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PD Forum submission to 40th Session of SBSTA in response to calls for input on the NMM

Introduction

The Project Developer Forum thanks the Parties for providing this opportunity to comment further on the development of the New Market Mechanism. As we will detail in our submission, we are convinced that Carbon Market Mechanisms of global reach are of fundamental importance for the fight against climate change and the prosperity of all societies in a sustainable environment. We therefore support any action which seeks to establish an effective, efficient, transparent and stable global carbon market that is capable of minimizing economic costs and reversing the dangerous trends which we are observing.

As referenced by IPCC's 5th AR, WG III, GHG emissions since the year 2000 have been growing 2.2% per year, close to twice the average rate of 1.3% observed in the three previous decades. In spite of this global trend, GHG missions of OECD countries in this period reduced slightly as expected for mature economies and given the comprehensive GHG mitigation policies that some of them adopted. In fact, according to the OECD (2013), some member countries are paying up to 800€ per t of CO2 mitigated, mostly in the form of feed in tariffs, capital subsidies or other regulations. On the other hand GHG emissions of developing countries have grown sharply since the year 2000 and today they represent the major share of global GHG emissions.

The drivers for this evolution are the fact that more than 90% of the world's population growth takes place in developing countries, that energy consumption grows fast from very low levels as people are lifted out of energy poverty and that these countries lack the capital to invest into clean infrastructure, which offers long term sustainability, but also requires high upfront investments and long periods of financial amortization and thus drain capital for other contemporary needs such as health and education. On the back of these drivers, we observe that developing countries swiftly expand their GHG intensive infrastructure to address immediate social needs, even if other alternatives are available, because they are more expensive, require complex planning and implementation or because they require long term capital commitments. The illustration of this fact that the cost of meeting the 450 ppm target increases with time is that the IEA estimates that each 1.0 USD of foregone mitigation investment in the pre-2020 period will have to be compensated by an investment of 4.5 USD in the post 2020 period. Based on this insight it is clear to members of the PD Forum that the NMM will have to be built upon existing experience, infrastructure and mechanisms in order to promote early action now and not waste precious time exploring new approaches whilst allowing carbon markets to remain ineffective until after 2020.

In this context it is paramount to build on the existing mechanisms to develop an effective, efficient, transparent and reliable global carbon market mechanism for the post 2020 regime that offers broad coverage, low transaction costs and addresses the needs of both developed countries and developing countries. Such a mechanism is capable of minimizing the cost of mitigation today, which is essential to enable all Parties to make increasingly ambitious contributions. In addition and more importantly, such a global carbon market will reduce the cost of mitigation in the future: Failure to prevent the ongoing GHG intensive development that we observe in developing countries will lead to technology lock-in which will compromise the global emission trajectory for decades to come and which will require very large expenditures to reverse.

Against this background, global carbon market mechanisms are essential to minimize economic costs today and in the future and thus allow increasing ambitions in the fight against climate change. Such market mechanisms have to be developed on the basis of a solid international cooperation, and sound and rational economic principles that allow the flexibility to develop, finance and implement cost effective GHG mitigation in any region or sector of the global economy on the back of variable and complementary sources of mitigation demand.

In spite of the discouraging evolutions that we have seen since the year 2000, we believe that we have developed solid experiences and mechanisms that we can build on in order to develop more comprehensive and globally effective solutions:

1. Market mechanisms are capable of channeling investments to developing countries and provide unprecedented opportunities for private sector involvement in low carbon technology and infrastructure development. Previous experience with project based activities has seen in excess of USD 500 Bn of finance earmarked for low carbon projects[1].
2. Market mechanisms are economically efficient and will help to achieve a desired level of performance at the lowest cost to society. Abatement costs of CDM projects start from well below USD 5 per tCO2e and come with a wide variety of sustainable development benefits, while the GHG mitigation policies and feed in tariffs being deployed in the OECD have costs as high as USD800 per tCO2e (OECD, 2013).
3. Using global carbon markets to promote GHG mitigation projects in any country helps to prevent the development of GHG intensive infrastructure today and thus allows the avoidance of high costs of substituting GHG intensive assets in the future.
4. The promotion and implementation of well-designed national or regionally connected Emission Trading Schemes (ETS) offers reliable and robust policy options that should be pursued by Parties to implement an incrementally integrated global carbon market. Nevertheless, their coverage is and will be limited for the time being and other carbon market mechanisms will have to offer opportunities in sectors, countries and regions where ETS coverage is not feasible, as well as the indirect linking between domestic, voluntary and international demands. We see the role of the NMM in providing this efficient, transparent and reliable instrument of flexibility and linking.
5. To avoid a complete rupture of the carbon market infrastructure and to continue and expand early action, the NMM, together with the FVA, must not only build on the CDM, but also integrate and ensure that its achievements for private investors and host countries will be recognized under any post 2020 agreement.
6. In the context of the post 2020 agreement where every country shall commit to its nationally determined contribution, an adequate accounting of emissions and tracking of

[1] The sum of declared investments in published PDDs on the UNEP Risoe CDM pipeline exceeds USD500bn. Approx. 68% of PDDs reported total investments. Publication of a PDD for stakeholder consultation is taken as a serious indication of intent to develop a project.

emissions reduction units is necessary and we suggest that units generated by the NMM will be reported and tracked under the national inventories as long as they are used for transfer between the parties.

