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SUSTAINABILITY IN OUR SECTORS

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COOPERATIVE APPROACHES OR THE ARTICLE 6.4 MECHANISM

WHICH OF THE ARTICLE 6 MARKET MECHANISMS WILL WIN THE RACE TO ENGAGE THE PRIVATE SECTOR?

At a glance:

This paper discusses which of the two approaches under Article 6 of the Paris Agreement (Cooperative Approaches under Article 6.2 and the Article 6.4 Mechanism) is most likely to engage the private sector?

By reference to three criteria - (i) private sector participation, (ii) infrastructure development and (iii) environmental integrity – for reasons elaborated on below, it seems that presently, the Article 6.4 Mechanism offers greater promise than Cooperative Approaches under Article 6.2. Ultimately, to attract private sector capital into the Article 6 mechanisms, efficiencies of scale will be a key feature. On that basis too, the Article 6.4 Mechanism offers greater promise than Cooperative Approaches.

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Introduction

Article 6 of the Paris Agreement was finally implemented at COP26 in Glasgow thereby starting the formal process to make the two market mechanisms for transacting in mitigation outcomes recognised under Article 6 operational. Cooperative approaches under Article 6.2 (**Cooperative Approaches**) had a head start with countries such as Switzerland taking the lead on establishing bilateral arrangements with a number of countries in anticipation of the Article 6 agreement at COP26. The mechanism under Article 6.4 (the **Art 6.4 Mechanism**), a centralised system to be operated under the auspices of the supervisory body of the Art 6.4 Mechanism (the **Supervisory Body**) couldn't really get started until formally mandated in Glasgow. With the benefit of COP27 behind us, we explore the relative progress made in respect of the two instruments to ask, which of the two is most likely to engage the private sector and why? We test this by comparing three factors: (i) private sector participation, (ii) infrastructure development, and (iii) environmental integrity.[1]

The Context

Article 6 of the Paris Agreement should have been implemented in 2016 together with the rest of the Paris Agreement rulebook. However, it wasn't and failure at successive COP meetings created uncertainty as to whether the COP process would ever deliver an international market mechanism under Article 6. The void created by that uncertainty, coinciding with net-zero or carbon neutrality pledges from deeper corporate engagement in environmental, social and governance (**ESG**) issues, led to the growth in voluntary sector activity that has breathed new life to the voluntary carbon markets (**VCM**).

With a belated but nonetheless welcome implementation of Article 6 in 2021, the challenge for the Parties to the Paris Agreement and for the Supervisory Body, is to get their act together to make these instruments operational. Host countries have a choice as to whether they seek support for financing of their carbon mitigation or removal activities via Cooperative Approaches, the Art 6.4 Mechanism or the VCM. Some may choose to shun one in favour of the other whilst other countries may wish to spread their activities between the Article 6 markets and the VCM. No doubt the memories of both the successes and the challenges of the Clean Development Mechanism under Article 12 of the Kyoto Protocol (**CDM**) will influence the choices that the host countries make.

However, the truth is that until units are issued under either Cooperative Approaches or the Art 6.4 Mechanism, the VCM remains the only game in town today in terms of where private capital can be invested towards mitigation or removal activities. Therefore, recognising the investment time horizons for project activity and lead-time for project implementation, until the infrastructure, rulebooks and methodologies are in place for the two Article 6 mechanisms, at least to a minimum level, the VCM is likely to lock in investments until at least 2025, if not beyond.

Therefore, VCM markets will have a first-mover advantage. Unless the Article 6 mechanisms are built intelligently and in a commercially attractive way, they may struggle to attract private capital towards them and away from the VCM. Given that the Article 6 instruments are mostly inter-governmental, perhaps the first question that should be considered is around the contributory role of the private sector in Article 6 instruments.

