CHAPTER I

A legal review of the key provisions and background to the Kyoto Protocol and the Buenos Aires Action Plan

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1. Introduction

Parties to the United Nations Framework Convention on Climate Change (UNFCCC) will shortly meet at the Sixth Conference of the Parties (COP-6), 13-24 November 2000. This paper looks at some items to be addressed at this session of COP, the process for addressing a number of key items, and the course that will put the world community on for the expected progress to be made in ratification and implementation of the Kyoto Protocol.

The science of climate change is characterized both by profound uncertainties and by rapid advances resulting from ongoing research. It follows that any governance system in this area must seek not only to stimulate the growth of knowledge but also to provide mechanisms for integrating new insights into the system, without triggering a time-consuming legislative process. To do that, in the case of climate change, requires recognition of the challenge and a determination to deal with it. Such a dynamic move is likely to involve the articulation of a new world view that redefines human aspirations and gives rise to a restructured ethical system to guide human and environmental relations. Almost certainly, this world view will take as its point of departure the perspective of ecology, which stresses linkages among the elements of complex systems, in contrast to the

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perspective of technology, which emphasizes the separation of complex systems into discrete parts that can be dealt with as self-contained entities. Success in the development of an effective governance system for the earth's climate will require a concerted effort to nurture these new intellectual underpinnings, as well as an effort to design the specific elements of the climate regime being established.

The Fifth Conference of the Parties (COP-5) 25 October–5 November 1999 at Bonn demonstrated the immediate concern the global community places on this issue. With over 3,000 participants and 165 Parties represented, COP-5 gave delegates a further opportunity to seek the fulfillment of the Buenos Aires Action Plan (BAPA) adopted at COP-4 in November 1998. BAPA set a two-year deadline under which the Parties committed at COP-6 to resolve the key issues necessary for the UNFCCC to be solidly implemented and for the future entry into force of the Kyoto Protocol.

The role of international agreements

"Soft law" versus treaties

There was a time when the need for a formal instrument such as the Convention was challenged. According to this view, letting the regime evolve more informally through the development of what is commonly referred to as "soft law" was a better option. Proponents of formalization stressed the role treaties and conventions can play in establishing legal obligations and in minimizing opportunities for members to ignore the dictates of regimes with impunity. "Soft law" advocates, by contrast, emphasized the virtues of more informal arrangements in avoiding the complications of the ratification process and in allowing regimes to adapt to changing circumstances in a flexible manner. The general conclusion was that there is no need to think of these alternatives as posing an either/or choice.

The role of different actors

Consequently, it was agreed that to be effective, the climate regime would require the loyalty of both public and private actors throughout the world. Partly, this is a matter of providing opportunities for all members of the international community to participate in a meaningful way in formulating provisions to be implemented through the framework of an international agreement to protect the earth's climate. Even more profoundly, however, there is a critical sense in which support for the evolving governance system must come both from the international state system as well as with the participation of non-state actors. Meaningful consultation in turn requires the empowerment of those directly affected through some recognized method for bringing their voice into the process.

The industrialized country role

The climate regime cannot succeed in the absence of a concerted effort to address the priority concerns of the world's developing countries. While the affluent residents of the industrialized countries are increasingly attentive to matters of environmental quality, many developing country leaders are understandably concerned that a focus on environmental issues will deflect worldwide attention from their economic problems. Worse, they are concerned this focus could even lead to the promulgation of restrictive rules that hinder their efforts to achieve sustained economic growth and a reasonable standard of living. Given the fact that the increase of greenhouse gases (GHG) in the earth's atmosphere in modern times are in large measure attributable to the industrialization of developed countries, and that no climate regime can be effective where there is no acceptance and active participation by the principal countries of the developing world, the need to accommodate the development concerns of developing countries as part of a planetary bargain relating to climate change is inevitable.

