

SUBSIDIARY BODY FOR SCIENTIFIC AND TECHNOLOGICAL ADVICE

Thirteenth session

The Hague, 13-18 November 2000

Agenda item 7

SUBSIDIARY BODY FOR IMPLEMENTATION

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**MECHANISMS PURSUANT TO ARTICLES 6, 12 AND 17
OF THE KYOTO PROTOCOL**

ARTICLE 17 OF THE KYOTO PROTOCOL

**Draft conclusions by the chairmen of the Subsidiary Body for Scientific and
Technological Advice and Subsidiary Body for Implementation**

At their joint meeting on 18 November 2000, the subsidiary bodies agreed to forward the draft decision on principles, modalities, rules and guidelines for emissions trading to the Conference of the Parties at its sixth session for further consideration.

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(Note: The text of this decision is from document FCCC/SB/2000/10/Add.3.)

**[Draft decision [C/CP.6]: Principles, modalities, rules and guidelines
for emissions trading**

The Conference of the Parties,

Recalling its decision 1/CP.3, in particular paragraph 5 (b) of that decision,

Recalling also its decisions 7/CP.4 and 14/CP.5,

Taking into account Articles 4 and 12 of the Convention and Articles [3 and 17] [2, 3, 4, 5, 7, 11, 17 and 18] of the Kyoto Protocol, [and reflecting provisions contained in appendix X to the annex to this decision],

Bearing in mind Articles 3 and 17 of the Kyoto Protocol, in accordance with which, any part of an assigned amount which a Party included in Annex B to the Kyoto Protocol transfers to another Party included in Annex B to the Kyoto Protocol shall be subtracted from the assigned amount for the transferring Party, and any part of an assigned amount which such Party acquires from another Party shall be added to the assigned amount for the acquiring Party, keeping in view that any such transfers and acquisitions are only for the purpose of contributing to the achievement of compliance with the quantified emission limitation and reduction commitments in Article 3 of the Kyoto Protocol without altering the assigned amount of the Parties pursuant to their quantified emission limitation and reduction commitments inscribed in Annex B,

Recognizing that the Kyoto Protocol has not created or bestowed on Parties included in Annex I to the Convention and in Annex B to the Protocol any right, title or entitlement to emissions of any kind in the pursuance of Articles 6, 12 and 17 of the Kyoto Protocol and further recognizing that emissions trading under Article 17 is only for the accounting of transfers and acquisitions of parts of assigned amounts for the purpose of fulfilling commitments under Article 3.

Further recognizing that emissions trading under Article 17 is only for the accounting of transfers and acquisitions of parts of assigned amounts for the purpose of fulfilling commitments under Article 3,

Affirming that, in their actions to achieve the purpose of emissions trading, the Parties included in Annex B to the Kyoto Protocol shall be guided by Article 2 of the Convention and the principles contained in Article 3 of the Convention and, inter alia, the following considerations:

[Equity between developed and developing countries relates to equitable per capita emission entitlements for developing country Parties, keeping in view that per capita emissions in developing countries are still relatively low and that the share of global emissions originating in developing countries will grow to meet their social and development needs, taking fully into account that economic and social development and poverty eradication are the first and overriding priorities of such Parties, while affirming that developed country Parties shall continue to limit and reduce their emissions with the aim of attaining lower levels of emissions

through domestic policies and measures with a view to reducing per capita inequities in emissions between developed and developing country Parties;

[Recognizing that the Protocol has not created or bestowed any right, title or entitlement to the Parties included in Annex I to the Convention and in Annex B to the Kyoto Protocol and that it has not created an international market system or regime for emissions trading;]

[Emissions trading is only for accounting of transfers and acquisitions of parts of assigned amounts between Parties included in Annex B to the Kyoto Protocol for fulfilling their commitments under Article 3 of the Kyoto Protocol;]

Transparency;

[Climate change effectiveness: Real, measurable and long-term benefits related to the mitigation of climate change shall be achieved.] [Overall emission reductions must not be lower than would otherwise be the case;]

[Special situations of developing country Parties that are particularly vulnerable to the adverse effects of climate change and impacts of mitigation activities: emissions trading should be implemented in such a way as to minimize adverse social, environmental and economic impacts on developing country Parties, particularly those identified in Article 4, paragraphs 8 and 9, of the Convention;]

[Fungibility/non-fungibility: Parties [may][shall][not] exchange emission reduction units[, certified emission reductions] and [assigned amount units] [parts of assigned amount] [in accordance with rules and procedures established by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol to ensure their effective environmental equivalence.]