Criteria 1: Private sector participation in Cooperative Approaches and the Art 6.4 Mechanism

The text of Article 6.4(b) of the Paris Agreement provides for *"participation in the mitigation of greenhouse gas emissions by public and **private entities authorized by a Party**"* (emphasis added). This provides the legal basis for private sector participation in an otherwise intergovernmental treaty that would not normally permit a role for a

1 There are of course other factors which may affect the desirability of one approach over another. For instance, the types of activities that may be eligible under each approach. For instance, India has announced that certain specified activities will be eligible Article 6.2 activities: https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1900216

private sector entity. The Article 6.4 guidelines agreed at COP26 (the **Art 6.4 Guidelines**), as subsequently elaborated on at COP27, require the host Paris Agreement Party of the Article 6.4 activity (the **Art 6.4 Activity**) to provide the Supervisory Body with its authorisation of public of private entities participation in the activity as 'Activity Participants' in the Art 6.4 Activity. Like the CDM, a purchasing private sector entity will have to obtain authorisation from its Paris Agreement Party to participate in the Art 6.4 Activity no later than before the first transfer of the units from the Art 6.4 Activity (**Art 6.4 ERs**) to the registry account of that private entity buyer in the registry established by the Supervisory Body for the Art 6.4 Mechanism (the **Mechanism Registry**).

Notably, Article 6.2 omits any references to private entity participation, which raises the question as to the legal basis for private sector participation in a Cooperative Approach. Cooperative Approaches can be bilateral or multilateral and therefore, the number of Paris Agreement Parties to a Cooperative Approach will vary from two to many (each a **Cooperative Approach Party**). The establishment of any Cooperative Approach will require binding legal obligations to be established between those Cooperative Approach Parties. The form of agreement necessary to establish such binding obligations between two or more countries (i.e. government-to-government or **G2G**) will be determined by the public international laws of the respective Cooperative Approach Parties.

Since the principal idea of Cooperative Approaches is to give participating countries the freedom to design something that is most suited for their own needs, the Paris Agreement does not expressly preclude the participation of private sector participants in Cooperative Approaches. However, all Cooperative Approaches must comply with the minimum requirements of the Article 6.2 guidelines agreed at COP26 (the **Art 6.2 Guidelines**), as subsequently elaborated on at COP27. Under the Art 6.2 Guidelines, a Cooperative Approach Party will have to submit certain information about its Cooperative Approach in its initial report to the Secretariat as well as part of its biannual transparency reports (**BTR**). Information relating to any private sector entities authorised to participate in that Cooperative Approach by that Cooperative Approach Party must be included in that Cooperative Approach Party's BTR.

Therefore, in any Cooperative Approach, if private sector participation is to be created, a clear and ideally, robust legal foundation will be required to give a private sector entity (e.g., from Country A) the necessary certainty around its own rights and obligations as an indirect participant to that Cooperative Approach between two or more Parties (e.g., Country A and Country B), including the ability to enforce cross-border contractual arrangements, where it is aggrieved.

Ideally, the legal framework establishing a Cooperative Approach between Cooperative Approach Parties would expressly create an authorisation framework for private sector participation from each Cooperative Approach countries (i.e. business-to-business or **B2B**) to deal in internationally transferred mitigation outcomes (**ITMOs**), which is the unit issued under Cooperative Approaches. An example of this can be seen in the Cooperative Approach agreed between Switzerland and Peru[2]. That arrangement expressly recognises authorisation of transfers of ITMOs by private entities domiciled in the respective Cooperative Approach Parties' territories.[3] Article 2 of the Swiss-Peru Cooperative Approach states that the objective of the agreement is to *"establish the legal framework for the transfers of [mitigation outcomes] for use towards the achievement of NDC or other mitigation purposes of the Parties, or their public entities or of **private entities domiciled on their territories**"* (emphasis added). The aim behind such a legal framework therefore, is to create a direct legal relationship between the Cooperative Approach Party and any authorised

2 Switzerland and Peru signed a bilateral agreement to cooperate under Article 6 of the Paris Agreement: see the Implementing Agreement to the Paris Agreement between the Swiss Confederation and the Republic of Peru dated 20 October 2020, online here (the **Swiss-Peru Cooperative Approach**).

3 See Article 2 (objective) and Article 5 (Authorisation) of the Swiss-Peru Cooperative Approach.

private sector participant. The absence of an express authorisation will create doubts as to the role and rights of a private sector participant in a Cooperative Approach.

Ultimately, given the level of public debt that many countries are carrying as a result of the longer-term effects of the global financial crisis, extreme weather events, the COVID 19 pandemic and, more recently, inflation and the energy crisis, this will limit these countries' ability to provide financial support to carbon reduction and removal activities. It is therefore crucial that governments, in negotiating their Cooperative Arrangements, leverage B2B funding under Article 6.2. To facilitate this, enabling Cooperative Approach frameworks that include legal and regulatory certainty will be critical.

