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UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

**AD HOC WORKING GROUP ON FURTHER COMMITMENTS  
FOR ANNEX I PARTIES UNDER THE KYOTO PROTOCOL**

**Seventh session**

**Bonn, 29 March to 8 April 2009**

**Item 5 (a) of the provisional agenda**

**Other issues arising from the implementation of the work programme of the Ad Hoc Working Group on  
Further Commitments for Annex I Parties under the Kyoto Protocol**

**Emissions trading and the project-based mechanisms**

**Further input on how the possible improvements to emissions trading  
and the project-based mechanisms, as contained in annexes I and II to  
document FCCC/KP/AWG/2008/5 and annexes I and II to document  
FCCC/KP/AWG/2008/INF.3, would function**

**Submissions from Parties**

**Addendum**

1. In addition to the nineteen submissions contained in document FCCC/KP/AWG/2009/MISC.3 and Add.1, one further submission has been received.
2. In accordance with the procedure for miscellaneous documents, this submission is attached and reproduced\* in the language in which it was received and without formal editing.

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\* This submission has been electronically imported in order to make it available on electronic systems, including the World Wide Web. The secretariat has made every effort to ensure the correct reproduction of the text as submitted.

SUBMISSION FROM AUSTRALIA

**Emissions Trading and the Project-based Mechanisms**

**Submission to the AWG-KP and the AWG**

Australia draws attention to its previous submissions on possible improvements to the flexibility mechanisms<sup>1</sup> and welcomes the opportunity to provide additional views to the AWG-KP and AWG-LCA.

Comprehensive and well-functioning carbon markets will assist countries to commit to, and achieve, ambitious mitigation objectives by facilitating least-cost abatement and providing incentives for the development and diffusion of low carbon technologies. Expanding and improving the flexibility mechanisms will be an integral part of building an effective international carbon market. As noted in our previous submission, Australia proposes that improvements to the mechanisms should be designed to increase environmental effectiveness and economic efficiency.

In light of these broad principles, Australia wishes to highlight a number of matters of particular relevance to the current discussion. Further Australian views on the proposals contained in annexes I and II of FCCC/KP/AWG/2008/5 are included in the attached paper.

**Support for ambitious differentiated mitigation commitments and actions**

The flexibility mechanisms should support the more ambitious differentiated mitigation commitments and actions of the post-2012 outcome. The flexibility mechanisms are a means of achieving our climate change mitigation objectives, not an end in themselves. It is therefore essential that the flexibility mechanisms negotiations are closely coordinated with the discussions on further mitigation commitments and actions for developed countries in the AWG-KP, and for developing countries and non-Kyoto Parties in the AWG-LCA.

The current mechanisms are designed to accord with the bifurcated structure of the Kyoto Protocol, in which one group of countries has economy-wide binding emission targets and another group has no quantified emission limits. An effective climate change response will require more ambitious mitigation objectives by all countries. The post-2012 outcome will need to reflect a wide range of differentiated mitigation commitments and actions that take account of the national circumstances and respective capabilities of particular Parties. The

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<sup>1</sup> FCCC/KP/AWG/MISC.1/Add.5 and FCCC/KP/AWG/MISC.7/Add.1

flexibility mechanisms should be developed to support these new commitment structures.

This suggests that the pure offset approach of the CDM may no longer be suitable for all developing countries in the post-2012 outcome. New mechanisms may need to be developed to facilitate a net contribution to mitigation, in accordance with the national circumstances and respective capabilities of host countries. Sectoral crediting and sectoral trading could be two such mechanisms. These mechanisms may be a way of increasing the scope of the carbon market to finance mitigation activities in developing countries (see further comments on proposals I.E, I.F and III.A in the attached document).

To promote a consistent and effective post-2012 outcome, it is important that every effort is made to ensure that all appropriate market mechanisms are accessible to all Parties that take on suitable commitments and actions, regardless of the forum of these discussions and regardless of the eventual legal form of the post-2012 outcome.

