INTERNATIONAL

WHAT DOES THE COP26 OUTCOME ON ARTICLE 6 MEAN FOR NON-PARTY STAKEHOLDERS?

by

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EXECUTIVE SUMMARY

Article 6 of the Paris Agreement established a framework for countries to cooperate in achieving their climate commitments (nationally determined contributions, NDCs), using market mechanisms to enable greater ambition than they could achieve independently. The Paris Agreement implementing guidance finalized at COP26 in Glasgow provides direction to countries that transfer emissions reductions under Article 6. This paper explains that COP26 outcome and its relevance for companies and other non-Party stakeholders (NPS).

In effect, the guidance recognizes a pathway for the use of credits in the voluntary carbon market (VCM), without restricting their ability to operate independently of UN oversight. The country where the emissions reductions originate (host country) may authorize the emissions reductions from mitigation projects for use toward "other purposes," including voluntary corporate commitments, in which case it must account for the transfer in its emissions balance (corresponding adjustment), so that the emissions reductions represent mitigation above and beyond the host country's climate commitment. Alternatively, non-authorized emissions reductions may be used by the host country toward its NDC, in which case the purchase of the carbon credit effectively represents a financial contribution toward implementing the host country's mitigation commitment, and no corresponding adjustment is made.

This paper provides a detailed analysis of the atmospheric impact (that is, the net effect on emissions reductions) of the international transfer and use of voluntary carbon credits by NPS. It also describes efforts underway to ensure the environmental integrity of the voluntary carbon market, including the Voluntary Carbon Markets Integrity initiative (VCMI) and the Integrity Council for the Voluntary Carbon Market (IC-VCM), as well as broader considerations around engaging in the VCM and carbon credits' authorization status.

Key conclusions:

1. The atmospheric impact of the resulting carbon credit does not depend on their authorization status; it can be neutral, harmful, or beneficial depending on the scopes of the countries' NDCs and the actions of the buyer (the NPS).
2. The key condition for voluntary carbon credits (whether authorized or non-authorized) to have a beneficial impact for the atmosphere is that emissions reductions in the buyer's country are the same as they would have been in the absence of the credit—a condition that is satisfied if the buyer's own emissions are within the scope of its country's NDC or if the buyer uses the credit for "beyond value-chain mitigation."
3. Non-authorized units are most valuable to the atmosphere when the emissions reductions are generated outside the host country's NDC.

BACKGROUND

Article 6 of the Paris Agreement applies to market-based approaches at the level of countries—more specifically Parties to the Paris Agreement. Parties can choose whether to participate in these market-based approaches or not. In other words, Article 6 has no direct impact or regulatory control over carbon markets that involve NPS.[1]

The term 'voluntary carbon market' (VCM) applies to any carbon market that is not exclusively between countries and is not a compliance market.[2] NPS have participated over the past 15 years or so in the VCM, which was born out of companies' interest to expand the pool of carbon credits or offsets supplied by the Kyoto Protocol's Clean Development Mechanism (CDM).

Article 6.2 of the Paris Agreement established high-level principles regarding the implementation of cooperative approaches, which essentially envisage arrangements between two or more Parties involving the international transfer of greenhouse gas emissions reductions or "mitigation outcomes" (units traded are called "internationally transferred mitigation outcomes", or ITMOs) in a way that facilitates the achievement of mitigation targets in Nationally Determined Contributions (NDCs) of the buying country. These high-level principles include environmental integrity and transparency, and the avoidance of double counting.

Article 6.4 established an international mechanism to credit reductions and removals in greenhouse gas emissions from projects through approved methodologies, so that they can be used by one Party as Article 6.4 emissions reductions (A6.4ERs) or transferred internationally as ITMOs to be used by another Party to fulfill the mitigation target in its NDC. In general terms, Article 6.4 can be seen as an evolution of the CDM.

