsequent transfers of mitigation outcomes, acquisition of mitigation outcomes, cancellation of mitigation outcomes, use of mitigation outcomes towards the Party's NDC, authorisation of use towards "other international mitigation purposes" and creating accounts, as necessary. The UNFCCC Secretariat is required to implement an international registry for use by Parties.

2.33 The Article 6.2 Rules also require the UNFCCC Secretariat to implement an Article 6 Database for the purposes of transparency, compiling the reports submitted by Parties, and supporting the Article 6 technical expert review. The Database enables the recording of corresponding adjustments and emissions balances, as well as other information relating to ITMOs.

2.34 Both the international registry and the Article 6 Database are to form part of the centralised accounting and reporting platform. The Secretariat will use the platform to maintain publicly available information on ITMOs and reports submitted by Parties, and will provide an annual report to the CMA on related activities, recorded ITMOs, corresponding adjustments and emissions balances.

Overall mitigation of global emissions and share of proceeds for adaptation finance

2.35 Whilst there were a number of countries seeking to include a share of proceeds for adaptation and a contribution to OMGE in the Article 6.2 Rules, this was not agreed. Participating Parties are not required to contribute resources to adaptation in the form of a share of proceeds-type levy on transfers like that applied under Article 6.4 (see paragraph 3.23), or to cancel ITMOs for the purpose of achieving OMGE, under Article 6.2. However, participating Parties are "strongly encouraged" to commit to contribute resources for adaptation, in particular through contributions to the Adaptation Fund, to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. Similarly, participating Parties are "strongly encouraged" to cancel ITMOs that are not counted towards any Party's NDC or for other international mitigation purposes, for the purpose of achieving OMGE. In both cases, Parties are to take into account such contributions / deliveries under the Article 6.4 mechanism, and are required to report on any such contributions / deliveries in their provision of "regular information".

2.36 As noted above, participating Parties are also expected to report on how each cooperative approach ensures environmental integrity, including through conservative reference levels, baselines set in a conservative way and below "business as usual" emission projections.

Additional work to be carried out

2.37 In 2022, Parties are requested to determine a number of issues for adoption at CMA 4. These matters include:

(a) further guidance on the application of corresponding adjustments to multi-year and single-year NDCs, including on methods for establishing a trajectory, averaging and calculating cumulative emissions, as well as methods to determine the difference between volumes of corresponding adjustments as compared to an average for the NDC period;

(b) consideration of whether ITMOs could include emissions avoidance;

(c) required infrastructure, including the international registry, Article 6 Database and the centralised accounting and reporting platform;

(d) options for tables and outlines that Parties are to use for the purposes of their reporting obligations under Article 6.2; and

(e) guidelines for the technical expert review.

2.38 Submissions have been sought (prior to 31 March 2022) on options for tables and outlines for reporting and on options for infrastructure related to recording and tracking.

2.39 The UNFCCC Secretariat will hold a range of technical workshops to support Parties in their understanding of a number of the above issues (e.g. infrastructure and reporting tables/outlines). It is also required to carry out further work, including to design and implement a capacity-building programme to assist Parties (in particular developing country Parties), which is to support the development of the required institutional arrangements, ensure that cooperative approaches support ambition and assist LDCs and SIDS to meet the participation requirements.

2.40 A review of the Article 6.2 Rules will commence in 2028 and is to be completed by 2030.

3 Detailed analysis of Article 6.4

3.1 Article 6.4 establishes a mechanism to contribute to mitigation and support sustainable development. It can be used by all Parties on a voluntary basis and will be supervised by the CMA.

3.2 Whilst the 6.4 mechanism builds upon the Kyoto Protocol's flexible mechanisms, in particular the CDM and Joint Implementation (**JI**), there is clearly scope to expand and scale up from these primarily project-based and programmatic mechanisms to a mechanism that could also recognise sectoral mitigation efforts, if appropriate methodologies were developed.[10]

3.3 The Article 6.4 Rules set out many of the key operational aspects of Article 6.4, including the participation and other responsibilities of host Parties, the governance of the mechanism (primarily through the Supervisory Body), the activity cycle of the 6.4 mechanism, the establishment of the mechanism registry, and the CDM transition. Importantly, the Article 6.4 Rules set out that A6.4ERs are measured in carbon dioxide equivalent and equal to 1 tonne of carbon dioxide equivalent. Some issues were deferred to be decided at CMA 4 (which runs parallel to COP 27 in November 2022), and additional work is required by the UNFCCC Secretariat and the Supervisory Body to fully implement the Article 6.4 mechanism.

3.4 Below, we set out the key elements of the Article 6.4 Rules, in order to identify the types of activities that may be carried out under Article 6.4, the form of such activities and the steps that must be satisfied by governments and the private sector in order to participate in the mechanism.

Governance – Supervisory Body

3.5 Unlike Article 6.2, the Article 6.4 mechanism is governed by a centralised **Supervisory Body** which operates under the authority and guidance of the CMA and which is fully accountable to the CMA.

3.6 The Supervisory Body comprises 24 members with representation from each of the five UN regional groups and members from LDCs and SIDS. The Supervisory Body is responsible for operational matters which relate to:

(a) the development and approval of methodologies and standardised baselines;

(b) the registration of activities as Article 6.4 activities, renewal of crediting periods and issuance of A6.4ERs;

(c) ensuring activities follow reasonable maximum time intervals between steps on the activity cycle;

(d) the registry for the mechanism;

(e) the share of proceeds; and

(f) promotion and consideration of human rights, application of robust social and environmental safeguards, development of tools and approaches for sustainable development.

3.7 It is also empowered to accredit operational entities as designated operational entities (**DOEs**) and to support the implementation of the mechanism through public awareness and engagement. DOEs are

[10] This could be through the development of methods to credit reductions at the sector level where baseline emission levels/rates and certified emissions would be defined for a range of sources together defined as a sector. The difference between the baseline emission levels and emissions from the sector would be credited and allocated to individual sources. Sectoral crediting options have been considered in the context of policy-based approaches – linked to reducing emissions occurring as a result of well-identified policy; rate or intensity-based approaches where the sector is credited for performance below the agreed baseline; and a fixed target approach, similar to cap and trade.

independent third-party verifiers or auditors that can validate and verify project/activity proposals and achievement of GHG emission reductions; the CDM includes an accreditation process for DOEs, which process is being transferred to Article 6. DOEs are distinguishable from DNAs which are government bodies established by the participating Parties to authorise and approve participation of public and private sector entities in the Article 6.4 mechanism.

3.8 Stakeholders, activity participants and participating Parties may appeal decisions of the Supervisory Body or request that a grievance be addressed by an independent grievance process.

Participation and other responsibilities of host Parties

3.9 The participation responsibilities for Article 6.4 are different to those under Article 6.2. A Party that wants to participate in the Article 6.4 mechanism as a host Party of Article 6.4 activities is required to ensure, prior to participating in the Article 6.4 mechanism, that:

(a) it is a Party to the Paris Agreement;

(b) it has prepared, communicated and is maintaining an NDC;

(c) it has communicated its DNA for the Article 6.4 mechanism to the Secretariat;

(d) it has publicly indicated how its participation in the Article 6.4 mechanism contributes to sustainable development (acknowledging that sustainable development is a national prerogative); and

(e) it has publicly indicated the types of Article 6.4 activities that it would consider approving and how such types of activity and any associated emission reductions would contribute to the achievement of its NDC and long-term low GHG emissions development strategy (if applicable).