1. *Adopts*, in accordance with these principles, the modalities, rules and guidelines, in particular for verification, reporting and accountability for emissions trading contained in the annex to this decision;
2. *Decides* that the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol shall have the authority to accept or reject acquisitions and transfers of parts of assigned amount that have been reported by the Parties participating in emissions trading;]
3. *Urges* the Parties included in Annex I to facilitate the participation in emissions trading of Parties included in Annex B undergoing the process of transition to a market economy;
4. *Decides also* that a share of proceeds, in accordance with provisions in the annex to this decision, to be used in accordance with Article 12 paragraph 8, of the Kyoto Protocol, shall be applied to transactions under Article 17 of the Kyoto Protocol and shall be [x per cent of y], of which [no more than z per cent] shall be allocated to administrative expenses and [no less than 100-z per cent] to the adaptation fund¹. The share of proceeds for assisting in meeting adaptation

¹ An adaptation fund shall be established to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change, in particular least developed countries and the small island developing States

costs shall be additional to financing by Parties included in Annex I of adaptation activities under other provisions of the Convention and the Protocol;]

5. *Further decides* that any future revision of the modalities, rules and guidelines in the annex shall [be made by consensus and shall] take into account the experience of Parties to the Protocol, bearing in mind that:

(a) The first review shall be carried out no later than one year after the completion of the first additional period for fulfilling commitments²;

(b) Further reviews shall be carried out [periodically thereafter] [at three-year intervals or upon the request of ...].

6. *Requests* [the secretariat of the Convention] to perform functions assigned to it as contained in this decision and its annex³.

7. [*Resolves* to take decisions [, at its ___ session,] to:

(c) Define the roles of verification and auditing entities, including private sector entities;

(d) Issue guidelines on national allocation and accountability procedures for legal entities;

(e) Track the potential for distortion of competition and include standard checks in the guidelines.]]

amongst them, and/or developing country Parties that are particularly vulnerable to the impact of the implementation of response measures, under Articles 6 and 17, to meet the costs of adaptation.

² As defined in the procedures and mechanisms on compliance.

³ The resource implications of this operative paragraph will need to be specified.

Annex

MODALITIES, RULES AND GUIDELINES FOR EMISSIONS TRADING

[Definitions

For the purpose of this Annex:

- (a) “Party” means, unless the context otherwise indicates, a Party to the Protocol.
- (b) “Protocol” means the Kyoto Protocol to the United Nations Framework Convention on Climate Change, as adopted on 11 December 1997.
- (c) “Party included in Annex I” means a Party included in Annex I to the Convention, as may be amended, or a Party which has made a notification under Article 4, paragraph 2(g) of the Convention, and is a Party to the Kyoto Protocol.
- (d) “Party not included in Annex I” means a Party not included in Annex I to the Convention, as may be amended, and which has not made a notification under Article 4, paragraph 2(g) of the Convention, and is a Party to the Kyoto Protocol.
- (e) “Article” means an Article of the Protocol, unless otherwise indicated;
- (f) [“Assigned amount units” or “AAUs”] [“Parts of assigned amount” or “PAAs”] are [serialized parts of the assigned amount of a Party included in Annex B] [units calculated pursuant to Article 3, paragraphs [3, 4,] 7 and 8].
- (g) “Emissions reduction units” or “ERUs” are units [issued] [transferred] pursuant to Article 6 and requirements thereunder;
- (h) “Certified emissions reductions” or “CERs” are units issued pursuant to Article 12 and requirements thereunder;
- (i) [AAUs][PAAs], ERUs and CERs are units each equal to one tonne of carbon dioxide equivalent, calculated using global warming potentials defined by decision 2/CP.3 or as subsequently revised in accordance with Article 5;
- (j) [“Assigned amount” includes [AAUs][PAAs], ERUs, and CERs.]]