COP26 OUTCOME ON ARTICLE 6

At the 26th Conference of the Parties (COP26), Parties completed most of the implementing guidance needed to fully operationalize Article 6 with regard to market-based cooperative approaches.[3] Below are the significant takeaways:

- In order to operationalize the no-double-counting provision in Article 6.2, the guidance sets out that the transfer of all ITMOs requires a corresponding adjustment. The application of a corresponding adjustment entails that the host country (the Party in which the ITMOs originate) accounts for the transfer so the emissions reductions are not counted toward its NDC. This is necessary to ensure that the recipient country (or other purchaser) becomes the sole user of the emissions reductions when counting these toward its NDC (or other obligation or target).
  - An A6.4ER becomes an ITMO when internationally transferred, therefore subject to the definitions, rules, and procedures set out in Article 6.2.
- Article 6.4 activities are required to demonstrate both financial and regulatory additionality.[4]
  - Articles 6.2 and 6.4 allow countries to authorize ITMOs and A6.4ERs to be used for "other international mitigation purposes," such as by NPS in the voluntary carbon market.[5] It is through this 'use authorization' that there is a possibility of an indirect link between Article 6 and the VCM.
- The corresponding adjustment for ITMOs and A6.4ERs is triggered by the host country authorizing the emission reduction unit for use toward an NDC or "other international mitigation purposes".[6]
  - When the A6.4ER is authorized for use by a NPS domestically for other purposes (i.e., the VCM), the host country still needs to apply a corresponding adjustment.

It is the host country that decides whether an ITMO or A6.4ER is authorized and specifies its use, toward achieving another country's NDC or for "other purposes," such as in the VCM. If the host country authorizes ITMOs or A6.4ERs to be used for other purposes, NPS can buy these emissions reductions for their exclusive use and claim; in which case the host country cannot count those emissions reductions toward its NDC.

Alternatively, a host country may decide not to authorize the emission reduction. In this case, no corresponding adjustment is made, and the resulting emissions reductions will be counted toward the host country's NDC. In effect, the voluntary purchase by NPS of carbon credits not authorized for other purposes thus represents a financial contribution toward implementing the host country's mitigation commitment.

However, there is still some uncertainty regarding how the process of authorization and consequent application of a corresponding adjustment will work in practice. There are ongoing discussions on the way in which carbon credits authorized under Article 6 for other purposes used in the VCM could be best accounted for. Under the Paris Agreement, Parties have obligations to report: (i) on their emissions through their national greenhouse gas inventories; and (ii) on their progress toward the achievement of their NDC in a biennial transparency report, by calculating the emissions balance including any corresponding adjustments for ITMOs and A6.4ERs transferred and authorized for other purposes.[7] In the VCM, the major standard setting organizations will record and track such correspondingly adjusted emissions reductions in their own registries with unique identifiers that differentiate these from non-authorized ones. Thought needs to be given to whether participants in the VCM should work toward providing a unified approach[8] making it easier to analyze the voluntary carbon market's contribution toward overall mitigation in global emissions.

IMPLICATIONS FOR THE VOLUNTARY CARBON MARKET

As in Article 6, a unit traded in the VCM represents a ton of carbon dioxide equivalent reduced or removed. Governed by private standards and not by international or national regulatory bodies, the VCM is essentially driven by NPS demand for carbon credits to meet voluntary climate commitments, beyond any greenhouse gas reductions and removals mandated by policy. Efforts to standardize and ensure the integrity of voluntary markets include:

- The IC-VCM, which is establishing Core Carbon Principles (CCPs) to serve as a threshold quality standard for high-integrity carbon credits, and will assess VCM methodologies and programs based on these principles.[9]
- The VCMI, which sets guidelines for credible and transparent claims by NPS when using carbon credits, as a function of both a company's efforts to decarbonize its own value chain and to contribute to 'societal net-zero' through the purchase of high-quality carbon credits.[10]

There are multiple reasons why NPS—and companies in particular—might want to participate in the VCM:

- Companies can use carbon credits as they seek to align their emissions with a net-zero pathway, and as a complement to emissions reductions within their value chains.
  - The claims guidelines developed by VCMI will be of particular relevance here.
- Companies can support host communities' sustainable development through the potential environmental and socio-economic co-benefits associated with high-integrity mitigation activities in host countries that they can help finance (e.g., job creation, diminished local pollution, biodiversity conservation).
  - The IC-VCM is including social and environmental considerations in its CCPs, and may also "tag" credits with certain attributes (such as co-benefits).