With these general comments, please see our responses to the specific questions below:

(a) Its design and governance;

The PD Forum proposes that a New Market Mechanism is designed to provide real, measureable, long term emission reductions from project based activities which deliver quantified sustainable development benefits to the host nation. We propose to distinguish between the mechanism which generates the emission reductions which is governed by Modalities and Procedures, and the use of those emission reductions by host and non-host Parties, investors and financiers, which is optional and beyond the scope of the Modalities and Procedures. As a result of this approach, the NMM can be used to develop initiatives and projects in the scope of a host country to minimize the cost of mitigation with or without any international transfer of units and accordingly accounted for under the country's national inventory and nationally determined contributions. Allowing this use of the NMM for domestic policies offers these countries a solid international instrument, ensures comparability, safeguards flexibility and the opportunity for indirect linking and avoids that each country has to develop its own domestic infrastructure, which would introduce greater complexity to the policy landscape and which may result in a systematic lowering of standards.

Emission reductions generated under the New Market Mechanism can be used for a wide variety of purposes including but not limited to:

- Voluntary cancellation by any entity against voluntary pledges;
- Cancellation against mandatory targets by participants in ETS, within limits enforced by system regulators and subject to eligibility criteria defined by system regulators;
- Cancellation by the host country as a contribution towards domestic mitigation;
- Cancellation by the host country or project participants in order to enhance the quality of the remaining emission reductions which may be sold to quality conscious buyers;
- Cancellation by an ETS regulator against issuance of allowances in order to enhance the environmental integrity of an ETS or in order to generate new allowances above a cap for auction to capped entities; and
- Cancellation by taxed entities, within limits and eligibility criteria, against GHG tax liabilities.

The design of NMM will encompass features of the CDM, POA and JI project based mechanisms, but it will seek explicit alignment with national policies (NAMAs), carbon financing instruments such as those offered by national and multilateral development banks and those developed by the GCF. Alignment with national policies will enable greater use of the concept of standardized baselines as a means of reducing the potential rewards for the most inefficient technologies. The new market mechanism will relate the duration of the crediting period to the development of host country policies and measures so that countries with pledges, targets or nationally determined

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contributions will need to add exported units to their national inventory in order to avoid double counting.

The New Market Mechanism will be governed by a full time professional Executive Board made up of members who are not active or recent members of, or advisors to, Parties to the UNFCCC.

For clarity, the PD Forum does not see any need for the NMM to cover the rules of ETS, but act in complement to nationally developed ETS according to national policies. Nevertheless, the units generated by the NMM facilitate indirect linking between domestic ETS until such linking can be formally negotiated and established. In any case, international transfers of NMM units between ETS would be tracked via the FVA – please see our submission on the FVA.

We propose that a New Market Mechanism as described above be named the Emission Reduction Mechanism or ERM.

(b) The elaboration of the possible elements of its modalities and procedures;

The New Market Mechanism will draw heavily on the existing modalities and procedures for the CDM and JI and will take into account proposals submitted by Parties and Observers for the reform of the CDM. In particular, the New Market Mechanism may learn from the challenges associated with:

- The need for clearly defined roles for all the actors in the New Market Mechanism
- The duration of crediting periods;
- The exclusive use of emission reductions to offset emissions in non-host countries;
- The necessity that units are backed by national allocations or that their transfer is reported in national inventories in order to overcome the discussion about additionality.
- The MRV of sustainable development benefits;
- The complexities around PoA;
- The impact of the threat of withdrawal of a Letter of Approval without due process;
- The threat of retrospective application of regulations and the lack of an appeals process.

These and other issues are further elaborated in the PD Forum's previous submissions on the reform of the CDM, available here.

(c) The meaning of "a net decrease and/or avoidance of global greenhouse gas emissions";

the PD Forum understands that "a net decrease and/or avoidance of global greenhouse gas emissions" is part of a list of criteria which the standards for a New Market Mechanism should meet in a transparent and science based manner. Therefore the term and its scope should be included in the design of the Modalities and Procedures. To ensure acceptability of the NMM for host country mitigation as well as for international transfer, projects shall demonstrate that they deliver a net decrease and/or avoiding of greenhouse gas emissions by following modalities and procedures which ensure the application of accurate and conservative monitoring, reporting and verification procedures. The PD Forum has previously proposed that the CDM M&P be reformed to transparently demonstrate conservativeness as a means quantifying the extent to which the CDM contributes to a net reduction in greenhouse gas emissions.