Looking outside the box

While it is certainly attractive to focus the attention on negotiations one after another, much of the work of bringing the terms of the resultant regime to bear on concrete problems must occur in more circumscribed settings. Partly, this is a matter of encouraging individuals, industrial enterprises, and the governments of specific countries to alter the current patterns of behavior. In part, it is a matter of facilitating the efforts of pairs or small groups of states to transcend rigid insistence on simplistic principles, such as the doctrine of "polluter pays," and to enter into mutually beneficial agreements leading to net reductions in GHG emissions.[1] Underlying all these approaches is the need to set aside any expectation that the provisions of the climate regime will be adhered to in practice just because they are enshrined in a convention and to begin thinking about the development of an array of implementation and strengthening techniques.

It is futile to ask governments of member states to take actions that are not feasible in economic, technical, or administrative terms. While we often assume that governments desiring to achieve well-defined goals have the capacity to alter the behavior of their citizens in the prescribed manner, reality in many instances is far different. This is particularly true of many developing countries and former socialist countries whose governments are relatively weak in the sense that their ability to deliver on com-

mitments made in good faith in connection with the creation of international regimes is sharply limited. It follows that an effective governance system for climate change must provide substantial assistance to governments prepared to make a concerted effort to implement the rules of the regime within their own jurisdictions. The appropriate tools for such an effort include technology transfers, training facilities, and additional development assistance earmarked for those who want to implement the terms of the climate regime.

Role of COPs

A look at the sessions of the COP of different environmental agreements reveals a certain pattern of high and low periods of public interest in different sessions of the same agreement. The level of public interest is often dictated either by benchmarks set in the agreement itself or by a natural or manmade event closely connected to the subject matter of the agreement. While to some extent this is inevitable, real progress in the timeframes identified in the agreements will come about when Parties to the agreement pay due and methodical attention to the challenges ahead.

Because of the preparations that preceded the COP-1 of the UNFCCC, many of these issues were addressed and agreement reached on addressing them in subsequent sessions. Sometimes this has resulted to mandating the Secretariat to produce a paper, asking governments to submit their views, or in other cases requesting the Intergovernmental Panel on Climate Change (IPCC) to either address the issue in the next Assessment or to produce a Special Report. All these notwithstanding, COPs are remembered for their accomplishments or failures oftentimes on one single, signal polarizing topic. In this sense, COP-1 is remembered for its adoption of the Berlin Mandate, and COP-3 for its adoption of the Kyoto Protocol. Some of the operational details of the provisions contained in Kyoto Protocol are expected to be agreed up on at COP-6. The main point here is that each session of the COP is critical to reaching the next step. If the Parties had not given the political endorsement of the scientific underpinnings of the climate change as outlined in IPCC reports, it is possible that some of the urgency felt by the Parties to adopt the Kyoto Protocol would be missing. Likewise, if COP-4 had not adopted the Buenos Aires Action Plan, even if adoption is equivalent only to the listing of some 140 items to be discussed over the next two years, the urgency to move forward in a timely manner could be missing, making it harder to accomplish the needed progress in COP-6. COP-5 was an important session for some of these same reasons because it was able to keep the process moving. This paper outlines those issues vital to future progress and their relationship to making the incremental advances at COP-6 and beyond.

2. The Kyoto Protocol

Once the UNFCCC was signed, the Parties agreed in the name of "prompt start" to immediately continue with work in preparation for the COP-1. The Intergovernmental Negotiating Committee (INC) that worked over five sessions to adopt the UNFCCC remained in session and met for six times more before COP-1. In these meetings the industrialized countries, began voicing the view that UNFCCC was seriously flawed and that, notwithstanding the principle adopted in 1992, i.e., "common but differentiated responsibility," it was vital that the developing countries join in the next phase of commitments.