ATMOSPHERIC IMPACT OF AN EMISSION REDUCTION TRANSFER

The atmospheric impact of an emission reduction transfer—that is, its effect on overall mitigation—will depend on the authorization status of the credit, the use that is made of it, and the scope of NDCs.[11]

To analyze the net impact of a transfer, we can separately consider the effects on the emissions reductions in the host country that generates the credit and in the home country of the NPS that purchases the credit (i.e., the buyer's country).[12]

The impact of a transfer on the emissions reductions in the host country depends on whether the credit is authorized and on whether it is generated inside or outside the country's NDC.

- A transfer of an authorized credit results in the host country reducing its emissions relative to the no-transfer case. That is because the requirement to make a corresponding adjustment ensures that the host country must reduce its emissions by more than it would have done otherwise in order to meet its NDC, regardless of whether the credit is generated inside or outside the country's NDC. (If the transfer makes it less likely that the country will meet its NDC, overall emissions may fall by less than the amount represented by the [correspondingly adjusted] transfer.)
- The impact of transferring a non-authorized credit depends on whether the emission reduction used to generate the credit lies inside or outside the scope of the host country's NDC. A non-authorized credit generated *inside* the host country's NDC will not affect the country's emissions much, if at all. If the host country would have met its NDC anyway, the effect of the transfer is zero: in effect, the buyer (e.g. a company) is indirectly facilitating the achievement of the host country's climate commitment through the provision of otherwise unavailable finance that allows for the mitigation activity to occur. If the host country might not have met its NDC, and the purchase of the credit makes it more likely that it will do so due to the provision of additional finance, then the transfer can be considered to result in slightly greater emissions reductions than would otherwise have been the case.
- A non-authorized credit generated *outside* the host country's NDC will result in greater emissions reductions than would have occurred without the transfer.

Meanwhile, the impact of a transfer on the emissions reductions in the buyer country depends on how the credit is used by the buyer and whether the buyer's emissions lie inside or outside the buyer country's NDC.

- If the buyer's emissions lie *inside* the buyer country's NDC, the transfer will have little to no impact on the buyer country's emissions reductions. If the buyer uses the credit for "beyond value chain mitigation," the transfer will not affect emissions in the buyer country. Even if the buyer uses the credit to offset its own emissions, the transfer will not affect emissions reductions in the buyer country as long as the buyer country still meets its NDC; to the extent that the buyer's decision to not reduce its own emissions as much makes it harder for its country to meet its NDC, the transfer would result in slightly less emissions reductions in the buyer country with respect to the no-transfer case.
- If the buyer's emissions are *outside* the buyer country's NDC (as could be the case if the buyer is in an emerging economy or developing country without an economy-wide NDC), the transfer could increase the buyer country's emissions. As before, if the buyer uses the credit for beyond value chain mitigation, the transfer will not affect emissions in the buyer country. However, if the buyer uses the credit to offset emissions that it would otherwise have reduced, then overall emissions reductions in the buyer country will be less than they would have been in the no-transfer case.

The above assumes that the transferred units comply with the principles for environmental integrity defined in the Article 6 guidance.[13] Given this assumption, cooperative approaches and (international) carbon markets reduce the cost of mitigation action and provide additional finance flows, while in nearly all cases having a neutral or beneficial overall impact on the atmosphere – and, ideally, enabling greater mitigation ambition from Parties and non-Party stakeholders alike. The Paris Agreement ambition cycle[14] is an important pressure mechanism in this regard.

These various scenarios are summarized in **Table 1**. The rows correspond to the scope of the NDCs in the host and buyer countries; for example, "Inside → Outside" refers to the case where the emissions reductions to generate the credit are inside the scope of the host country's NDC, but the credit is used toward an obligation that is outside the NDC of the country the buyer is in.