*(Note: Paras. 1 and 3 below refer to requirements for **eligibility of Parties included in Annex I**. These paras. may have linkages with decisions --/CP.6 establishing procedures and mechanisms on compliance.)*

Option 1: para. 1

1. A Party included in Annex I may [transfer and] acquire parts of assigned amount under the provisions of Article 17 if the Compliance Committee has decided that the Party has demonstrated that it has met the eligibility requirements in paragraph 3 (g) [(h)] [(i)] [(j)] [(k)] [(l)] below.

Option 2: para. 2

2. A Party included in Annex I may:

(a) Transfer and acquire any part of an assigned amount under the provisions of Article 17 after [XX⁴] months have elapsed since the submission of a report to the secretariat documenting that it meets the requirements in subparagraphs (b) through (e) [and (g) through [(i)][(1)]] of paragraph 3, unless the Compliance Committee has found that it has not met one or more of such requirements;

(b) Transfer and acquire any part of an assigned amount under the provisions of Article 17 at an earlier date if the enforcement branch of the Compliance Committee has notified the secretariat that it is not proceeding with any question of implementation relating to the requirements in subparagraphs (b) through (e) [and (g) through [(i)][(1)]] of paragraph 3;

(c) A Party may continue to participate in emissions trading, unless and until the Compliance Committee has found that it has not met one or more of the requirements in subparagraphs (b) through (f) [and (g) through [(i)][(1)]] of paragraph 3. If the Compliance Committee has found that a Party does not meet one or more of such requirements, the Party may acquire only if and when the Compliance Committee finds that the Party meets such requirements and therefore reinstates its eligibility to acquire.

3. In order to meet the eligibility requirements referred to in paragraph [1] [2], a Party shall:

Option 1: *This option relates to sub-paragraph (a)*

(a) Be in compliance with its commitments under Articles [3,]5 and 7 of the Protocol and the requirements set out in the guidelines decided thereunder, including the submission of the last available annual greenhouse gas inventory and greenhouse gas inventory report and the provisions on registries as defined in [...];

Option 2: *This option relates to sub-paragraphs (b) through (f)*

(b) Have in place, by the time a report is submitted pursuant to paragraph 2 (a) and thereafter, a national system for the estimation of anthropogenic emissions by sources and removals by sinks of all greenhouse gases not controlled by the Montreal Protocol, in accordance with Article 5.1 and the requirements in the guidelines decided thereunder;

(c) Have in place, by the time a report is submitted pursuant to paragraph 2 (a) and thereafter, a computerized national registry to account for and track [all changes in its assigned amount] [[ERUs, CERs and [AAUs] [PAAs] transferred or acquired] under the provisions in Article 3, paragraphs 10, 11 and 12], in accordance with Article 7.4 and the requirements in the guidelines decided thereunder;

(d) Have established, by the time a report is submitted pursuant to paragraph 2 (a), its [initial] assigned amount, in accordance with Article 7.4 and the requirements in the guidelines decided thereunder;

(e) Have submitted, in the report described in paragraph 2 (a), one annual inventory for the relevant recent year, [of anthropogenic emissions by sources [and removals by sinks] of

⁴ A specified time period sufficient to allow the Article 8 expert review teams and the enforcement branch of the Compliance Committee a reasonable opportunity to identify and rule upon any problems.

greenhouse gases not controlled by the Montreal Protocol] in accordance with the provisions of Articles 5.2 and 7.1 and the requirements in the guidelines decided thereunder [pertaining to Annex A gases and sources], other than those relating to the deadline for the first submission;

(f) Have subsequently submitted for each year following the submission of the report described in paragraph 2 (a), annual reports [information on its assigned amount], in accordance with Article 7.1 and the requirements in the guidelines decided thereunder, and annual inventories, in accordance with Articles 5.2 and 7.1 and the requirements in the guidelines decided thereunder [pertaining to Annex A gases and sources];

(Note: The following sub-paras (g) through (l) could form part of option 1 or option 2.)