When disputes arose between authorised project participants in CDM projects, after the collapse of demand in 2009 when the EU Emission Trading Scheme (**EU ETS**) announced it would not accept Certified Emissions Reductions (issued under the CDM) (**CERs**) for compliance purposes in Phase 3 of the EU ETS, the relevant countries notionally participating in the projects did not interject in the disputes. This is partially because the contractual terms placed the commercial risk of CER prices and their use at the B2B level rather than at the G2G level. However, in a Paris Agreement context, where the host country has an obligation to carry out a corresponding adjustment and the purchasing country is relying on the authorisation for use towards its nationally determined contribution (**NDC**), and the price for the ITMO commensurately reflects those elements, recourse needs to exist for buyers where the corresponding adjustment is not carried out or the authorisation for NDC use or for the project is withdrawn, revoked or cancelled without cause. Ideally, a bilateral or multilateral agreement that establishes the cooperative approach should address how private sector participants can, therefore, seek remedies in such circumstances against the host Cooperative Approach Party.

Criteria 2: Infrastructure development

Cooperative Approaches under Article 6.2

The Art 6.2 Guidelines are not highly prescriptive about what form a Cooperative Approach should take between Cooperative Approach Parties but there are nonetheless certain common fundamental rules that apply to any Cooperative Approach. For example, any Paris Agreement Party wishing to participate in a Cooperative Approach must meet the minimum eligibility requirements. Such requirements include, among others, that it has in place a framework for authorisation of ITMOs for NDC use and that it has the ability to track those ITMOs. The COP27 decisions on Article 6.2[4] expanded on some of these requirements obliging a Cooperative Approach Party to have access to a registry for the purposes of tracking ITMOs. Where a Cooperative Approach Party does not have its own registry it can use the international registry to be established by the Secretariat (the **International Registry**) no later than 2024. Where a Cooperative Approach Party has its own registry, it is at the discretion of that Party as to whether it will connect to the International Registry. Therefore, one immediate impediment to the operationality of a Cooperative Approach is the status of the Cooperative Approach Party's registry.

The accounting rules for Cooperative Approaches were fundamentally put in place at COP26. It recognises that a mitigation outcome arising from a Art 6.4 Activity (an **Art 6.4 ER**) will, when transferred internationally, be treated as an ITMO. There are three different use cases for an ITMO originating under either the Article 6.4 Mechanism or a Cooperative Approach:

4 Decision -/CMA.4

Type of Use	Description	Corresponding Adjustment to be applied by the:	
		Host Country?	Acquiring Country?
NDC Use	ITMOs authorised for use so that an acquiring Paris Agreement Party can use it towards its NDC	✓ (on 'first transfer')	✓
International Mitigation Use	International mitigation purposes other than NDC Use, broadly understood to be for CORSIA-use or any future mechanism that might be developed by the International Maritime Organisation	✓ (on 'first transfer')	✗
Other Purpose Use	Mitigation outcome has been authorised by the host Cooperative Approach Party for 'other purposes', for example use in the VCM	✓ (on 'first transfer')	✗

Table: Types of uses for ITMOs under a Cooperative Approach and Corresponding Adjustment Requirements

However, the Article 6.2 Guidance is clear that a corresponding adjustment should be applied (i) to any ITMO by the host Cooperative Approach Party upon its 'first transfer', irrespective of a use case, and (ii) by the using Cooperative Approach Party, for ITMOs with an NDC Use authorisation upon its use towards its NDC. Therefore, an acquiring country does not have to apply a corresponding adjustment for use of an ITMO that has been authorised for use for International Mitigation Use or Other Purpose Use. One of the few eligibility requirements in the Article 6.2 Guidance for participating in a Cooperative Approach, is that a Cooperative Approach Party must have arrangements in place for authorising the use of ITMOs for NDC Use. Essentially, authorisation frameworks must be established by the host countries of mitigation outcome activities.

COP27 saw disagreement among parties on the question of when and upon what conditions an authorisation, given by a Cooperative Approach Party for a specific use, should be considered final or irrevocable. Different views existed regarding this issue ranging from, on the one hand, that host Cooperative Approach Parties could swap use authorisations at their will (e.g., switching to an authorisation of Other Purpose Use in place of NDC Use), to on the other hand, that determining such matters is outside the competence of the Article 6.2 Guidelines. With no agreement having been reached on the point, the issue was referred to the Subsidiary Body for Scientific and Technological Advice (**SBSTA**) to develop recommendations for the CMA[5] to consider at its next meeting in Dubai (i.e. **COP28**). Specifically, SBSTA is to consider what process a Cooperative Approach Party should follow to grant authorisation of ITMOs including managing any changes to the scope of uses as well as authorisation of entities.