From this analysis we conclude that:

- The authorization status of emissions reductions transferred in the voluntary carbon market (VCM) does not, on its own, determine the atmospheric impact of the resulting carbon credit. In particular, whether credits are authorized or not, their use can be neutral, harmful, or beneficial depending on the scopes of the countries' NDCs and whether the buyer (the NPS) reduces its own emissions by the same amount as it would have absent the credit—although as **Table 1** shows, in most cases the impact is neutral or beneficial.
- The key condition for voluntary carbon credits (whether authorized or non-authorized) to have a beneficial impact for the atmosphere is that the buyer (or more generally the buyer's country) achieves the same reductions in its own emissions as it would have in the absence of the credit. This condition is satisfied if the buyer's own emissions are within the scope of its country's NDC[15] or if the buyer uses the credit for beyond value chain mitigation, rather than to offset emissions that it would have reduced otherwise.
- Overall, non-authorized units used in the VCM are most valuable to the atmosphere when the emissions reductions are generated outside the host country's NDC, since such reductions represent additional effort over and above what the host country would have achieved otherwise.

These conclusions underscore the importance of initiatives to ensure the integrity of voluntary carbon credits and the credibility of corporate claims, such as the IC-VCM and VCMI.

Table 1: Atmospheric impact of voluntary carbon credit transfer and use under various scenarios

REDUCTION INSIDE OR OUTSIDE SCOPE OF NDC OF HOST COUNTRY → CREDIT USED TOWARD AN OBLIGATION THAT IS INSIDE OR OUTSIDE THE NDC OF BUYER'S COUNTRY	CREDIT IS AUTHORIZED BY HOST COUNTRY FOR "OTHER PURPOSES" AND A CORRESPONDING ADJUSTMENT IS MADE	CREDIT IS NOT AUTHORIZED, AND NO CORRESPONDING ADJUSTMENT IS MADE
Inside → Inside	**Beneficial**: Host country must do more to reduce emissions; buyer's country does about the same as it would have otherwise in order to meet NDC	**Neutral**: Both countries achieve about the same emissions reductions as they would have otherwise
Outside → Inside		**Beneficial**: Host country does more than under its NDC, buyer's country does about the same as it would have otherwise
Inside → Outside	**Depends on credit use**: Host country must do more to reduce emissions. If the buyer uses the credit for beyond value chain mitigation, the effect is beneficial. If the buyer uses the credit to fully offset emissions, it would otherwise have reduced, the effect is neutral or even slightly harmful	**Depends on credit use**: Host country does about the same. If the buyer uses the credit for beyond value chain mitigation, the effect is neutral or can even be slightly beneficial. If the buyer uses the credit to fully offset emissions it would otherwise have reduced, the effect is harmful
Outside → Outside		**Beneficial to Neutral**: Host country does more than under its NDC. If the buyer uses the credit for beyond value chain mitigation, the effect is beneficial. If the buyer uses the credit to fully offset emissions, the effect is neutral

Notes: The key assumptions underlying this analysis are: (i) that voluntary carbon credits being transferred have high environmental integrity (i.e., represent real, additional, durable emissions reduction); and (ii) that the marginal impact of the generation and use of the credit on the likelihood that the host country or the buyer's country will meet its NDC is small and comparable in size in the host and buyer countries. Cf. Lambert Schneider, "Addressing double claiming for the voluntary carbon market," webinar presentation (8 July 2020), available at https://www.oeko.de/fileadmin/oekodoc/Voluntary-market.pdf.

TO AUTHORIZE OR NOT TO AUTHORIZE? CORRESPONDING ADJUSTMENTS AND THE VCM

Many practical aspects of voluntary carbon market credits, including how credits are generated, registered, and transacted, will be unaffected by their authorization status (i.e. whether a corresponding adjustment is applied to them or not). However, whether VCM credits are authorized or not will have implications for how they can be used by NPS—and the role they play in climate action. There is ongoing debate on the issue of corresponding adjustments in the voluntary carbon market, in terms of whether, when, and how they should be used or even required. Meanwhile, below are preliminary considerations that may help VCM participants better assess their options.