This objective could be achieved within the New Market Mechanism by designing baseline and monitoring methodologies to promote accuracy of measurement and applying one single, justifiable conservativeness factor to the methodology after all of the calculations have been undertaken. This value would be published in the monitoring methodology and applied at the point of issuance such that emission reductions are deducted from the issuance and placed into an account specifically designed to hold "conservativeness units" which can be used to demonstrate the extent to which the design of the New Market Mechanism contributes to a net decrease in emissions, irrespective of how end-users use the emission reductions. If these units were then credited to the host country, they would demonstrate host country mitigation. Both uses could be claimed as generating a net decreased and/or avoidance of global greenhouse gas emissions.

This step would be expected to have a negligible impact upon the number issued emission reductions because baseline and monitoring methodologies would be designed to be accurate in contrast to existing CDM methodologies which frequently contain somewhat arbitrary conservativeness and uncertainty corrections.

This action is not to be confused with enhanced mitigation which is addressed below.

(d) Lessons learned from the mechanisms under the Kyoto Protocol that could be relevant to the further elaboration of the possible elements of the work programme referred to in paragraph 1 above;

The PD Forum believes that there has been substantial learning from the existing mechanisms and many of these lessons have already been presented in the submissions of Parties and Observers on the reform of the CDM. Some of these are listed under (b) above.

(e) Its relationship with the framework for various approaches and the mechanisms under the Kyoto Protocol;

The PD Forum considers that the focus of the New Market Mechanism is the creation of units for transfer between entities which can be located in the same or different jurisdictions. As long as these units are issued, transferred and cancelled within the boundaries of a national or jurisdictional inventory, then the transaction would be concluded without international transfer and the mitigation result would be captured at the level of the national inventory. In this case the NMM would exclusively facilitate the host country meeting its pledge, commitment, nationally determined contribution or other form of legally binding or voluntary target. This is an example of using the NMM as a tool to achieve "host country mitigation".

However, when units are issued in one jurisdiction and transferred to another, then an accounting procedure is required to track those units and ensure that they are not counted twice. While mitigation initiatives and projects will lead to an emission reduction equivalent to the units created, the tracking of units will ensure that the transfer and use of the units to other jurisdictions is adequately accounted for. Under this concept the NMM will attract international investments, provide flexibility to international commitments and/or facilitate host country mitigation. The FVA would perform this accounting function in the absence of an international unit such as an Assigned Amount Unit, which was used to track JI transactions and ensure their zero sum nature. At the same time, project based activities under the NMM may deliver additional (non-carbon) outcomes and these may also be quantified and recorded in the FVA along with financial flows.

(f) Its relationship to enhanced mitigation ambition.

The key objective of efficient and effective carbon market mechanisms is to reduce the global financial and economic cost of mitigation and minimizing this cost is fundamental to increase capability and ambition of all parties. As we have exposed in our introduction, the current focus on unilateral action is leading to high expenditures and costs that are being incurred by OECD countries and in fact ambitious renewable energy targets in countries such as Portugal, Italy and Spain have contributed to the European debt crisis, thus harming economic development. On the other hand the cited IPCC data has shown that developing countries lack the incentive to invest into clean infrastructure which is sustainable in the long term because of the high upfront costs that are being incurred, even if the incremental cost today would be as low as 5 to 20 USD / tCO2e abated and knowing that this will lead to very high abatement costs in the future.

In this context the establishment of an efficient and effective, transparent and reliable international carbon market mechanism in the short term is essential to reduce cost today and in the future and thus to allow ambition at a level which is compatible with the 450 ppm target.

To achieve this it is paramount to build on the lessons learned from the Kyoto Mechanisms, to ensure their continuity, as well as their integration in a future climate regime.

The project based mechanisms of CDM and JI were designed to provide flexibility to economies holding QELRCs under the Kyoto Protocol. As our understanding of the challenge of climate change has grown and as the need to reduce emissions has become more pressing, there is a growing recognition that more sources of mitigation are required. This leads to the concept of using emission reductions in other ways than to simply offset excess emissions by entities under a cap.

Having listened to the Parties' negotiations around the concept of host country mitigation, we now propose that enhanced mitigation takes place post-issuance and outside the scope of the NMM Modalities and Procedures. Thus the use of emission reductions from a New Market Mechanism is a voluntary activity undertaken by the Host country or another entity.

One proposal out of many - see (a) above, is to allow and encourage host parties to utilize a share of emission reductions as a contribution towards host country mitigation ambition.

The challenge is how to compensate project developers for the cancellation of such emission reductions and it is proposed that buying entities (Parties, funds, voluntary actors etc.) could recognize such actions in tendering criteria and reward such actions by paying above market price.

The PD Forum has made a number of proposals around the concept of host country mitigation and the duration of crediting periods and we believe that a constructive approach can be designed which would provide sufficient flexibility to all participants whilst achieving a number of desirable objectives including, but not limited to:

- Enhanced mitigation action
- Alignment of project based activities with host country policies and measures
- Expansion of the use of emission reductions beyond pure offsetting
- Environmentally beneficial selection criteria for Party and fund purchasing programs

The PD Forum is committed to the development of good and effective climate policies and supports the World Bank's 'Put a Price on Carbon' initiative.