It is surprising to think that a host Cooperative Approach Party could make such choices unilaterally. As discussed above, one would expect that when two or more countries enter into bilateral or multilateral Cooperative Approaches, where B2B participation is to be facilitated, conditions that support investment certainty would have been mutually agreed as part of the formal arrangements for that Cooperative Approach, in particular, that ITMOs agreed for a specified use type (e.g., NDC Use) must be available for that use. Private sector investment decisions will become more challenging in circumstances where investor protection rights can be revoked without due process. See the Ghana Example.

Besides the already well-known examples of finalised Cooperative Approaches that have been led by Switzerland (e.g., with Peru, Ghana, Senegal etc.), as at the date of publication of this paper,[6] 12 finalised Cooperative Approaches exist and 52 other prospective Cooperative Approaches have reached memorandum of understanding (**MOU**) stage. For example, Singapore has announced 6 MOUs for Cooperative Approaches, South Korea has announced 18 MOU,[7] and Japan has plans to convert its existing 17 bilateral Japan Crediting Mechanism (**JCM**) arrangements, developed as an alternative to the CDM mechanism after Japan pulled out of the second commitment period of the Kyoto Protocol, into bilateral Cooperative Approaches, recently adding 8 new countries to its JCM list.[8] Japan is also taking a lead role by hosting the 'Article 6 Implementation Partnership', announced at COP27 to support common understanding of the Article 6 rules and to establish linkages with NDCs and support tools for designing 'high integrity carbon markets'.[9]

Ghana Example

Recently Ghana published its Article 6 framework (the **Ghana Art 6 Framework**). Although described as a policy document, it is notionally supported by legislation that mandates the Ghana Environmental Protection Agency to prescribe standards and guidelines. Under the terms of the Ghana Art 6 Framework, once a letter of authorisation is given it shall be binding until the period for the authorisation lapses. There is, however, a significant caveat to the certainty otherwise offered by that authorisation. For example, if there are unforeseeable circumstances that prevent Ghana from fulfilling the terms and conditions of the letter of authorisation then it may no longer be binding on Ghana. What are unforeseeable circumstances in this instance? Is a change in government that brings a change in climate policy an unforeseeable circumstance? What about under-performance by Ghana of its overall NDC that then tempts it to not export the ITMOs authorised by the letter of authorisation? The dangers of unilateral declarations or of bilateral agreements that are silent on such issues, is that it ultimately raises questions around investment certainty, which in turn risks value erosion and thereby often leaves the private sector bearing the risk and cost when things go wrong.

5 Conference of the Parties serving as a Meeting of the Parties to the Paris Agreement.

6 To best of our knowledge. We note for completeness that there are also other initiatives which we have not covered below. For instance, the Climate Market Club is a group of national governments and non-sovereign members that agree on common principles and jointly develop modalities for piloting activities under Article 6.2 of the Paris Agreement. The Climate Market Club counts the governments of Bangladesh, Bhutan, Chile, Ghana, Kazakhstan, Japan, Peru, Rwanda, Senegal, Singapore, Sweden, Switzerland, Ukraine, and Namibia as its members.

7 With Gabon and Mongolia.

8 Japan recently announced new JCMs with Papua New Guinea, Azerbaijan, Georgia, Moldova, Senegal, Sri Lanka, Tunisia and Uzbekistan.

9 We note also that the UNDP have provided points for parties to consider as part of operationalising Article 6.2: https://www.learningfornature.org/en/courses/operationalizing-article-6-2-of-the-paris-agreement-achieving-ambitious-climate-action-through-cooperative-approaches/

The Art 6.4 Mechanism

The calendar year between COP26 and COP27 did not see the desired advances made by the Supervisory Body towards setting up the Art 6.4 Mechanism. Half of the year was lost in selecting the country representatives to sit on the Supervisory Body, leaving just two meetings in the run up to COP27 in which to make any real progress. Therefore, going into COP27, expectations for progress on the Art 6.4 Mechanism were limited.