3.10 A host Party may, prior to participating in the mechanism, specify to the Supervisory Body its baseline approaches and other methodological requirements to be applied to activities it intends to host and crediting periods to be applied.

3.11 On a continuing basis, host Parties are required to ensure that they are maintaining an NDC and their participation in the mechanism contributes to the implementation of their NDC (and its long-term low GHG emissions development strategy, if applicable).

Activity cycle

3.12 The Article 6.4 mechanism has an activity cycle that reflects the CDM. The following requirements apply to **activity design** (by the public/private entities participating in an activity):

(a) activities must be designed to achieve mitigation of GHG emissions that is additional (including reducing emissions, increasing removals and mitigation co-benefits) and not lead to an increase in global emissions;

(b) activities may be projects, programmes of activities, or other types of activities approved by the Supervisory Body;

(c) activities must minimise risks of non-permanence, leakage and negative environmental and social impacts. Where reversals occur, they must be addressed in full, and similarly any leakage must be adjusted for;

(d) local stakeholder consultation (and subnational, where appropriate) must be carried out consistent with applicable domestic arrangements;

(e) crediting periods can be a maximum of either 5 years (renewable twice) or 10 years with no option of renewal, however activities involving removals may apply a crediting period of a

maximum of 15 years (renewable twice), both subject to the approval of the Supervisory Body; and

(f) activities must apply a methodology approved by the Supervisory Body (including updated methods transitioned from the CDM) in order to set a baseline for the calculation of emission reductions, demonstrate additionality, ensure accurate monitoring of emission reductions and calculate the emission reductions achieved.

Methodology development

3.13 The Article 6.4 Rules set out a number of requirements for **methodologies** to be approved under the 6.4 mechanism. Overall, methodologies shall encourage ambition over time; encourage broad participation; be real, transparent, conservative, credible and below business as usual (**BAU**); avoid leakage, where applicable; recognise suppressed demand[11]; align to the long-term temperature goal of the Paris Agreement; and contribute to reducing emissions levels in the host Party, and align with its NDC and long-term low GHG emission development strategy.

3.14 Methodologies may be developed by the Supervisory Body or any other stakeholders, for approval by the Supervisory Body.

3.15 Methodologies must apply one of the following baseline approaches (and justify why the chosen baseline is appropriate):

(a) a performance-based approach, taking into account best available technologies that represent an economically feasible and environmentally sound course of action;

(b) an ambitious benchmark approach where the baseline is set at least at the average emission level of the best performing comparable activities providing similar outputs and services in a defined scope in similar social, economic, environmental and technological circumstances; or

(c) an approach based on existing actual or historical emissions, adjusted downwards over time to ensure alignment with the above requirements for methodologies.

3.16 The Supervisory Body is also able to develop (and review and approve) standardised baselines and other supporting tools.

3.17 Methodologies must specify an approach to demonstrating additionality (noting the Supervisory Body may also develop simplified approaches for LDCs and SIDS).

Approval and authorisation

3.18 Host Parties are required to approve Article 6.4 activities (typically being undertaken by private sector entities) prior to a request for registration of the activity being made to the Supervisory Body.

3.19 Approvals must include specified information relating to how the activity fosters sustainable development, approval of a potential renewal of the activity's crediting period, and how the activity contributes to the host Party's NDC.

3.20 Host Parties must also authorise the participation of public and private entities to participate in mitigation activities under the mechanism. The host Party must also provide a statement to the

[11] Suppressed demand recognises that many countries with low emissions levels (mostly developing countries) only have low emissions because they lack basic services for their populations and that, theoretically, in order to provide those services, emissions would be higher. Consequently, the baseline against which any emission reductions are compared is a higher, theoretical baseline that accords with the emissions that would have been emitted had the country been operating services that satisfied its people's needs. This concept addresses the fact that low emissions level countries would otherwise generate fewer carbon credits, while at the same time encouraging these countries to keep their emissions low and develop in sustainable, climate-friendly ways.

Supervisory Body specifying whether it authorises A6.4ERs issued for the activity towards an NDC and/or other international mitigation purposes. Where authorisation is given for use towards NDCs or towards international mitigation purposes, corresponding adjustments must be applied by the host Party for first transfer (as defined by the host Party). For use as emission reductions for other international mitigation purposes, where authorised, a corresponding adjustment shall also be applied, consistent with the Article 6.2 Rules.

3.21 Where authorisation is not expressly given for an A6.4ER to be used towards an NDC or towards other international mitigation purposes, the so-called "Japanese Solution" applies: in this case, the host Party can report the A6.4ER as part of its inventory report under Article 13.7(a), but does not apply a corresponding adjustment. Consequently, the transfer of A6.4ERs to a public or private entity without authorisation as an ITMO would not attract a corresponding adjustment. This effectively allows host Parties flexibility to sell A6.4ERs into the voluntary market without corresponding adjustments, or to use A6.4ERs for domestic purposes (for example, where carbon pricing mechanisms applied in that country) – again without corresponding adjustments as the A6.4ERs are not exported.

3.22 Other participating Parties are required to approve the participation of public and private entities prior to the first transfer of A6.4ERs to any such entity's mechanism registry account.

3.23 The following steps then apply in terms of the activity cycle:

(a) **validation** of the activity is to be carried out by an independent DOE;

(b) **registration** of activities is to be approved by the Supervisory Body, at which time the activity participant (being the person undertaking the Article 6.4 activity – which may be a public or private sector entity) must make payment of a share of proceeds to cover the administrative expenses of registering the activity (at a level determined by the CMA, taking into account the likely scale of the activity);

(c) **monitoring** of the activity is to be carried out by the activity participants, in accordance with the approved methodology;

(d) **verification and certification**, involving independent review by a DOE of the implementation of the activity and the emission reductions achieved;

(e) **issuance** of offset units (A6.4ERs) by the Supervisory Body into the mechanism registry, following a request for issuance by the DOE. The registry will distinguish A6.4ERs that are authorised for use towards NDCs and/or for use for other international mitigation purposes, including any specified uses authorised; and

(f) **first transfer** of A6.4ERs shall include a transfer of 5% of the issued A6.4ERs to an account held by the **Adaptation Fund for the share of proceeds**[12] and a minimum of 2% of the issued A6.4ERs into a cancellation account for OMGE (at which point the A6.4ERs are cancelled). The remaining A6.4ERs shall be forwarded in accordance with the instructions of the activity participants. This applies to A6.4ERs transferred for other international mitigation purposes and for the achievement of NDCs under Article 6.2.

3.24 Crediting periods of registered activities may be renewed, subject to further decisions of the CMA.

[12] Once A6.4ERs are transferred into the account of the Adaptation Fund, these may be transacted and monetized by the Adaptation Fund to generate funds which can be deployed to support adaptation activities in developing countries in accordance with the mandate of the Fund.

Registry

3.25 The Article 6.4 mechanism registry is to be administered by the UNFCCC Secretariat (under the supervision of the Supervisory Body) connected to the international registry developed for the purposes of Article 6.2. It is to have a holding account for each Party and authorised public or private entity that requests an account, as well as a pending account, retirement account, cancellation account, an account for the share of proceeds for adaptation and an account for cancellation for OMGE.