### **Comprehensive coverage**

An effective, efficient and fair response to climate change will require all countries and all sectors to be engaged in the task of emissions reduction. It is important that the full range of abatement opportunities is available to the market. The flexibility mechanisms should therefore cover as many sectors and activities as possible. In particular, effective treatment of reduced emissions from deforestation and forest degradation in developing countries (REDD) and other forest-related activities in a post-2012 outcome could make a significant contribution to global mitigation efforts: recent modelling by Australia indicates that the inclusion of REDD and other forest-related activities in a post 2012 outcome could reduce global mitigation costs by 20 to 25 per cent. Australia intends to make a substantial contribution on REDD in the negotiations (see further comments under I.A in the attached document and Australia's submission to the AWG-LCA on REDD).

The flexibility mechanisms should be technology-neutral and not prescribe or proscribe particular technologies. For example, carbon capture and storage (CCS) should not be excluded from the flexibility mechanisms. CCS is expected to be a key technology for reducing greenhouse gas emissions. Fossil fuels, especially coal, are likely to remain a major source of the world's energy in the coming decades. A wide range of global mitigation studies project that CCS will deliver a significant share of global emissions reductions. CCS will be an important technology for many developing countries and the flexibility mechanisms provide incentives for technology cooperation and diffusion between developed and developing countries. Inclusion of CCS in the flexibility mechanisms will support the ability of developing country Parties to choose

nationally appropriate development paths, including the choice not to deploy CCS. Australia notes that it is, and should remain, the prerogative of host Parties to determine which projects/technologies are appropriate for their territory.

## **Governance**

Effective and efficient governance and institutional arrangements are critical to ensuring that the objectives of the flexibility mechanisms are delivered in a transparent, efficient, timely and accountable fashion. Every effort should be made to increase administrative simplicity and minimise transaction costs.

Governance arrangements will need to be developed for new flexibility mechanisms, such as sectoral crediting. In doing so, Parties should be careful not to duplicate roles, functions and processes, but also be prepared to learn from experiences in the first commitment period.

Australia considers that there is a good case to re-examine the structure and operation of the CDM and its project approvals system to facilitate an increased flow of crediting proposals post-2012.

## **ATTACHMENT**

### **Additional comments on the proposals in annexes I and II of FCCC/KP/AWG/2008/5**

#### **ANNEX I**

##### **I. A. Include other land use, land-use change and forestry activities**

Australia supports including a broader range of land use, land-use change and forestry (LULUCF) activities in the flexibility mechanisms. The definitions for any new LULUCF activities included in mechanisms must be consistent with the activity definitions agreed for Parties with economy-wide mitigation targets. The inclusion of additional eligible activities should be in a way that is rigorous and robust, accounts for anthropogenic emissions and removals at the time they occur, and be policy relevant.

Increased capacity to measure and verify emissions reductions since adoption of the Kyoto Protocol allow for the development of a more comprehensive and effective approach to LULUCF, in particular forest-related activities (A/R activities and REDD). Australia believes that market-based approaches are likely to be the most effective and efficient way of addressing forest-related emissions in developing countries. Australia intends to make a substantial contribution on these matters in the negotiations and welcomes further discussion of them in both the AWG-KP and the AWG-LCA.

##### **I.B. Introduce a cap for newly eligible land use, land-use change and forestry activities**

Australia does not support a cap on eligible LULUCF activities under the flexibility mechanisms. All genuine abatement activities should be included in the flexibility mechanisms without restriction. Placing undue limitations on particular activities will increase the cost of abatement to the global economy.

##### **I.C. Include carbon dioxide capture and storage**

Australia draws attention to its submissions to the SBSTA regarding approaches to including CCS in the flexibility mechanisms. Australia reiterates that the flexibility mechanisms should be technology-neutral and not prescribe or proscribe particular technologies. For example, CCS is expected to be a key technology for reducing greenhouse gas emissions, given that fossil fuels, especially coal, are likely to remain a major source of the world's energy in the coming decades. A wide range of global mitigation studies project that CCS will deliver a significant share of global emissions reductions.