The Convention entered into force in 1994. The first COP-1 was held in Berlin, Germany, in March and April of 1995. Because of "prompt start," this meeting turned out to be the most substantive of any first meeting of the Conference of the Parties of any international environmental agreement. Parties agreed to the "Berlin Mandate;" a "pilot phase" for Activities Implemented Jointly (AIJ); and the Ad Hoc Group on the Berlin Mandate (AGBM) was constituted. Among results, adoption of the Berlin Mandate witnessed some very intensive debate. The developing countries succeeded in ensuring that the result adequately reflected their concerns.[2]

Developing countries were able to ensure that they had no new commitments in the Protocol

The months of work that followed led the Parties to Kyoto, Japan. There, after 11 days of intensive negotiations that engaged, in addition to the delegates at the Conference, Ministers of Environment, Foreign Affairs, Finance, and Treasury, and in some cases, even Heads of State and Government; the Kyoto Protocol was adopted on 11 December 1997. It required the delegates to work late for three nights in a row, and the last article was adopted only after an all night session was allotted for the Conference after it was over. The Kyoto Protocol contains 28 articles and 2 annexes. Decisions 1, 2 and 3 also adopted at COP-3, directly pertain to the Kyoto Protocol. Decision 1 provides for work on implementation; Decision 2 provides for the determination of methodological issues; and Decision 3 provides for the implementation of Articles 4.8 and 4.9 of the UNFCCC concerning impacts and mitigation.

The Protocol, for the first time in the evolving climate regime, provided for legally binding emission commitments for Annex I Parties. It covers the six main GHGs as

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The Protocol established legally binding GHG emissions restrictions for developed countries

listed in Annex A to the Protocol: carbon dioxide (CO_2); Methane; Nitrous Oxide; Hydrofluorocarbons; Perflurocarbons; and Sulphur Hexafluoride. The target for each Annex I Party is listed in Annex B. The targets range from a *reduction* of 8 percent to an *increase* of 10 percent calculated as an average over the commitment period 2008-2012. If all Parties meet their targets, the overall reduction in emissions from 1990 levels for that group will be approximately 5.2 percent.

The key feature of the Kyoto Protocol is that by requiring a group of countries to take on binding legal commitments, it provided for some innovative and not-so innovative mechanisms to allow Parties to achieve their Quantified Emission Limitation Reduction Commitments (QELRC). These include, joint implementation (JI) of projects to reduce the emissions of GHGs (Article 6); establishment of a Clean Development Mechanism (CDM) (Article 12); and Emissions Trading (ET) (Article 17).[3] Other topics taken up for consideration at COP-4 include "meaningful participation" by non-Annex I countries; the ability of Parties to amend the Annexes to delete Turkey from Annexes I and II and to add Kazakhstan to Annex I; treatment of the IPCC Special Report on Land Use, Land Use Change, and Forestry (LULUCF) and related provisions; treatment of the IPCC Special Report on Transfer of Technology and National Communications and Review Mechanisms. These issues and others discussed at COP5 demonstrated some of the limitations of international agreements.

The limitations of the Kyoto Protocol

International agreements generally, and international environmental agreements in particular, are susceptible to criticism because as products of compromise they rarely please all interested parties. Unfortunately, and to some extent unfairly, the UNFCCC and the Kyoto Protocol do not escape this criticism. Compromises arrived at as a result of the late-night negotiating sessions and the simple inability to "tie all loose ends" make these instruments easy targets. These criticisms hardly serve any useful purpose, if one were to look at these instruments as "work in progress."

That said, it is still important to answer the criticism that Kyoto was not even a modest accomplishment. The suggestion is that even if all Annex I countries were to live up to the commitments they made at Kyoto, the total emissions from these countries by the end of the first commitment period would, in fact, be nearly the same as they are today! In other words:

> *the Annex I countries will not follow through on the obligations entered into in Kyoto; and even if they did, it will not have any beneficial impact.*

The implicit suggestion is that Kyoto makes or made no difference in getting us on a path to reducing GHG emissions in Annex I countries.