NPS considering the purchase of emissions reductions that are authorized under Article 6 for other purposes (i.e., correspondingly adjusted credits) may take the following into account:

- Such credits support the 'societal' long-term goal of a just transition to 1.5 degrees C: Because the underlying emissions reductions are not counted toward an NDC, they represent reductions above and beyond what the host country must do to meet its climate target.
- NPS may find potential reputational benefit from contributing to mitigation beyond the host country's NDC.
- Depending on the final VCMI guidance or further discussion among voluntary carbon market stakeholders, companies may be able to make more expansive claims when using authorized credits with corresponding adjustments —for example, claiming those credits as compensation for their own emissions.
- NPS seeking to purchase authorized emissions reductions may not know whether the reduction or removal project of interest will generate credits that will receive authorization because host countries have discretion over it. Some host countries may prefer to wait to authorize credits for use in the VCM until they have more confidence that they will meet their NDCs, or have a well-defined strategy for doing so. This uncertainty may complicate decisions to invest in such projects.

NPS considering the purchase of non-authorized emissions reductions (without corresponding adjustments), certified through Article 6.4 methodologies or other crediting standard, may take the following into account:

- By purchasing (and retiring) emissions reductions without corresponding adjustments, NPS are supporting the host country in meeting its NDC. In effect, this represents a form of climate finance, as explained above.
- NPS should still ensure that they are buying only high-quality credits that represent real and additional emissions reductions, such as those meeting the IC-VCM standard.
- Depending on the final VCMI guidance or further discussion among voluntary carbon market stakeholders, NPS may use non-authorized credits to compensate for their emissions beyond any reduction or removal established in NDCs and mandated by policy, in order to avoid risks of double counting between NDCs.
- Whether or not the use of corresponding adjustments for voluntary carbon credits is a matter of environmental integrity is still a subject of active discussion among voluntary carbon market participants. Essentially, the debate hinges on whether voluntary climate commitments may appropriately be treated as separate and distinct from NDCs for accounting purposes, or whether the voluntary carbon market and transfers under Article 6 should be considered as a single system. The VCMI has acknowledged the open debate and the IC-VCM has requested comment on the appropriate treatment of corresponding adjustments as part of its public consultation.[16]

Finally, from a host country perspective, there are different considerations to make when engaging in the VCM. Regarding authorized units:

- Countries with ambitious NDCs may want to ensure that they can meet their climate commitments before authorizing and transferring emissions reductions including for other purposes, as a corresponding adjustment would require them to further reduce emissions.
  - This raises a potential perverse incentive in terms of NDC ambition: countries with commitments that are relatively easy to meet, or that do not cover all sectors, may be more willing to authorize emissions reductions.
  - Recognizing this potential incentive, NPS (including companies interested in buying voluntary carbon credits as well as civil society) may seek to purchase credits only from countries with

relatively ambitious NDCs, and encourage others to do likewise.

- On the other hand, authorized emissions reductions may earn a price premium if potential buyers of credits see additional value from the reputational benefit of securing additional reductions, or from the ability to claim those emissions reductions toward their own commitments (to the extent allowed by VCMI guidance or further discussion among voluntary carbon market stakeholders).

Regarding non-authorized units:

- Countries may value the use of non-authorized units in the VCM as a form of climate finance that can supplement emissions reductions achieved through public spending or incentivized by a domestic carbon pricing scheme (e.g., carbon tax or emissions trading system).
- Countries may currently lack the institutional capacity in place to authorize emissions reductions for other purposes and make corresponding adjustments.

In either case, host countries will benefit from the potential environmental and socio-economic value-added that comes with these additional mitigation activities, as mentioned earlier.

Other C2ES Resources:

COP 27: Pivoting from negotiation to implementation (Blog), October 2022.

COP27: Considerations for a Loss & Damage Finance Facility, October 2022.

COP27: The Mitigation Work Programme & The Ministerial Roundtable, October 2022.

The Santiago Network: Decision Options for COP27, October 2022.