Additional work to be carried out

3.26 The Supervisory Body is responsible for the majority of the work required to make the Article 6.4 mechanism operational. Its work program includes:

(a) developing provisions for the development and approval of methodologies, validation, registration, monitoring, verification and certification, issuance, renewal, first transfer from the mechanism registry, voluntary cancellation and other processes;

(b) developing and approving new methodologies for the mechanism, including reviewing and revising CDM methodologies and considering baseline and monitoring methodologies used in other market-based mechanisms;

(c) developing a tool to promote sustainable development, to be completed by the end of 2023;

(d) developing accreditation standards and procedures by the end of 2023;

(e) accrediting operational entities as DOEs;

(f) ensuring special circumstances of LDCs and SIDS are taken into account and considering ways to encourage participation by small and micro businesses in those countries, engagement with the local and indigenous people platform (**LIPP**), and the gender action plan (**GAP**); and

(g) elaborate the Supervisory Body's rules of procedure.

3.27 The Supervisory Body is also required to evaluate the implementation and delivery of the share of proceeds and OMGE in 2026 and every 5 years thereafter.

3.28 Parties are also required to consider (for the purpose of reaching a decision at CMA 4 in November 2022) a number of issues that would benefit from additional guidance, for example the operation of the Article 6.4 mechanism registry and whether or not activities could include emissions avoidance and conservation enhancement activities.

3.29 In support of that additional guidance, SBSTA has been tasked with a work programme during 2022 to develop recommendations on matters including:

(a) further responsibilities of the Supervisory Body and host Parties;

(b) processes for transition of CDM activities;

(c) processes for transition of CERs;

(d) reporting by host Parties on their Article 6.4 activities;

(e) operation of the mechanism registry;

(f) processes for implementation of share of proceeds for adaptation and for administration (to be evaluated no later than 2026 and every 5 years thereafter);

(g) processes for delivering OMGE (to be evaluated no later than 2026 and every 5 years thereafter); and

(h) consideration of whether activities could include emissions avoidance and conservation enhancement activities.

3.30 The Secretariat is required to design and implement a capacity-building programme to assist Parties wishing to participate in the mechanism to, among other things, establish the necessary institutional arrangements to implement the requirements, and develop the technical capacity to design and set baselines for applications in host Parties.

3.31 The Parties are required to begin a review of the Article 6.4 Rules in 2028 and complete the review by 2030.

CDM transition

3.32 The Article 6.4 Rules provide for a limited transition of the CDM, including CERs issued by the CDM, activities registered under the CDM and methodologies approved under the CDM.

3.33 In relation to CERs, CERs issued under the CDM may be used towards the achievement of the first NDC of a Party, provided that:

(a) the CDM activity from which the CERs were issued was registered on or after 1 January 2013;

(b) the CERs are held in the Article 6.4 mechanism registry and identified as pre-2021 emissions reductions; and

(c) temporary and long-term CERs cannot be used towards NDCs.

3.34 In order to transfer CERs into the Article 6.4 registry, the CDM registry will need to be linked with the Article 6.4 registry in some way, or processes will need to be developed to enable the cancellation of CERs in the CDM registry and their re-issuance in the Article 6.4 registry.[13]

3.35 CERs are not subject to a corresponding adjustment or the share of proceeds for adaptation and administrative expenses. The carryover of CERs was particularly important to China, India and Brazil, who have the highest number of issued CER units. These countries assert that project developers engaged in the CDM in good faith and on the assumption that the CERs generated would be able to be sold on the compliance market. However, there are concerns that if China, India and Brazil's CER units are used towards Parties' NDCs, this will significantly reduce global ambition.

3.36 In relation to CDM activities, projects already registered (or listed as provisional as per the temporary measures adopted by the CDM Executive Board in 2020) are permitted to transition to the Article 6.4 mechanism, provided that:

(a) the project participants make a request to the Secretariat and the host Party to transition the activity by 31 December 2023, and the host Party approves the transition by 31 December 2025; and

(b) the activity may continue to apply its approved CDM methodology until the earlier of the end of its current crediting period or 31 December 2025, following which it is required to apply a methodology approved by the Article 6.4 mechanism Supervisory Body. Subject to this, the

[13] A similar process for the re-issuance of CERs as VERs exists in the Verra Registry where CDM projects can transition to the Verified Carbon Standard (VCS).

activity must comply with the Article 6.4 Rules (including the application of corresponding adjustments).

3.37 The CDM will no longer register activities, renew crediting periods or issue CERs in relation to emission reductions achieved post-2020. This is likely to result in a gap between CER issuance and A6.4ER issuance, which may have a negative impact on the financial viability of such projects in the meantime.

3.38 In relation to CDM-approved methodologies, the Article 6.4 mechanism Supervisory Body is required to review the baseline and monitoring methodologies in use for the CDM with a view to approving them with revisions under the Article 6.4 mechanism.

3.39 Through complementary decisions of the Conference of the Parties serving as the meeting of the Parties (**CMP**)[14], guidance has also been provided on the functioning of the CDM post-2020 and cooperation between the CDM Executive Board and the Supervisory Body to make hard and soft infrastructure developed for the CDM available to expedite implementation of the Article 6.4 mechanism. In addition, financial resources sitting in the Trust Fund for the CDM will be transferred to the Trust Fund for Supplementary Activities to expedite implementation and support capacity building and CDM transition.

[14] FCCC/KP/CMP/2021/L6

4 Detailed analysis of Article 6.8

4.1 Article 6.8 is essentially a framework for the development of non-market (i.e. non-trading) approaches to implementing a Party's NDC. These NMAs are voluntary and cooperative, and seek to support poverty eradication and sustainable development.

4.2 Article 6.8 sets out express aims for NMAs, being:

(a) promoting mitigation and adaptation measures;

(b) enhancing public and private sector participation in the implementation of NDCs; and

(c) enabling opportunities for coordination across institutions.

4.3 In particular, the Article 6.8 work programme will initially be focused on:

(a) enabling adaptation and resilience, and building sustainability;

(b) mitigation measures in order to address climate change while promoting sustainable development; and

(c) encouraging the development of clean energy sources.

4.4 An NMA under Article 6.8 should benefit the host Party's NDC in a way that is integrated, holistic and balanced. It should also:

(a) contribute to achieving the Paris Agreement goals; and

(b) in respect of any mitigation or adaptation measures, allow for higher ambition by a host Party.

4.5 The work programme for Article 6.8, initiated in 2022, seeks to identify forms of NMAs as well as set out measures to facilitate such approaches.

4.6 In practice, an NMA is to be voluntarily identified by a participating Party and must involve more than one participating Party. It cannot involve the transfer of any form of mitigation outcome (such as ITMO or A6.4ER) – it is not a trading-based mechanism. Ultimately, the NMA should be holistic and consider broader social and moral issues such as human rights and gender equality (to name just two), as well as minimise adverse impacts on the environment, the economy and society.

Governance and modalities of the work programme

4.7 The Article 6.8 framework is governed by the 'Glasgow Committee on Non-Market Approaches' (**Glasgow Committee**), established under the Article 6.8 work programme. The Glasgow Committee is tasked with implementing the framework as well as providing Parties with opportunities to cooperate under the framework.

4.8 The Glasgow Committee will operate in various ways, including through workshops, engagement with the public and private sector, submissions, technical papers and reports, as well as collaboration with relevant institutions and processes related to the Paris Agreement.

Activities of the work programme

4.9 The activities of the work programme will include:

(a) identifying measures for enhancing existing linkages, creating synergies and facilitating coordination and implementation of NMAs, through identifying NMAs as focus areas for the

work programme and identifying measures to enhance linkages, synergies and coordination of NMAs at different levels; and

(b) implementing measures, through the development and implementation of tools, with the assistance of the Secretariat, including a UNFCCC web-based platform for recording and exchanging information on NMAs, and identifying and sharing information and best practices, lessons learned and case studies in relation to implementing NMAs.