In this light it is key to ask whether the reductions agreed in Kyoto are so small as to make them meaningless? A UNFCCC study looked at "business as usual" projections for 2010 from 1990 levels and concluded that they constitute an increase of between 19 percent and 33 percent. The mid-range is an increase of 24 percent from 1990 levels. When one takes the overall reductions agreed to in Kyoto and adds that to the mid-range of the projected increase, the reductions in 2010 would be approximately 29 percent.[4] By virtue of the fact that emissions reductions are counted from 1990 levels, the Parties could go back to their respective legislatures and point out that they have agreed only to modest commitments which are only between a decrease of 8 percent and an increase of 10 percent.

An additional key question is how does one address the possibility that the variety of mechanisms agreed to in Kyoto (in order to gain political acceptance of industrialized countries and the private sector) do not subvert the modest goal of accomplishing the 5.2 percent reduction from 1990 levels? The way to address this is not by recognizing what is wrong with the Protocol, but by ensuring that the use of the cooperative implementation mechanisms (CIMs) is done in such a way as to accomplish net reductions from Annex I countries and to achieve global stabilization to prevent anthropogenic interference with the climate system.[5] This is precisely the reason why any one interested in the healthy development of the climate regime should be interested in each and every opportunity presented by each COP.

3. The Buenos Aires Action Plan

Since the adoption of the Kyoto Protocol, a great deal has happened — particularly during COP-4 in Buenos Aires and to a slightly lesser extent during COP-5 in Bonn. At COP-4 the BAPA was adopted. In addition, there were two meetings of the UNFCCC's subsidiary bodies. Now, as the Parties prepare for their next COP at The Hague, Netherlands, a great many questions remain to be resolved.

In preparation for this meeting, a few important points should be kept in mind. Clearly, most of the work will focus on the details to be worked out in operationalizing the

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provisions of the Kyoto Protocol. But it is wise not to lose sight of the work that still needs to be done in implementing many of the provisions of the UNFCCC that has already been ratified by more than 176 countries and is in force. What are the "commitments" contained in UNFCCC?

Annex I countries agreed to adopt national policies and take corresponding measures to mitigate climate change, by limiting their anthropogenic emissions of greenhouse gases, and protecting and exchanging their greenhouse gas sinks and reservoirs. Further, Annex I countries agreed to take the lead in modifying longer-term emissions consistent with the objectives of the Convention, recognizing that the return by the end of the decade to earlier levels of anthropogenic emissions of GHG (not controlled by the Montreal Protocol) would contribute to such modifications.

The developed countries (not including countries undergoing the process of transition to a market economy) agreed to provide new and additional financial resources to meet full agreed costs incurred by developing country Parties in complying with their obligations concerning communication and information. The developed country Parties also promised to provide such resources, including those for transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs of implementing their commitments.

The extent to which developing country Parties will effectively be able to implement their commitments under the Convention will, it was agreed by all, depend on the effective implementation by developed country Parties of their commitments under the Convention. This is especially the case pertaining to financial resources and their willingness to transfer technology, taking fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties. Thus, the question remains how to achieve these ends.

Prior to COP-4, a workshop involving several participants in the climate negotiations identified the following measures for the purpose of enhancing success of the Kyoto Protocol. These measures are the following:

- Encouraging signature and ratification of the Kyoto Protocol
- Encouraging implementation of the Protocol pending its entry into force
- Encouraging more direct and formal private sector participation
- Building confidence and increasing cooperation
- Expanding participation by non-Annex I Parties
- Formulating a Buenos Aires Action Plan

It is instructive to note that outside of formulating a BAPA, which is heavily concerned with the CIMs, virtually everything else remains central to the development of the elementary climate regime. Before going into the details of what or how these might be addressed, it may be useful to look at the specific issues identified at COP-4 in BAPA. Those issues were taken up in Buenos Aires and in Bonn. COP-4 did produce the Buenos Aires Action Plan, and COP-5 helped lay the groundwork for the plan's actions to be agreed upon at COP-6. The principal disappointment at COP-5 among many countries was the inability to agree on the Second Review of the Adequacy of Commitments (by Annex I Parties).