Although the ability to get the Art 6.4 Mechanism up and running is aided by its ability to draw on the intellectual capital and infrastructure that already existed in the CDM, that did not help in accelerating operationalisation during the first 6 months of the existence of the Supervisory Body.

The centralised nature of the Art 6.4 Mechanism requires it to establish a Mechanism Registry, updating CDM methodologies that are to be grandfathered, establishing new methodologies such as those relating to removals, appointing verification and validation bodies, elaborating on rules to enable all of the above etc.

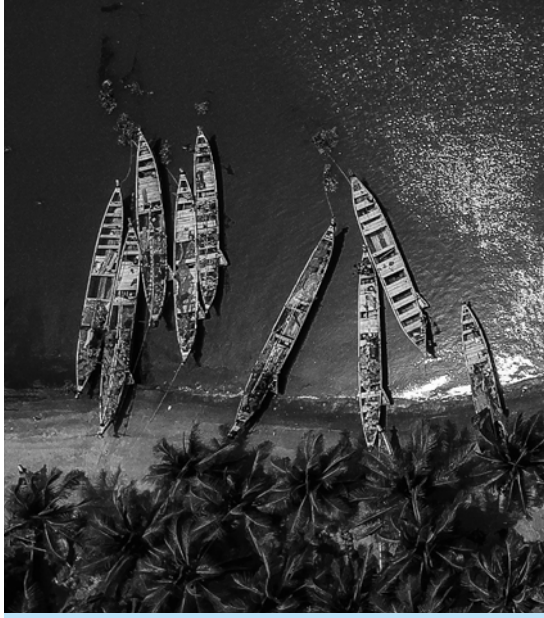
The operational procedures for the Mechanism Registry, to be operated by the UNFCCC secretariat, are to be finalised by the third meeting of the Supervisory Body to be held in 2023. Pursuant to Decision -/CMA.4, it seems that only Paris Agreement Parties and Activity Participants may request that accounts be opened in the Mechanism Registry, although the final requirements adopted by the Supervisory Body may be more permissive. The Mechanism Registry is to be connected to the International Registry to allow automated pulling and viewing of information on holdings and action authorisation of Art 6.4 ERs for use by Paris Agreement Parties who are Activity Participants. SBSTA has been tasked with developing the rules, modalities and procedures for the Mechanism Registry, including the nature and extent of its interoperable features and its connections to (i) the International Registry and (ii) other registries, for adoption by the CMA at COP28.

One of the challenges faced by the Supervisory Body is that many of the staff who were at the UNFCCC secretariat supporting the CDM executive board are no longer there. The fewer number of experienced people available, who could otherwise facilitate a speedy implementation of the Art 6.4 Mechanism, has become a limiting factor.

An example of the lack of experience in removals methodologies can be seen from the negative reception given to the Supervisory Board's draft recommended guidance on activities involving removals and the difference between the initial draft and the significantly pared back, high-level guidance that was adopted by the CMA at COP27. The criticisms levelled at the draft guidance included suggestions that it was riddled with ambiguity, there were concerns around how permanence was addressed and on how much discretion should be retained by host countries. By adopting guidance at COP27 that leaves most of the issues to be addressed by provisions *"to be developed by the Supervisory Body"*, the CMA kicked the proverbial 'can down the road' for another year.

Combining this with the failure to adopt the Supervisory Body's recommendations for a methodological framework for the Art 6.4 Mechanism (essentially agreeing on the acceptable methodologies), meant that the opportunity for investment decisions in respect of activities, that might qualify for the Art 6.4 Mechanism, could not reasonably be taken for another year or until the framework is agreed (hopefully at COP28). This delays investment into Art 6.4 Activities by at least a year. Disagreements on suitable approaches to additionality and baselines seem to have impacted progress.

Many commentators observed that, with baseline and additionality of projects and programmes being such a crucial issue for the integrity of the Art 6.4 Activity, it is better for this not to be rushed. However, as the public debate on appropriate baselines for Verra REDD+ activities has highlighted, there is no one approach to these issues.