4.10 Whilst there is limited guidance on what constitutes an NMA, examples of activities that could form part of the scope of NMAs include actions that promote:

(a) adaptation, resilience and sustainability, such as reforestation of degraded lands;

(b) mitigation and sustainable development, such as reducing methane emissions from livestock and waste; or

(c) development of clean energy sources, such as using renewable energy to power irrigation infrastructure.

Reporting

4.11 Reporting on the work programme's progress and outcomes will occur, insofar as it is required, at each session of the CMA.

4.12 The work programme will be reviewed in November 2025 at CMA 7.

5 Implications of the Article 6 Rules for Australia

5.1 While further work is to be carried out to achieve the full implementation of Article 6.2 (including the implementation of the international registry, which is likely to be critical for the full participation of many LDCs and SIDS), the Article 6.2 Rules do provide a sufficient basis for Parties to begin actively preparing for participation and to undertake capacity building.

5.2 Although participation is voluntary, there are likely to be a number of benefits for participating Parties and for early engagement with cooperative approaches. These include:

- access to ITMOs which can be used towards NDC commitments, for using Parties;
- creating new markets and industries related to emission reductions and supporting investment in mitigation outcomes in countries which may be able to export ITMOs;
- building bilateral and multilateral diplomatic relationships with other countries, including through the provision of capacity building and transfers of knowledge and skills; and
- supporting activities which seek to enhance ambition in NDCs and contribute to OMGE.

Australian participation under Article 6.2

5.3 In order for the Australian Government to facilitate its own participation, as well as that of Australian stakeholders, under Article 6, it must ensure that it has the institutional architecture and processes in place that are required for authorising the use, and tracking, of ITMOs in the Australian context so that they may be transferred internationally for approved mitigation purposes.

Designated Australian Government body and its responsibilities

5.4 Practically speaking, this means that the Australian Government should nominate a designated body (**Designated Body**) for issuing authorisations for the transfer and permitted uses of ITMOs (both for export and import) and a DNA for the purposes of the Article 6.4 mechanism (which may be the same body). This body (assuming it is the same) would be responsible for establishing and implementing decision-making around approvals to generate ITMOs and authorisations to transfer ITMOs, including establishing relevant pathways for different types of ITMOs, being for use towards a Party's NDC or for other international mitigation purposes (as determined by a participating Party in the case of international mitigation purposes or by the first transferring Party for other purposes). Note that, under Article 6.2, the purpose for which an ITMO can be used is to be specified in the initial report and in subsequent annual information and regular information. Whilst it is conceivable that the permitted use may change and be updated in subsequent reports, it could be problematic if a use authorisation, once granted, was wound back.

5.5 In the context of Article 6.4, the DNA's functions would also extend to approving public and private sector participation in Article 6.4 activities, communicating with the Supervisory Body and developing procedures with respect to those functions. A DNA would be approving participation by activity participants undertaking activities in its country, which for a host Party may be project developers and market intermediaries and in a using Party may be market intermediaries who may be buying and trading A6.4ERs.

5.6 When looking at the types of domestic mitigation approaches that may generate ITMOs, it is generally acknowledged that these could involve mutual recognition of units that are tradeable in different countries' emissions trading schemes or that are generated under domestic offset schemes, or various other types of approaches that achieve emission reductions that are measurable against clearly defined baselines (provided in each case that they meet the underlying characteristics and environmental integrity requirements in the Article 6.2 Rules).

5.7 In terms of defining an ITMO in the Australia context, a key consideration will be whether an ACCU issued in accordance with the *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth) (**CFI Act**) or

any other environmental product measured in a non-GHG metric (such as a large-scale renewable energy generation certificate (**LGC**)) could be capable of export from Australia and authorised for use in accordance with Article 6.2. Consideration would also need to be given to potential new cooperative approaches that could generate ITMOs in a manner that ensures the environmental integrity requirements of the Article 6.2 Rules are met.

5.8 With respect to ITMOs eligible for import into Australia and use towards Australia's NDC, consideration will need to be given to (i) whether only ITMOs with GHG metrics can be used; and (ii) what parameters sit around eligibility. This could be through recognition of particular types of units such as A6.4ERs, units from other participating Party's domestic schemes or units issued under recognised VCM standards that have Article 6 "labels" referencing host Party application of corresponding adjustments – in each case that have been subject to review and screening by the Australian Government. We would anticipate that the Australian Government would adopt a set of criteria that reflected its expectations on environmental integrity. That criteria could take the form of a positive list of schemes and standards that were deemed to have integrity (similar to the approach adopted to select eligible unit types for CORSIA) or could take the form of a list of particular characteristics that units eligible for use towards Australia's NDC would need to meet (for example meeting core carbon principles developed by the Integrity Council for Voluntary Carbon Markets or an equivalent for non-VCM schemes). Alternatively (or in addition), the Australian Government could adopt a more flexible case-by-case assessment in respect of each cooperative approach which would be articulated in the bilateral agreement with the host Party. However, this bespoke approach alone would risk creating market uncertainty and limit participation by public and private sector entities.

5.9 Additionally, the Designated Body will need to be responsible for tracking ITMOs, which will require establishing a tracking system that can follow ITMOs from their point of origin across their transfer both to and from Australian entities. This is likely to include interactions with various registry systems (discussed below at 5.12 to 5.14) and also interface with the teams collating Australia's national inventory and preparing the various reports that will need to be submitted to the CMA.

5.10 It will be a matter for the Government to determine whether those processes are specified in legislative instruments or more general guidance. However, there may be merit in the Government seeking to pass legislation that:

(a) confirms Australia's position in respect to participation in the cooperative approaches under Article 6 of the Paris Agreement; and (assuming there is a positive intent to participate),

(b) establishes or designates one or more bodies to oversee participation in the cooperative approaches and outlines its governance, functions and powers, including how it interacts with divisions within the Department of Foreign Affairs and Trade (**DFAT**) responsible for international treaty negotiations and compliance with reporting obligations under the UNFCCC and Paris Agreement;

(c) provides guidance on the types of cooperative approaches that may be eligible to create ITMOs for international transfer from Australia for different uses in accordance with the Article 6.2 Rules;

(d) provides guidance on the types of ITMOs that may be imported and eligible for use towards Australia's NDC and for use for international mitigation purposes and other purposes;

(e) sets out procedures for how corresponding adjustments will be made and recorded; and

(f) provides for the transparent disclosure of ITMO creation, authorisation, transfer, acquisition, holdings, cancellation, use and corresponding adjustments.

5.11 The type of regulatory framework described above would also need to align and dovetail with Australia's existing regulatory framework for GHG and energy reporting, the schemes overseeing the creation of different forms of environmental products that could be approved as cooperative approaches (e.g. the CFI Act) and our national registry. It may be the case that consequential amendments will be required across these laws.

Registry system and integration into international or transnational networks

5.12 As noted above, there is a need for a robust registry system in order to keep track of ITMOs. The most obvious option would be to adapt the ANREU to cover different forms of ITMOs, given the ANREU already deals with ACCUs and, relevantly, other eligible emissions units issued under the Kyoto Protocol. This would require changes to the legislation and regulations underpinning the ANREU, being the *Australian National Registry of Emissions Units Act 2011* (Cth) and the *Australian National Registry of Emissions Units Regulations 2011* (Cth), to provide a framework for the registration and regulation of ITMOs issued by participating Parties under the Paris Agreement. The ANREU will functionally need to be adapted both to receive the incoming transfer and identification of ITMOs authorised for use towards Australia's NDC as well as for other uses authorised by the Australian Government of incoming and outgoing ITMOs (for instance, for use by an airline towards CORSIA or for use by a private sector entity for voluntary use).