(g) [Have ratified the Protocol];

(h) [Be bound by the procedures and mechanisms on compliance adopted by the COP/MOP;]

(i) [Have submitted the last required [all] periodic national communication[s] in accordance with Article 7.2 and in the guidelines decided thereunder.]

(j) [Have not been excluded from participation in the CDM [according to its procedures and mechanisms] [, in particular provisions regarding Article 2, paragraphs 1 and 3, Article 3, paragraphs 2 and 14, and Articles 6, 11, 12 and 17] [and in accordance with relevant provisions under the Protocol];]

(k) [Have submitted the last required information on net changes in greenhouse gas emissions by sources and removals by sinks resulting from direct human induced activities in conformity with the requirements under Article 3.3 and 3.4, in accordance with the relevant decisions by the COP and the COP/MOP; and]

(l) [Have achieved sufficient emission reductions through domestic [action] [policies and measures][in accordance with appendix X].

*(Note: The following paras. refer to **participation**.)*

4. Option 1: (a) A Party included in Annex B authorizing any legal entity subject to its jurisdiction to participate in international emissions trading shall establish and maintain a domestic system for accurate monitoring of greenhouse gas emissions of all relevant authorized legal entities.

(b) A Party included in Annex B authorizing any legal entity subject to its jurisdiction to participate in emissions trading under Article 17 shall remain responsible for the fulfilment of its obligations under the Protocol and shall ensure that such participation is consistent with this annex. Legal entities may not participate in emissions trading under Article 17 during any period of time in which the authorizing Party is ineligible according to the provisions of paragraphs 1 to 3 above.

Option 2: *(This options consists of para. (b) above.)*

Option 3: Transfers and acquisitions of PAAs shall take place between Parties included in Annex B.

5. [A Party included in Annex B authorizing any legal entity to participate in emissions trading under Article 17 shall maintain an up-to-date list of such entities and make it available to the secretariat and the public.]

(Note: The following para. refers to modalities of operation.)

6. Option 1: Transfers and acquisitions of [ERUs,] [CERs] and [PAAs] [AAUs] may take place through bilateral and multilateral arrangements and market exchanges.

Option 2: Transfers and acquisitions of [ERUs] [, CERs] and [AAUs] [PAAs] shall take place through an open and transparent exchange if more than [x] million tonnes are transferred by a Party [or legal entity] during a one year period. This provision shall not apply to transfers of [AAUs] [PAAs] of less than [y] million tonnes of carbon.

Option 3: Transfers and acquisitions of [AAUs] [PAAs] shall take place through bilateral arrangements between Parties included in Annex B. A Party included in Annex B wishing to transfer or acquire PAAs may publish the amount to be transferred prior to the transfer.

(The following para. refers to the share of proceeds.)

7. [A share of proceeds shall be transferred by the [transferring][acquiring] Party to the appropriate account in accordance with appendix B.]

(The following para. refers to issues related to compliance.)

8. Option 1: Originating Party liability: A Party included in Annex B whose actual emissions for the commitment period, after the additional period for fulfilling commitments referred to in the procedures and mechanisms on compliance, exceed the ERUs, CERs and [AAUs] [PAAs] it has retired for compliance purposes, shall be subject to the provisions of the procedures and mechanisms on compliance adopted by the COP/MOP.

Option 2: Commitment period reserve:

(a) At the beginning of each commitment period, each Party included in Annex B shall place a portion of its assigned amount in a reserve account specific to that commitment period in its national registry. This portion shall be either [x] per cent of its assigned amount, or the portion determined in accordance with sub-paragraph (b) below, whichever is the lower.