Ghana Example: Additionality under the Paris Agreement

Additionality has to be reimagined from the Kyoto Protocol context and reinterpreted in a way that is suitable for the Paris Agreement. It is notable that the Ghana Art 6 Framework has expressly stated that any entities seeking a letter of approval for Art 6.4 Activities in Ghana will not get authorisation for international transfers[10] where those activities are listed in the unconditional part of its NDC. This is consistent with the position Ghana has adopted on additionality for Cooperative Approaches, where it states: *"Ghana shall NOT authorise mitigation outcomes arising from the unconditional mitigation programmes in Ghana's latest NDC for 2021-25. The unconditional NDC mitigation programmes are categorised as the red list … and shall not be considered **additional** to the NDC"*[11] [emphasis added].

Notably, Art 6.4 Activity approval is permitted for activities in 25 programmes that are part of its conditional NDC and a number of listed areas that fall outside of its NDC entirely (e.g., livestock, rice cultivation, flaring in energy industries etc.). Essentially, if the activity is inside the NDC (**Inside NDC**) it is not additional but would be additional if outside the NDC or as part of its conditional NDC (i.e. **Outside NDC**).

10 This does not preclude authorisations for Art 6.4 Activity that doesn't require international transfers.

11 At p.10 paragraph 1.30-1.31 of the Ghana Art6 Framework.

Given the position adopted by Ghana above, beyond the impact this has on its Cooperative Approaches with Switzerland, Singapore and Sweden, it is also a forerunner for its position under the Art 6.4 Mechanism methodology even though the methodology is yet to be adopted by the Supervisory Body. This is also indicative of where the fault lines on additionality may settle.

The challenges, in resolving these and other fault lines, were manifest at COP27 around the rebranding of the COP26 'Japanese solution'. COP26 allowed Paris Agreement Parties that authorised a Mechanism Activity to not authorise the Article 6.4 ERs generated thereunder for Paris Agreement use. Essentially, it allowed Art 6.4 ERs to be issued without a need for the host country to apply a corresponding adjustment to it, thereby enabling a UN backed mechanism for domestic only mitigation outcomes to exist. That solution was offered up to win over the dissenters at COP26 who had refused to accept the illogical requirement for corresponding adjustment to be applied for transfers of ITMOs or Art 6.4 ERs on mitigation activity that was Outside NDC. Those Art 6.4 ERs that do not oblige a host country to carry out a corresponding adjustment have been renamed 'mitigation contribution Art 6.4 ERs' at COP27.

In the section of Decision -/CMA.4 relating to the purpose of the Mechanism Registry, it states that the Mechanism Registry shall track mitigation contribution Art 6.4 ERs which may be used *"**inter alia**, for results based finance, domestic mitigation action pricing schemes, or domestic price-based measures, for the purposes of contributing to the reduction emission levels in the host Party."* It is odd that a provision that describes a function of the Mechanism Registry should narrate, let alone prescribe the use of such mitigation contribution Art 6.4ERs. The use of "inter alia" clearly indicates that the list is non-exhaustive but that has not stopped assertions being made or conclusions being drawn that Art 6.4 ERs cannot be used for the purposes of making offsetting claims. There is a misplaced view that concerns associated with the additionality of a mitigation activity can be cured by insisting on a corresponding adjustment. The extension of that same view argues that an Art 6.4 ER that does not have a corresponding adjustment must therefore be non-additional. To link questions of additionality to the role of corresponding adjustments is simply nonsensical given that they exist to serve two entirely different purposes.

Criteria 3: Environmental Integrity

One of the distinguishing features between Article 6.2 and Article 6.4 of the Paris Agreement is the distinctive requirement for Art 6.4 Activities to *"deliver an overall mitigation in global emissions"* (**OMGE**). By contrast, Article 6.2 requires Cooperative Approaches to promote sustainable development and *"ensure environmental integrity and transparency ..."*. However, the Paris Agreement does not define environmental integrity. So, does the express inclusion of OMGE in the Art 6.4 Mechanism act as a proxy for the express 'environmental integrity' requirement otherwise demanded of Cooperative Approaches? If not, what is 'environmental integrity' for the purposes of a Cooperative Approach?

Article 6.4 and OMGE

As explained by the Alliance of Small Island States (**AOSIS**) in their 2017 submission to the UNFCCC on the subject of operationalising the market mechanisms under Article 6: *"...overall mitigation in global emissions (OMGE) takes place when emission reductions are delivered at a level that goes beyond what would be achieved through the delivery of the Host Party's NDC and the Acquiring Party's NDC in aggregate. This can be achieved by designing the Article 6.4 mechanism to ensure that some verified reductions are not used by either the Host or Acquiring Party toward its NDC."*[12]

The aim to deliver an overall mitigation in global emissions is a new element in the Art 6.4 Mechanism that did not exist under the CDM or Joint Implementation (i.e. the mechanism under Article 6 of the Kyoto Protocol). The Art 6.4 Guidelines include a number of deductions from any Mechanism Activity at the issuance stage. These are set out in the table below.