5.13 Whilst the Secretariat is tasked to develop a UNFCCC-based international registry that will provide a centralised accounting and reporting platform, Australia would likely look to use ANREU to track ITMO transfers in and out of its jurisdiction and, to the extent necessary, to link with the international registry and the registry of other participating Parties. From that perspective, it may also be necessary to adapt the ANREU to integrate with other registries, including the UNFCCC-based registry once available, in order to allow for the transfer of ITMOs.

5.14 Providing for ITMOs and integration with other registries will require technical changes to the ANREU, as well as clear accounting and reporting practices, to ensure there is no double counting of mitigation outcomes.

Accounting practices

5.15 The Australian Government will need to implement rigorous accounting practices to ensure corresponding adjustments, and/or cancellations, are made following the transfer of ITMOs.

5.16 Again, this will involve establishing different accounting practices depending on the form of ITMO. For ITMOs being used towards Australia's, or another Party's, NDC, Australia's emissions target must be adjusted upwards or downwards depending on the direction of the transfer (i.e. if the ITMO is going towards Australia's NDC, Australia's NDC will be adjusted downwards; if it is going to another Party's NDC, Australia's NDC will be adjusted upwards). Practices also need to be established in relation to accounting for the transfer of ITMOs for international mitigation purposes and other purposes. Such practices must be transparent, comparable and, in relation to transfers going towards NDCs, be representative of Australia's NDC implementation.

5.17 In relation to ITMOs comprising A6.4ERs, corresponding adjustments and accounting practices will need to account for the 5% contribution of proceeds to the Adaptation Fund as well as the cancellation of 2% of transferred ITMOs to achieve OMGE.

Reporting practices

5.18 Australia will need to implement reporting practices that meet the requirements of the Article 6.2 Rules and ensure that Australia's ITMOs and accounting practices are operating effectively, transparently and in accordance with the Article 6 Rules. Australia already has processes in place to meet the requirements of UNFCCC reporting obligations, however, these new reporting requirements link to what may be a dynamic and potentially scaled carbon market involving new and additional data points. The Designated Body will therefore be required to prepare Australia-specific standards and guidelines for reporting practices for those agencies and stakeholders that input into the preparation of the initial report, annual information, and regular information (see paragraphs 2.22 to 2.31 above).

Australian participation under Article 6.4

5.19 Whilst much of the oversight of the Article 6.4 mechanism is centralised through the CMA and the Supervisory Body, there are still a number of important steps that a host Party government must take in addition to simply appointing a DNA. A participating Party that is accepting A6.4ERs as ITMOs will

also need to address this in the procedures it establishes to authorise use and apply corresponding adjustments (described above).

5.20 The Australian Government will need to give consideration as to whether it will allow private sector entities to develop mitigation activities in Australia in accordance with the Article 6.4 Rules and for the emission reductions achieved through those activities to be represented as A6.4ERs which could be transferred internationally and used for ITMO and potentially non-ITMO purposes. This presents both a risk and an opportunity for the existing Australian carbon market.

5.21 Participation in the Article 6.4 mechanism could provide an alternative route to market for emission reduction activities carried out in Australia, in particular where the Article 6.4 mechanism enables activities that would not otherwise be eligible under the CFI Act. The attractiveness of that route to market (and its impact on the domestic ACCU market, for example) will depend upon international supply and demand factors and pricing, and there could be disparity in the actual or perceived environmental integrity of activities undertaken under the different routes.

5.22 The methodologies that will be developed by the Supervisory Body are likely to draw from existing methodologies under the CDM, but also could potentially include new methodologies derived from other domestic and voluntary offset schemes. This provides an opportunity for Australia to possibly put forward methodologies it has developed under the CFI Act for wider global application. Expanded application of Australian methodologies would be beneficial to existing Australian market participants who may be able to explore the development of projects internationally, or the transfer of technical know-how to support the application of those methods overseas.

5.23 If Australia were to allow Article 6.4 activities to be carried out in Australia, the Government would need to determine and communicate to the Supervisory Body how participation in the mechanism contributes to sustainable development; the types of activities that it intends to host; and how the approaches and requirements are compatible with its NDC and long-term low GHG emissions development strategy. It would also need to consider its approach to baselines and other methodological requirements, such as additionality, for activities it intends to host, along with the crediting periods to be applied.

5.24 Australia would need to develop processes for the host Party approval of activities it wishes to register under the Article 6.4 mechanism and also processes for the authorisation of public or private entities to participate in activities as activity participants (in accordance with the Article 6.4 Rules).

5.25 Similar to the analysis for Article 6.2 above, there may be merit in providing the processes and guidance on Article 6.4 participation in legislative instruments.

Interaction with Climate Active

5.26 A further consideration for Australia in respect of A6.4ERs is whether these are accepted as eligible offsets units for the purposes of the Climate Active Carbon Neutral Standard (**Climate Active**) either with or without corresponding adjustments being made. In the absence of clear guidance on the accepted methodologies and activity types that may be approved by the Supervisory Body, it is difficult to provide an immediate view on whether these new units would meet the integrity requirements of Climate Active (this will also depend on the criteria adopted by Climate Active to screen units from different schemes, standards and practices coming out of the CCA's review). However, a view could be taken that, given the features built into the Article 6.4 Rules, including in terms of expectations as to how baselines are to be set in methodologies, requirements to deduct A6.4ERs for the share of proceeds and OMGE, and more prescription around sustainable development contributions, that crediting will be conservative and environmental integrity is embedded in the mechanism.

5.27 Linked to the acceptability of A6.4ERs in Climate Active in future is the status of, first, pre-2021 CERs that have been issued on or after 1 January 2013 and are held in the mechanism registry; and, second, CDM projects and programmes of activities that are approved for transition to the Article 6.4 mechanism.

5.28 In the first case, CERs are currently eligible offset units for the purposes of Climate Active (subject to review) and are recognised in other international schemes. However, a view may be taken on the vintage or year in which the abatement has taken place and how it corresponds to offsetting current public or private sector emissions.

5.29 With respect to the second case, it is expected that the Supervisory Body will be undertaking an assessment process to determine whether CDM project activities and programmes of activity can be approved for transition – in particular, having regard to whether the activity complies with the Article 6.4 Rules and the application of corresponding adjustments. On this basis, query whether there is a need to distinguish between these activities and new activities registered by the Supervisory Body. However, noting the concerns raised about matters such as the continued additionality of some CDM projects, there could be a view that some of these activities fall short of current integrity requirements.

5.30 Noting that Climate Active is a voluntary standard, we have not considered the use of ITMOs (other than A6.4ERs) in the context of Climate Active. We would assume that the broad range of possible standards and units that could comprise an ITMO may also independently be considered for eligibility under Climate Active.

6 Areas for regional engagement and capacity building

Capacity building

6.1 As part of Australia's response to the finalisation of the Article 6 rulebook, Australia should consider its ability to help build capacity for participation under Article 6 in other country Parties. At a minimum, this will require supporting Parties to develop the corresponding institutional architecture and processes to those set out above for Australia, tailored to the relevant Party's context.

6.2 The development of IPCOS represents a possible platform for Australia to provide capacity building assistance to the Indo-Pacific in particular, by using Australia's learnings and the regular engagement with other Indo-Pacific countries in establishing IPCOS to foster the development of other Parties' efforts to operationalise Article 6 for their contexts.