Australia acknowledges that some Parties have concerns about certain aspects of the inclusion of CCS in the flexibility mechanisms. These concerns appear to centre around issues relating to: long-term liability, standards for monitoring, and monitoring and accounting for any seepage from the storage reservoir. Australia recognises that addressing these issues is of critical importance in ensuring that CCS projects meet appropriate social, health, safety, and environmental requirements.

CCS activities must be committed to protecting the environment, providing community confidence and providing certainty for investors on safe and secure geological storage of greenhouse gases. As such, the following issues should be addressed in any CCS-related Project Design Document:

- conformity with all relevant national and international laws, policies and regulations of the host government and any other territories that fall within the project's boundaries;
- any transboundary implications of potential leakage and other potential liability issues under appropriate national and international regulatory mechanisms;
- application of appropriate monitoring, reporting and verification procedures;
- clear allocation of short-, medium- and long-term liabilities;
- fully developed operational procedures and plans, including strategies and procedures to address any possible leakage risks;
- procedures for the proper and safe sealing of storage reservoirs; and
- specification of closure and decommissioning plans.

These issues are of course in addition to those issues such as additionality and stakeholder consultation which must be addressed by all CDM Project Design Documents.

The CDM Executive Board should establish appropriate guidelines and methodologies that give effect to the above mentioned principles.

**I.E Introduce sectoral CDM for emission reductions below a baseline defined at a sectoral level; and I.F Introduce a sectoral crediting of emission reduction below a previously established no-lose target**

Sectoral crediting along with sectoral trading (see III.A) may be a way of increasing the scope of carbon markets to finance mitigation activities in developing countries. Such an approach would involve developing countries agreeing to either appropriate sectoral baselines or no-lose targets. A country would then receive credits for any reductions beyond the baseline or target. Where appropriate, and in accordance with the national circumstances and

respective capabilities of the host Party, the baseline or target could be set to facilitate a net mitigation contribution.

Sectoral crediting and trading would not be appropriate for all Parties and all sectors, for example, it is likely that project-by-project CDM will remain the most viable option for LDCs.

Sectoral crediting and sectoral trading could work alongside the project-by-project approach of the CDM. For example, a Party could take on a sectoral commitment for one sector and continue to participate in project-by-project CDM in other sectors. To avoid double-counting, sectoral and project-by-project CDM could not be undertaken together in the same sector. Provision would need to be made for CDM activities currently occurring in sectors put forward for sectoral approaches.

Australia acknowledges the need to support countries in building capacity to facilitate sectoral approaches, including technical and inventory support.

#### **I.G Introduce crediting on the basis of nationally appropriate mitigation actions**

The post-2012 outcome should recognise all commitments to nationally appropriate mitigation action and make provision to assist developing countries to meet these commitments. In cases where the emissions reductions from nationally appropriate mitigation actions can be accurately quantified (eg, sectoral no-lose targets), crediting can provide a useful means of financing mitigation actions by developing countries. However, if the emissions reductions flowing from the action cannot be accurately quantified, crediting risks undermining the environmental integrity of the carbon market. In these cases, other financing tools should be used in preference to crediting.

#### **I.H Ensure environmental integrity and assess additionality through the development of standardised, multi-project baselines**

The requirement to demonstrate additionality has been identified as one of the most resource-intensive steps in the CDM process. Methods to assess additionality through the development of standardised, multi-project baselines may assist in improving the efficiency of the approvals process.

#### **I.J Differentiate the eligibility of Parties through the use of indicators**

The mechanisms will need to support new and differentiated commitment structures and provide incentives for enhanced mitigation action by all countries. Consequently, offsetting approaches may not be appropriate for certain

developing countries and consideration should be given to new mechanisms which facilitate a net contribution to mitigation in accordance with Parties' national circumstances and respective capabilities. This discussion will need to be integrally linked to the discussion on mitigation commitments by developing countries in the AWG-LCA.