12 https://www4.unfccc.int/sites/SubmissionsStaging/Documents/167_318_131382305846319606-AOSIS_Submission_Art%206%202%20and%206%204%20of%20%20PA.27.04.2017.FINAL.pdf

Type of Deduction	Percentage of Deduction	Delivery account for the Art 6.4 ERs	Correspondingly Adjusted by host country?
Share of Proceeds for Adaptation (SOP Adaptation)	5% of issued Art 6.4 ERs	Adaptation Fund account in the Mechanism Registry	Yes
OMGE	2% (minimum) of issued Art 6.4 ERs	Mandatory cancellation account for OMGE (i.e. may not be further used)	Yes
Voluntary cancellation for further OMGE	At the discretion of the Activity Participants	Voluntary cancellation account for OMGE	Yes

“One justification that has been used for requiring corresponding adjustments to be applied where an ITMO originates from an emission source that is Outside NDC as part of the Article 6 Guidelines, is that it reduces the incentive for that host to simply sell off its easy to abate emissions without facing penalties, thereby enhancing the environmental integrity of ITMOs that is does sell. Practically, this amounts to using a tool designed for avoiding double counting as a penalty mechanism to compensate for under ambitious NDCs.”

The OMGE element therefore ensures a minimum mandatory cancellation of Art 6.4 ERs to accommodate the objective outlined by AOSIS above. The level of such cancellation can be higher if Activity Participants request so in their Mitigation Activity documentation.

Article 6.2 and Environmental Integrity

The comparative lack of guidance in the Article 6.2 Guidelines leaves it to the Cooperative Approach Parties to determine how their Cooperative Approach will ensure ‘environmental integrity’. In the absence of any Article 6.2 Guidance on the issue, it will be up to the parties to build ‘environmental integrity’ into their Cooperative Approach. So, how does one determine the elements of ‘environmental integrity’ for such purposes? Having considered a number of academic papers[13] on this point, several common principles emerge. These are as follows:

1. **There must be robust accounting of international transfers:** This is primarily to avoid double counting. Partially, this requires clarity as to a party’s NDC targets (e.g., which sectors and gases are Inside NDC and which are not and therefore, are Outside NDC). It also requires certainty around the corresponding adjustments of ITMOs upon transfer. Most of this has now been addressed in clear detail by the Art 6.2 Guidelines.
2. **ITMOs must represent high quality units:** ITMOs can include allowances from a cap and trade system covered by the Cooperative Approach or emission offsets such as reductions or removals. The characteristics of the different units then invite consideration of different features. For example, if the ITMO is a cap and trade allowance, is the cap *“set below the emissions level that would occur in the absence of the trading system…”*[14]? How ambitious are the targets? In contrast, if the ITMO is an offset unit, factors such as the additionality of the mitigation action leading to the creation of the offset unit or the overestimation of the reductions by reference to a baseline will be relevant considerations.
3. **Ambition and scope of the mitigation target of the transferring country:** The ambition and scope of the host Cooperative Approach Party’s NDC may be a factor in determining the integrity of the ITMO because it highlights the effort that country went through in order to make available that ITMO for sale to another country. The weaker a host Cooperative Approach Party’s NDC, the more likely it will overachieve its NDC, therefore giving it plenty to ITMOs to sell, in exchange for very little effort. Instances of ‘hot air’ were widely seen in the context of unilateral issuances of Track 1 Joint Implementation units under the Kyoto Protocol (a scenario that could be repeated if unilateral Art.6.2 declarations of ITMOs are permitted). One justification that has been used for requiring corresponding adjustments to be applied where an ITMO originates from an emission source that is Outside NDC as part of the Article 6 Guidelines, is that it reduces the incentive for that host to simply sell off its easy to abate emissions without facing penalties, thereby enhancing the environmental integrity of ITMOs that is does sell. Practically, this amounts to using a tool designed for avoiding double counting as a penalty mechanism to compensate for under ambitious NDCs.
4. **Incentives or disincentives for future mitigation action:** This is best understood from the comparative strength and weakness of the two or more Cooperative Approach Parties’ ambition levels arising from

13 For example, (i) The World Bank. ‘Ensuring Environmental Integrity Under Article 6 Mechanisms,’ World Bank Working Paper, Washington DC, and (ii) ‘Environmental integrity of international carbon market mechanisms under the Paris Agreement’, L Schneider, S, Theuer, Climate Policy, 2019, Vol.19, No.3, 386-400.