6.3 This capacity building can take various forms, including:

(a) technical capacity training through educational workshops on specific topics, such as corresponding adjustments and reporting requirements, and legal frameworks for ownership of carbon rights, as well as learnings from Australia's experience in developing its domestic carbon market;

(b) aiding the design of institutional procedures and policies, including training and support in the development of standards relating to the establishment of a national (or interim) registry, and reporting requirements;

(c) helping establish designated government bodies responsible for implementation of Article 6 participation and reporting;

(d) supporting the adaptation of existing institutional structures (for example DNAs set up for the CDM) to Article 6 requirements, including consideration of the creation of new roles and functions, and training on the participation and authorisation requirements under the Article 6 Rules;

(e) developing authorisation and corresponding adjustment procedures, as well as reporting templates;

(f) providing for the transition from the CDM to Article 6.4, including reviews of existing registered projects and programmes of activity;

(g) supporting the development of, or connection to, international registry systems to enable ITMO transfers – noting that there may be incremental scaling of functionality over time as engagement matures. Such support could include technical training on registry use, and also facilitating connection with other government agencies responsible for the NDC, monitoring reporting and verification and development of national inventory reports;

(h) providing technical training for local and regional verifying institutions and auditors; and

(i) providing training to potential activity developers and other market intermediaries on the legal rules governing participation in mitigation activities and the contractual means by which A6.4ERs or ITMOs can be transacted.

Piloting Article 6

6.4 Another area to foster capacity building and early market engagement is through undertaking pilot activities.

6.5 A number of countries have already entered into bilateral arrangements pursuant to Article 6.2 to pilot future ITMOs. For example, Switzerland's Klik Foundation has entered into agreements with Peru, Ghana, Morocco and Senegal for the development of mitigation activities or programs in these countries, and the subsequent transfer of the mitigation outcomes generated from these activities to Switzerland.

6.6 These types of pilot activities enable participating Parties to test various aspects of the Article 6 Rules (as in place or as earlier anticipated), including consideration of how to calculate emission reductions using different metrics; the application of corresponding adjustments, in particular across NDCs of different periods; testing expectations about contributions to enhanced ambition and sustainable development objectives; and testing the processes for approvals and authorisations.

6.7 To date we have seen a few countries enter into memorandums of understanding (**MOUs**) and bilateral framework agreements to implement pilots and/or explore cooperative approaches (without a necessary sale and purchase of ITMOs). As participating Parties develop a better understanding of the requirements for participation and put in place the necessary institutional architecture and procedures, it is anticipated that bilateral framework agreements may expand to comprehensive mitigation outcome purchase agreements (**MOPAs**) for the transfer of ITMOs from specific cooperative approaches.

(a) A MOPA is essentially a bilateral contract for the sale and purchase of ITMOs. The contract would set out the volume and price for the ITMOs, delivery obligations and timing, payment requirements and timing, obligations of the parties to the agreement (for example, for the host Party or its authorised entity to develop the cooperative approach in accordance with the Article 6.2 Rules; and for the participating Parties to meet and continue to meet the participation requirements under the Article 6.2 Rules), processes to address non-delivery and other events of default, termination rights and dispute resolution measures etc.

(b) A MOPA may be entered into between (i) two Parties to the Paris Agreement; or (ii) potentially one or more Parties and a public or private sector entity that is undertaking or financing the cooperative approach. In the latter case, the public or private sector entity would need to demonstrate that it had the authorisation to participate in the cooperative approach and was able to warrant that the participating Party authorising its involvement had agreed to make the necessary corresponding adjustments upon first transfer and/or use of the ITMO as the case may be.

A note on ambition and integrity

6.8 As noted above, one key element of Article 6 that is being tested through piloting and bilateral cooperation is environmental integrity. In the closing days of COP 25, 32 countries including Costa Rica, Switzerland, the UK, many EU member states, Norway, some Central and South American countries and Pacific Island countries released the **San Jose Principles for High Ambition and Integrity in International Carbon Markets** (**San Jose Principles**). They urged for an Article 6 rulebook that at minimum:

(a) ensures environmental integrity and enables the highest possible mitigation ambition;

(b) delivers OMGE, moving beyond zero-sum offsetting approaches to help accelerate the reduction of GHG emissions;

(c) prohibits the use of pre-2020 units, Kyoto units and allowances, and any underlying reductions toward Paris Agreement and other international goals;

(d) ensures that double counting is avoided and that all use of markets toward international climate goals is subject to corresponding adjustments;

(e) avoids locking in levels of emissions, technologies or carbon-intensive practices incompatible with the achievement of the Paris Agreement's long-term temperature goal;

(f) applies allocation methodologies and baseline methodologies that support domestic NDC achievement and contribute to achievement of the Paris Agreement's long-term temperature goal;

(g) uses CO_2-equivalence in reporting and accounting for emissions and removals, fully applying the principles of transparency, accuracy, consistency, comparability and completeness;

(h) uses centrally and publicly accessible infrastructure and systems to collect, track, and share the information necessary for robust and transparent accounting;

(i) ensures incentives to progression and supports all Parties in moving toward economy-wide emission targets;

(j) contributes to quantifiable and predictable financial resources to be used by developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation; and

(k) recognises the importance of capacity building to enable the widest possible participation by Parties under Article 6.

6.9 The San Jose Principles were not included within the Article 6 Rules, and some of the San Jose Principles are contrary to the Article 6 Rules (e.g. the Article 6 Rules allow limited carryover of pre-2020 units). However, prior to the Article 6 Rules being agreed, the San Jose Principles were used by a number of countries (e.g. Switzerland's Klik Foundation) as the basis for future transactions under Article 6.2.

6.10 After the Article 6 Rules were agreed at COP 26, the "San Jose Principles Coalition" (currently made up of Costa Rica, Colombia, Finland and Switzerland) issued a statement pledging to "fully operationalize their principles in order to further support the rules agreed in Glasgow and ensure environmental integrity". It is possible that these countries will form a "high integrity" carbon club, whereby any countries wishing to trade mitigation outcomes with these countries will have to comply with the San Jose Principles.

7 Public and private sector opportunities and risks associated with involvement in Articles 6.2 and 6.4

7.1 Both Article 6.2 and 6.4 present opportunities for private sector engagement.

7.2 As noted above, we have already seen a number of countries beginning to engage in Article 6.2 bilateral or multilateral agreements. Australia's IPCOS with Fiji and PNG as partner countries is an example of this. Under these bilateral or multilateral arrangements, a public or private sector entity may partner with the participating Parties involved for the purpose of financing or implementing the mitigation activity and associated services (e.g. relating to community engagement, adaptation co-benefits, assisting with the establishment of a registry or other infrastructure). Options for engagement under Article 6.2 include:

(a) providing mitigation activity development services in the host Party. Under this option, the public or private sector entity is most likely to enter into a services contract with a participating Party and receive monetary payments, and it is less likely that they would also receive a share of ITMOs (however, ITMOs could be transferred to the service provider provided processes were in place to allow for corresponding adjustments to be made);

(b) where a host Party delegates the development of a mitigation activity to a public or private sector entity and authorises that entity to enter into a MOPA and transfer the mitigation outcomes generated to another participating Party, in which case the host Party is still required to undertake all necessary corresponding adjustments and comply with the Article 6 Rules. Under this option, the public or private sector entity is most likely to receive monetary payments upon transfer of the ITMOs to the user Party under the MOPA, however it is also possible that the terms of the host Party's authorisation would enable the public or private entity to retain and claim some ITMOs for its own use or trade;

(c) where the public or private sector entity participates in any other international mitigation purpose (e.g. CORSIA or a VCM where a corresponding adjustment is required), it may seek to buy ITMOs from a host Party or an authorised entity; or

(d) a public or private sector entity seeking to create and transfer ITMOs to offset the emissions from its operations in one country with mitigation activities carried out by itself or its subsidiaries in another country, or to bring units or allowances from one emissions trading scheme into another emissions trading scheme (should the two governments recognise each other's units through linking their schemes).