(b) Option (i): The portion shall be determined by projecting the Party's emissions for the commitment period using a straight line, fitted by least-squares regression analysis, to the Party's emissions for the seven most recent years, as reviewed pursuant to Article 8.

Option (ii): Subject to sub-paragraph (c) below, the portion shall be equal to five times the Party's emissions during the most recent year for which emissions data, as reviewed pursuant to Article 8, are available.

(c) After each annual review of the Party's emissions data pursuant to Article 8, the portion of assigned amount in the reserve account shall be recalculated. The recalculated portion shall be equal to the sum of the emissions during each year of the commitment period for which these data are available plus, for each remaining year of that commitment period, an amount equal to the emissions in the most recent year for which these data are available.

(d) If the recalculation under sub-paragraph (c) above results in a portion which is smaller than the portion in the Party's commitment period reserve account, a number of [AAUs] [PAAs] corresponding to the difference may be transferred out of the reserve account. If the recalculation results in a portion which is larger than the portion in the Party's commitment period reserve account, the Party shall transfer a number of [AAUs] [PAAs], ERUs or CERs corresponding to the difference into the reserve account before it is allowed to transfer any [AAUs] [PAAs], ERUs or CERs out of its national registry.

(e) The calculation of the commitment period reserve account and revisions thereto shall be reported in accordance with Article 7.

(f) Except as provided in sub-paragraph (d) above, [AAUs] [PAAs], ERUs or CERs held in a commitment period reserve account [may not be transferred and may only be used to establish a Party's compliance with its commitments under Article 3, paragraph 1] [may only be transferred into a Party's retirement account].

Option 3: Units in surplus to plan:

(a) Prior to the start of the commitment period, a Party included in Annex B that wishes to transfer [AAUs] [PAAs] under Article 17 shall allocate a portion of between 15 and 25 per cent of its total assigned amount to each year of the commitment period, and shall notify the secretariat of these allocations.

(b) In the first year of the commitment period, the Party shall calculate the difference between the portion allocated to 2008 and its emissions in 2006, as reviewed pursuant to Article 8. The secretariat shall verify this calculation and issue certificates for the difference. All issued certificates shall be valid on the market without any liability or trade-specific compliance rules.

(c) In each subsequent year, the Party shall add together the portions it has allocated to each year of the commitment period, up to and including the current year. It shall deduct the sum of its emissions, as reviewed pursuant to Article 8, for an equal number of years beginning in 2006. It shall also deduct the amount of [AAU] [PAA] certificates issued to it for previous years of the commitment period, and the amount of ERUs which it has transferred under Article 6. The secretariat shall verify this calculations and issue certificates for the difference. All issued certificates shall be valid on the market without any liability or trade-specific compliance rules.

(d) A Party may re-allocate portions for future years of the commitment period, and shall notify the secretariat of any such re-allocation.

Option 4: Surplus units: Only excess reductions may be transferred and acquired under Article 17, after the adjustments taking into account the transfers of ERUs and CERs. The

assigned amount is the emission reduction commitment of a developed country Party. A Party included in Annex I to the Convention and in Annex B may transfer a part of its assigned amount to another such Party under Article 17 if that Party, in the achievement of its quantified emission limitation and reduction commitment under Article 3, has been able to limit or reduce its greenhouse gas emissions through domestic policies and measures to an extent which exceeds its emission limitation and reduction commitment, thereby resulting in a part of the assigned amount of emissions not being used. Nothing else can be transferred and acquired under Article 17.

Option 5: Mixed liability: If a Party included in Annex B which has transferred parts of an assigned amount to another Party under the provisions of Article 17 is found to be in non-compliance with its commitments under Article 3, a portion of the transferred parts of assigned amount corresponding to the amount by which the emissions of the transferring Party exceeded its assigned amount and determined in the reverse chronological order of the original transfer (last in, first out), shall be temporarily invalidated and cannot be used for the purpose of meeting commitments under Article 3.1 for the period during which these parts of assigned amount were issued. The transferring Party remains liable for the entirety of its excess emissions and shall face the consequences provided for the breach of commitments under Article 3 under the procedures and mechanisms on compliance. The invalidated parts of assigned amount may be banked by the acquiring Party under the provisions of Article 3.13 but may not be used for the purpose of meeting commitments under Article 3.1 until the Compliance Committee deems the transferring Party to have fulfilled any requirement resulting from the breach of commitments identified above.