What does the COP26 outcome on Article 6 mean for non-Party stakeholders? (Blog), April 2022.

Designing a Meaningful Global Stocktake, January 2022.

ENDNOTES

1 Non-Party stakeholders is a term used by the United Nations Framework Convention for Climate Change (UNFCCC) to indicate all stakeholders to the Paris Agreement that are not signatory countries, namely, civil society (e.g. businesses, NGOs, academia, organized youth and communities), sub-national governments (e.g. state, regional, and local), and single individuals.

2 A compliance market (of which the EU ETS is an example) is one that is meant to create an economic incentive for companies to comply with regulation. This regulation usually consists of an emission cap for industry sectors declined to regulate single emitting entities within a jurisdiction (or several linked jurisdictions). This is an efficient way for a jurisdiction to achieve its emission reduction target while allowing regulated entities to make profits through the trading of carbon credits or emission permits ('allowances').

3 Article 6.2 and Article 6.4 https://unfccc.int/sites/default/files/resource/cma2021_10_add1_adv.pdf#page=41.

4 That is, A6.4ER certification requires the Article 6.4 activity to demonstrate that it would not have occurred without the incentives from the mechanism, and that it takes into account existing and developing policies of the host country when setting the baseline from which to calculate the achieved emissions reductions.

5 The term "other international mitigation purposes" applies to the use of emission reduction units by non-Party stakeholders, regardless of their geographical location. The term "other purposes" will be used in this paper hereafter to refer to the use of emission reduction units in the voluntary carbon market and/or domestic compliance markets, as specified.

6 The timing of the application of a corresponding adjustment coincides with the "first transfer" of the emission reduction. When authorizing a mitigation outcome, the host country can define "first transfer" at the point of (i) authorization, or (ii) issuance, or (iii) use or cancellation of the mitigation outcome, as per paragraph I in the Article 6.2 guidance.

7 Enhanced Transparency Framework decision at COP26, https://unfccc.int/sites/default/files/resource/cma3_auv_5_transparency_0.pdf.

8 See ICROA, December 2021: Article 6 of the Paris Agreement and implications for the Voluntary Carbon Market https://www.icroa.org/_files/ugd/653476_4cb8eae730b04813b63180619f16ae5b.pdf.

9 ICVCM website https://icvcm.org/.

10 VCMI website https://vcmintegrity.org/.

11 The analysis in this section is distinct from the potential impact of the share of Article 6.4ERs cancelled under the Overall Mitigation in Global Emissions (OMGE) requirement in Article 6 of the Paris Agreement. The COP26 outcome established that Article 6.4ERs first transferred undergo a 'haircut' of 2% in volume, i.e. a share of carbon credits are cancelled, i.e. withdrawn from the market to the sole benefit of the atmosphere. For internationally transferred mitigation outcomes that do not stem from credited Article 6.4 activities, there is no such OMGE requirement, although Parties and (non-Party) stakeholders are strongly encouraged to cancel some share of ITMOs so that they are not counted towards any Party's NDC or used for other international mitigation purposes. For Article 6.4ERs, the mitigation achieved by OMGE would be in addition to the impact analyzed in this section.

12 For another analysis with a somewhat different approach but broadly similar conclusions, see Lambert Schneider, "Addressing double claiming for the voluntary carbon market," webinar presentation (8 July 2020), available at https://www.oeko.de/fileadmin/oekodoc/Voluntary-market.pdf.

13 Article 6 requires units to be real, verified, additional, and Parties to demonstrate the quality of the mitigation outcome including through conservative baselines and addressing any risk of non-permanence, among other requirements.

14 Paris Agreement Q&A https://www.c2es.org/content/paris-climate-agreement-qa/.

15 Article 4.4 of the Paris Agreement requires that all countries move toward economywide NDCs over time.

16 Besides this issue, the IC-VCM has consulted on two other questions regarding the alignment of the threshold standard with the Paris Agreement, namely, provisions for a Share of Proceeds for adaptation finance and Overall Mitigation of Global Emissions (OMGE).

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