7.3 We also note that some multilateral development banks are establishing Article 6 Funds, such as the Asian Development Bank's Climate Action Catalyst Fund, which will provide a means by which the public and private sector may be able to invest in the Fund and secure access to ITMOs. These approaches, similar to what we saw in the early days of the Kyoto Protocol mechanisms, are likely to provide an opportunity to get early access to the new international carbon markets and to test and refine the offtake and contracting structures for transactions.

7.4 The Article 6.4 mechanism is specifically designed to enable public and private sector participation. Similar to the CDM, we consider it highly likely that some project developers and market intermediaries will look to undertake early activities to test the market, as soon as the Supervisory Body completes the steps required to operationalise activity registration, which is expected at COP 27. A number of entities will also be looking at how they can leverage the window for CDM transition.

7.5 Given the increasing demand for offsets from organisations (including for the purpose of meeting net zero targets), there is likely to be considerable interest in developing mitigation activities under the Article 6.4 mechanism and purchasing A6.4ERs from the private sector.

7.6 There is also a possibility that some jurisdictions may allow A6.4ERs to be used for compliance purposes under domestic carbon pricing mechanisms. To date, a number of countries, including

South Africa, South Korea and Colombia, have allowed CERs generated under the CDM to be used for compliance purposes with domestic carbon pricing schemes, although in the case of South Africa and Colombia the CERs must be generated within the relevant jurisdictions. A similar approach could be taken for A6.4ERs.

7.7 While Article 6.4 is in many respects the more obvious choice for private sector engagement given its centralised organisation and clear requirements, public and private sector entities may still wish to engage with Article 6.2 for the following reasons:

(a) First, a key feature of Article 6.2 is that it is intended to be flexible. Depending on the approach of particular Parties, there may be opportunities to engage with Parties to work together in the design of a cooperative approach under Article 6.2.

We also note that cooperative approaches under Article 6.2 are not restricted to mitigation activities that can be quantified in tCO_2e, and on this basis there may be scope to engage in types of cooperative approaches that have not yet been implemented under other carbon markets (e.g. funding the development and implementation of policy approaches that result in mitigation outcomes such as improved energy efficiency). However, to ensure that such approaches have sufficient levels of environmental integrity, it would be necessary to design approaches which clearly demonstrate (and quantify) the mitigation outcomes achieved by such approaches.

(b) Second, the mandatory share of proceeds for adaptation and OMGE levies that apply to Article 6.4 may have the effect that engaging with Article 6.2 mitigation activities and mitigation outcomes is more cost effective, although we note that contributions to the Adaptation Fund and OMGE are strongly encouraged under Article 6.2. However, this should be balanced against the potential for higher transactional and administrative costs under Article 6.2, which may arise through the need to engage more with the Parties involved and agree on quantification methodologies, among other matters. It is also possible that some Parties engaging in Article 6.2 transactions may require voluntary levies to apply for the purpose of delivering adaptation finance and OMGE.

(c) Third, it is possible that mitigation activities may be able to be implemented under Article 6.2, and begin generating mitigation outcomes, before the Article 6.4 mechanism is active – noting that the earliest that new Article 6.4 activities can seek registration is likely to be 2023 (and even then preparation of necessary documentation can take many months lead time). This will depend on the political will of the Parties involved in the Article 6.2 transaction, the complexity of the mitigation activity and the availability of the required infrastructure and governance structures (e.g. access to a registry and ability of both Parties to make corresponding adjustments).

7.8 Public and private sector entities will need to balance the opportunities associated with participating in Article 6.2 with risks (arising both on the host and using Party sides) related to domestic policy change, and enforcement limitation, particularly if a party claims sovereign immunity.

8 Implications of the Article 6 Rules for the voluntary carbon market

8.1 The Article 6.2 Rules provide much-needed guidance that will inform VCMs in the period post-2020. There has been much confusion and concern that voluntary projects being undertaken in host countries could be at risk of being nationalised, or that the emission reductions achieved by those projects would be at risk of double counting, and therefore have the integrity of units issued to the projects compromised.

8.2 Under the Article 6.2 Rules, it is clearly a matter for each participating Party to determine what is required within its NDC, and for related cooperative approaches, and to authorise ITMO use for those purposes. As the International Carbon Reduction and Offset Alliance (**ICROA**) has noted, the Article 6 Rules in no way exclude or prevent the ongoing operation of the VCM, but instead may provide for increased convergence between Article 6 and the VCM.

8.3 What is clear from the Article 6 Rules is that, by intentionally leaving the definition of "other international mitigation purposes" vague, this enables each participating Party to determine what activities and transactions constitute "other international mitigation purposes" and to state where authorisations and corresponding adjustments are required for the transfer of mitigation outcomes for specific purposes.

8.4 In some cases, a participating Party, as the first transferring Party, may expressly state that it authorises an ITMO for other purposes as determined by it, with that other purpose being for use in the VCM. If such authorisation is given, the participating Party will need to specify when that first transfer for the purposes of Article 6.2 occurs, i.e. at authorisation, issuance, or use or cancellation of the mitigation outcome. The entity to whom the ITMO is issued or transferred, which in this case is likely to be a public or private sector entity participating in the VCM, can then transfer or use the ITMO, provided that a corresponding adjustment is made at the nominated point for first transfer. If that nominated first transfer is upon authorisation or issuance, a subsequent corresponding adjustment by a using Party would only need to be made if the public or private sector entity ultimately transferred the ITMO to a using Party for retirement or surrender. If the nominated first transfer was on use or cancellation, then the host Party would need to be able to track the ITMO and its use, to enable the host Party to make the corresponding adjustment at that final point.

8.5 The scenario outlined above provides clear steps in respect of Party obligations; it also provides guidance and evidence to the standard and registry administrators that transfers of the emission reductions are authorised and that corresponding adjustments have or will be made. As discussed below, this means that the voluntary standard registry can be updated to record these facts, giving transparency to voluntary market participants.

8.6 There may be circumstances where a participating Party expressly states that the export of emission reductions from activities that fall within its NDC (or more generally within its jurisdiction) is not permitted, either on a temporary basis, until further rules and regulations are developed, or absolutely. This approach is currently in place in Indonesia, which has seen issuance of Voluntary Emission Reductions (**VERs**) temporarily suspended until national rules are finalised. In these cases, where the intent of the host Party is clear, the voluntary market project is clearly exposed to risk and the potential for double counting is high if a VCM standard issues credits while such a moratorium exists, particularly if the emission reductions are intended for use in another national scheme.

8.7 There is also a middle ground where a host Party has no position on the export of mitigation outcomes and has not authorised emission reductions from voluntary projects for any particular use. In this case, the emission reductions arguably fall outside of the Article 6 framework and remain exclusively governed by the rules of the standard that regulates them. Therefore, the use of these emission reductions by private sector entities for voluntary offsetting purposes is unlikely to carry significant risks of double counting (at a national level). This is because, although the host Party may account for the emission reductions achieved in a sector in its national inventory, emission reductions claimed by a corporate buyer which are not retired in a national scheme would not be accounted for by the national government of the corporate buyer. Whilst this potentially exposes a double claim for the emission reductions, this is not reflected as double counting in national inventories.