9. [The secretariat of the Convention] shall perform functions as requested by Parties and, in particular, shall maintain a publicly accessible list of Parties included in Annex B [and legal entities] that are ineligible to participate in emissions trading under Article 17.

[Appendix X (to the annex to decision [C/CP.6] on emissions trading)

“Part of”/Supplementarity

1. Option 1: No elaboration of supplementarity.

Option 2: Parties included in Annex I shall meet their emission limitation and reduction commitments primarily through domestic action. [Use of the mechanisms pursuant to Articles 6, 12 and 17 by a Party included in Annex I shall be limited to a maximum of 30 per cent of the effort required to meet its commitment under Article 3. This ceiling may be reviewed periodically by the COP/MOP.] Compliance with this requirement will be assessed by the compliance committee on the basis of information submitted under Article 7.

Option 3: Net acquisitions by a Party included in Annex I for all three mechanisms pursuant to Articles 6, 12 and 17 together must not exceed the higher of the following alternatives:

- (a) [5][25] per cent of: its base year emissions multiplied by 5 plus its assigned amount
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(where ‘base year emissions’ may be replaced by ‘average annual emissions in the base period, as provided for in Article 3, paragraph 5’);

- (b) 50 per cent of the difference between its annual actual emissions in any year of the period from 1994 to 2002, multiplied by 5 and its assigned amount.

However, the ceiling on net acquisitions can be increased to the extent that a Party included in Annex I achieves emission reductions larger than the relevant ceiling in the commitment period through domestic action undertaken after 1993, if demonstrated by the Party in a verifiable manner and subject to the expert review process to be developed under Article 8.

If a Party is a member of an Article 4 agreement to fulfil commitments jointly, the assigned amount is the assigned amount allocated to the Party under that agreement. Otherwise, it is the assigned amount for the Party as calculated in accordance with Article 3, paragraph 7.

[Issues related to Article 4]

2. [Any limitations on the transfer or acquisition of CERs under Article 12 shall apply to the allocation of emission levels under Article 4.]
3. [Any limitations on net transfers or acquisitions of CERs under Article 12 shall apply to each individual Party operating under Article 4.]
4. [Reallocations under Article 4 shall count against the limitations referred to in Options 2 - 3.]

Appendix A (to the annex to decision [C/CP.6] on Article 17)**Determination and allocation of the share of proceeds**

Option 1: No share of proceeds

Option 2:

1. The share of proceeds is defined as [x] [10] per cent of the initial transfer of [AAUs] [PAAs] from the registry into which they were issued.
2. The executive board shall auction and convert any [AAUs] [PAAs] into currency through an open competitive public process and deposit the respective funds to the adaptation fund account and administrative expenses account.
3. [The [COP] [COP/MOP] shall adopt the budget to cover the administrative expenses of the executive board on a biennial basis. The equivalent amount shall be derived from the share of proceeds and shall be deposited to an account maintained for this purpose by the secretariat. The [COP] [COP/MOP] shall [ensure that the administrative budget will not be more than 10 per cent of the share of proceeds] [strive to maintain the administrative budget within a maximum of 10 per cent of the amount of the share of proceeds]. The remaining [amount, which shall not be less than 90 per cent of the share of proceeds,] [[90 per cent] [amount] of the share of proceeds] shall be devoted to assisting Parties not included in Annex I that are particularly vulnerable to the adverse effects of climate change, in particular least developed countries and small island developing States amongst them, [and/or to the impacts of the implementation of response measures] to meet the costs of adaptation and shall be transferred to an account maintained for this purpose by the adaptation fund [established by the COP/MOP] [referred in the relevant provisions].]