14 ‘Environmental integrity of international carbon market mechanisms under the Paris Agreement’, L Schneider, S, Theuer, Climate Policy, 2019, Vol.19, No.3, 386-400.

having a Cooperative Approach and not having one. The idea behind Article 6.2 is for it to be used to enhance the ambition of the respective Cooperative Approach Parties. For example, for a buying country this might mean taking on greater NDC ambition knowing that cost of meeting that ambition is capable of being met more efficiently by buying ITMOs. Imagine Singapore or Japan's NDCs in 10 years' time once they have run out of energy efficiency and other low carbon energy options. For a selling country, this might mean a chance to finance its conditional NDCs so that it can achieve more mitigation without the cost becoming a burden on its economy. Of course, if the buying country's attitude is merely to lock in supply and not care whether they are sourcing from inside or outside a country's NDC sectors, then this could lead to ITMOs with comparatively weaker environmental integrity. However, since this is left to the Paris Agreement Parties who wish to enter into a Cooperative Approach, it essentially boils down to political will and the commercial interests of the negotiating parties. This could lead to a situation where arguably, not all ITMOs are of the same quality.

On balance, therefore, when considering acquiring ITMOs generated through the various Cooperative Approaches that are in place or being put in place, this will require an analysis of the legal framework supporting the Cooperative Approach together with an analysis of the relative factors that impact the environmental integrity of those ITMOs. Even though these will be UN endorsed units, for the reasons outlined above, some Cooperative Approach ITMOs may be better than others.

Conclusion

By reference to the three criteria discussed above, (i) private sector participation, (ii) infrastructure development and (iii) environmental integrity, it seems that the Art 6.4 Mechanism offers greater promise than Cooperative Approaches under Article 6.2:

- **Private sector participation:** Many of the existing Cooperative Approaches (e.g., those involving Switzerland to date) have not built in mechanisms affording the level of protection that private sector participants would find necessary or desirable. It is not clear whether the Cooperative Approaches that are currently the subject of MOUs will be any better. The majority seem to be approaching this as a G2G opportunity and not a G2G plus B2B opportunity. In contrast, the private sector role in the Art 6.4 Mechanism is hardwired into the Paris Agreement and Art 6.4 Guidelines.
- **Infrastructure development:** The Art 6.4 Mechanism infrastructure is centralised and therefore less dependent on the individual Paris Agreement country's respective state of readiness to become operational. Since the Supervisory Body is a UN organisation, it will have all the disadvantages of bureaucratic hurdles an organisation like this will have to jump through before it can make the Mechanism Registry operational or link it to the International Registry, but once it is done, it is done. In contrast with the plethora of Cooperative Approaches, most of which are bilateral, the question around those registries' linkages to the International Registry infrastructure will vary based on the respective stages of their progress and development.
- **Environmental integrity:** The environmental integrity of the Art 6.4 ERs generated by the Art 6.4 Mechanism (which, when transferred internationally, become ITMOs) via the OMGE is guaranteed to at least a minimum standard. It is not clear that an equivalent level of assurance will arise from ITMOs generated by the Cooperative Approaches that are currently being put in place. It will add to the inefficiencies of private sector participants that they will have to assess the quality of the Cooperative Approach to become comfortable with the environmental integrity of the ITMOs generated by that Cooperative Approach.

Ultimately, to attract private sector capital into the Article 6 mechanisms, efficiencies of scale will be a key feature. On that test, the Art 6.4 Mechanism also offers greater promise than Cooperative Approaches.
That is not to say that multi-party Cooperative Approaches, involving a group of selling and buying countries with some depth in their supply and demand, could not achieve the efficiencies of the Art 6.4 Mechanism; it is just that there don't seem to be many such approaches planned for at the moment and they would also need to take into consideration the issues raised in relation to the three criteria discussed above.

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