8.8 To manage these issues, the leading voluntary market standards are taking the following approaches:

(a) **Gold Standard** considers there to be two pathways for voluntary emissions reduction units. All Gold Standard-certified emissions reduction units are aligned with the Paris Agreement, but only some will be authorised as ITMOs under Article 6, such that:

(i) those that are approved as ITMOs can then go towards a using Party's NDC, be treated as a voluntary offset or go towards international schemes such as CORSIA, with the host Party making an adjustment in each case; or

(ii) those that are not approved as ITMOs can be traded on the domestic market and are simply counted by the host Party, but not adjusted.

Gold Standard has indicated that it plans to phase in corresponding adjustments for carbon units by 2025, and that the Gold Standard registry is being updated to be able to issue, transfer and cancel mitigation outcomes.[15]

The process steps set out in Figure 1 on the following page are included in the *Requirements for Credits Authorised for Use Under Article 6 of the Paris Agreement* which is an Annex to the Gold Standard's *GHG Emission Reduction and Sequestration Product Requirements.*[16]

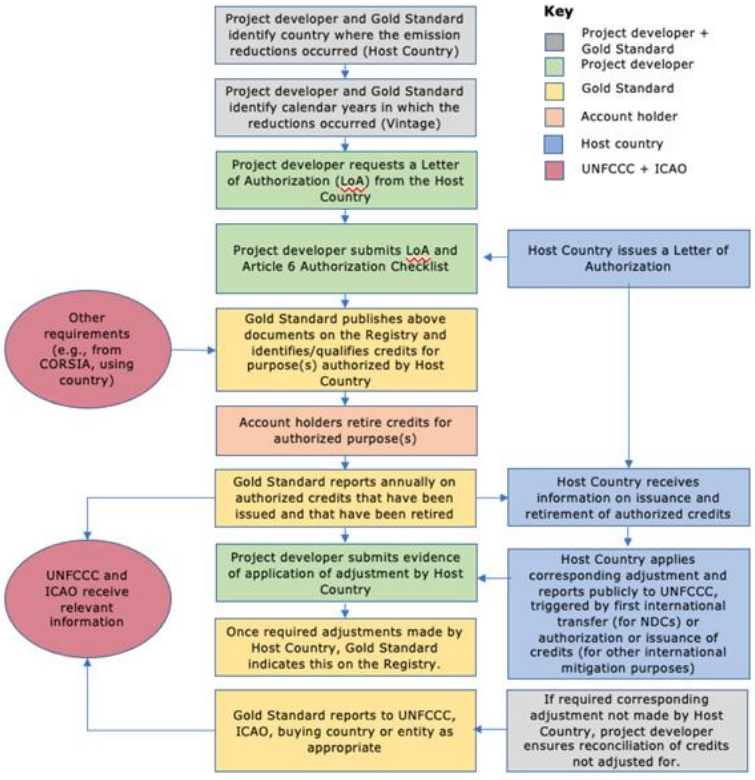


Figure 1 - Overview of required steps and respective responsibilities

[15] Gold Standard, *Treatment of Double Counting and Corresponding Adjustments in Voluntary Carbon Markets* (version 0.5, 18 February 2021) https://www.goldstandard.org/sites/default/files/documents/gs_guidance_correspondingadjustments_feb2021.pdf.

[16] Gold Standard, *GHG Emissions Reduction & Sequestration Product Requirements* (version 2.1, 24 February 2022) https://globalgoals.goldstandard.org/501-pr-ghg-emissions-reductions-sequestration/.

(b) **Verra** has indicated for the purposes of the Verified Carbon Standard that it is unlikely to require corresponding adjustments for voluntary offsetting purposes. Verra recognises that the Article 6 Rules allow host Parties to incorporate VCM transactions in their accounting under Article 6. We assume this is where ITMOs that are derived from projects developed for the VCM are authorised for use for other purposes and the host Party agrees to make corresponding adjustments. However, this is not mandated and it will be up to each country to decide its own approach. Where countries have authorised voluntary activities to create ITMOs, the Verra registry is already anticipating incorporating labels that can record that authorisation and note where corresponding adjustments have or will be made. The diagram below, produced by Verra, summarises where corresponding adjustments will likely take place.

8.9 For private sector entities that are already implementing (or are looking to implement) projects under a voluntary market standard, a first step would be engaging with the host country government to determine their policy position on the issuance of letters of authorisation and corresponding adjustments, and allowing such projects to export mitigation outcomes internationally on an ongoing basis.

8.10 However, it is important to note that many of the elements of institutional architecture and procedures for authorisation and corresponding adjustments are unlikely to be in place in a number of countries in the immediate future. Therefore, whilst it may be prudent for project developers to seek comfort about how voluntary market projects will be treated, assurances may be difficult to obtain.

8.11 Over time, buyers of voluntary carbon units who are interested in purchasing units that demonstrate the highest levels of credibility and environmental integrity will seek (wherever possible) to purchase units that have been authorised for international transfer and will be subject to a corresponding adjustment by the host Party. Additionally, they may seek to ensure their units are verified by independent high integrity standards, such as those being developed by the Integrity Council for the Voluntary Carbon Market.

8.12 Going forward, it is also possible that existing voluntary projects may seek to transition to the Article 6.4 mechanism, should comparable methodologies be available. While, on the one hand, the Article 6.4 mechanism will involve discounts for the share of proceeds and OMGE, it may be the case that, similar to the CDM, the A6.4ERs become fungible instruments recognised in multiple international and domestic schemes, giving the mechanism a more universal application.

9 Glossary

Abbreviation	Meaning
A6.4ERs	Article 6.4 emissions reductions
ACCU	Australian Carbon Credit Unit
ANREU	Australian national registry of emissions units
Article 6 Rules	Rules governing the cooperative approaches under Article 6 of the Paris Agreement
BAU	Business as usual
BTR	Biennial Transparency Report
CCA	Climate Change Authority
CDM	Clean Development Mechanism
CER	Certified emission reduction
CFI Act	*Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth)
Climate Active	Climate Active Carbon Neutral Standard
CMA	Conference of the Parties serving as the meeting of the Parties to the Paris Agreement
CMP	Conference of the Parties serving as the meeting of the Parties
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
DFAT	Department of Foreign Affairs and Trade
DNAs	Designated national authorities
DOEs	Designated operational entities
GAP	Gender action plan
GHG	Greenhouse gas(es)
Glasgow Committee	Glasgow Committee on Non-Market Approaches
ICROA	International Carbon Reduction and Offset Alliance
IPCC	Intergovernmental Panel on Climate Change
IPCOS	Indo-Pacific Carbon Offsets Scheme
ITMOs	Internationally Trade Mitigation Outcomes
JI	Joint implementation
LDC	Least Developed Country
LGC	Large-scale renewable energy generation certificate
LIPP	Local and indigenous people platform
MOPAs	Mitigation outcome purchase agreements
MOUs	Memorandums of Understanding
NDC	Nationally determined contribution
NMAs	Non-market approaches
OMGE	Overall mitigation in global activities
San Jose Principles	San Jose Principles for High Ambition and Integrity in International Carbon Markets
SBSTA	Subsidiary Body for Scientific and Technological Advice
SIDS	Small Island Developing States
UNFCCC	United Nations Framework Convention on Climate Change
VCM	Voluntary carbon market
VER	Voluntary Emission Reduction