### **I.K Improve access to clean development mechanism project activities by specified host Parties**

Australia supports efforts to build capacity and facilitate access to CDM project activities in underrepresented countries. However, this should not be done by mandating where project activities should occur; this would raise the cost of abatement to the global economy, thus reducing the efficiency of global climate change mitigation.

It is to be expected that CDM and JI projects will be concentrated in those countries where there is high potential for cost-effective mitigation. However, creating the right enabling environments (legal, social and economic policy frameworks) to promote private investment in low emissions development is of critical importance. It would be valuable for the AWGs to consider lessons learnt from successful host Parties, that could be adopted in other Parties. In addition, Parties may also wish to consider ways to reduce market barriers to the uptake of project-based activities in certain locations, including by building capacity and strengthening good governance arrangements in underrepresented countries.

Expanding the scope of market mechanisms to include additional sectors, in particular those relating to LULUCF and REDD is likely to facilitate a wider geographical distribution of CDM projects.

### **I.L Include co-benefits as criteria for the registration of project activities**

In line with the objective of the Convention, the flexibility mechanisms should remain tightly focused on emissions reduction. While projects should be allowed scope to contribute towards co-benefits, the introduction of additional mandatory criteria may inadvertently detract from the emissions reduction objective. Host Parties are best placed to determine what constitutes sustainable development and which co-benefits are most appropriate to their circumstances.

### **I.M Introduce multiplication factors to increase or decrease the certified emission reductions issued for specific project activity types**

Market-based approaches deliver least-cost abatement by providing incentives to reduce emissions where this is most cost-effective. It is therefore preferable to allow the market to determine which types of project activity to pursue and the



introduction of multiplication factors should therefore be very carefully considered. The introduction of positive multiplication factors, in particular, risks undermining the environmental integrity of the mechanisms. It is important that each Kyoto unit represents at least one tonne of CO<sub>2</sub>-e reduced or our mitigation objectives may not be met.

### **III.A Introduce emissions trading based on sectoral targets**

In the post-2012 outcome, some developing countries may wish to adopt legally binding sectoral emissions reduction targets. Such mitigation commitments, properly monitored, verified and reported, should be able to link to the international carbon market to provide participating countries with the flexibility to choose how best to meet these commitments. An advantage of sectoral trading based on legally binding sectoral targets is that emissions units can be awarded at the beginning of the commitment period thereby providing an option for up-front financing for mitigation activities.

Decisions regarding national policy choices to meet sectoral targets should remain the prerogative of the particular Party.

See also the related discussion on sectoral crediting (above at I.E and I.F).

### **IV.A Relax or eliminate carry-over (banking) restrictions on Kyoto units**

Australia supports efforts to relax or eliminate carry-over (banking) restrictions on Kyoto units. Facilitating increased banking by relaxing carry-over restrictions on Kyoto units will improve intertemporal flexibility and therefore improve the economic efficiency of the market.

### **IV.C Introduce borrowing of assigned amount from future commitment periods**

Like banking, borrowing would also improve intertemporal flexibility and therefore improve the economic efficiency of the market. However, long-term borrowing could lead to significant and potentially detrimental delays in the global abatement effort. Australia assesses that this risk outweighs the potential flexibility benefits of any form of long-term or unlimited borrowing.

### **IV.D. Share of proceeds**

It is important that the international community identify additional means to finance adaptation that are efficient, effective and equitable. However, a discussion on share of proceeds as a means of assisting developing countries to meet the costs of adaptation should not be considered in isolation from the

broader discussion on financing adaptation which is to be taken up in the AWG-LCA.

The flexibility mechanisms are a key mitigation tool. Applying a share of proceeds to the flexibility mechanisms may reduce the efficiency of the global mitigation response as it could distort international market price signals, reduce incentives for investment in mitigation activities in developing countries and discourage international permit trade.

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