As already pointed out the BAPA contained a listing of some 140 items to be taken up over the two following years. In addition to the CIMs, there are a number of issues that were touched on in BAPA. All concerned agree that BAPA dealt at some length about designing the mechanisms to support long-term climate protection in a fair and equitable manner. But there are other issues as well. These include land use change and forestry and technology transfer issues, both of which are being dealt with in IPCC special reports. Further, there are other issues including the role of developing countries in the emerging climate regime; creating an effective compliance system; including linkages and interdependence; developing a compliance regime; and improving the record on technology transfer.

Although BAPA listed 140 issues for negotiation, several important issues have been left out

What can be done as we wait to develop the details outlined above? It is important to encourage every possible effort to reduce greenhouse gas emissions. Whether or not Annex I countries accept in the near term their quantitative obligations, it is crucial that they begin reducing their domestic GHG emissions as soon as possible if there is to be any hope of meeting the GHG reduction goals set for the 2008-2012 time period. In some instances, reductions have been or may be achieved for unrelated reasons,[6] or as a result of other policies. Whatever the reasons, these results are still important in moving towards the Protocol goals.

There are at least three ways an Annex I country can benefit by reducing GHG emissions domestically while conducting the formal processes of Protocol ratification and awaiting its entry into force. First, by documenting and publicizing its reduction efforts, a it will enhance its international reputation. Second, if it helps other countries to learn from its efforts, it will make reductions by other countries more likely. For example, a country may be encouraged to reduce its own emissions when it learns

The private sector needs the rules to be made clear if it is to take action to reduce GHG emissions

just how substantial the economic benefits of fuel-switching have been for its neighbor. Third, if it can show low or negative economic costs and significant environmental benefits from its actions, it will build domestic political support for reducing GHG emissions.

It now appears that the availability of CIMs, once their operation is clarified, can play a large part in encouraging voluntary action while ratification proceeds. By offering incentives to industry, they, in turn, will be eager to encourage governments to act if there are corresponding and sufficient financial rewards. Thus, the further development and implementation of CIMs discussed in Kyoto are important to encouraging voluntary action.

It is timely to encourage the private sector to become more formally involved in implementing the goals of the UNFCCC, particularly the design of the CIMs contained in the Kyoto Protocol. Not only is its involvement likely to be critical to the success of the CIMs, but the private sector is in a position to bring significant inducement to countries that have not yet signed, or may be hesitant to ratify, the Kyoto Protocol.

Why might corporations become more active supporters of the UNFCCC process? In various parts of the world, much to the surprise of national governments, corporations are now asking for clarification of the "rules" governing emissions trading and domestic efforts to reduce GHG emissions. The high degree of uncertainty, both globally and domestically, as to which actions for reducing GHG emissions will receive credit, is making it difficult for corporations to plan their business efforts, and discouraging them from taking early action. Moreover, a number of companies have realized that there are substantial economic gains to be realized by corporations ready to make the global treaty system work for them. Given a choice, some corporations might prefer that the UNFCCC had never been signed. Nevertheless, recognizing that more than 175 countries have already ratified the UNFCCC to reduce GHG emissions, many of the world's leading corporations are now focused on the opportunities this might create.

It is important that all Parties have confidence that each is doing its share to implement the convention. Non-Annex I countries are generally unaware of the efforts that Annex I countries are making to fulfill the mandate of the Climate Change Convention. With a number of Annex I Parties calling for the expanded participation of non-Annex I Parties in the ongoing effort to implement the UNFCCC, it is critical that these non-Annex I countries have confidence in the fact that Annex I Parties are taking their commitments seriously, by their actions domestically.[7]

There are several ways in which confidence building and increased cooperation of non-Annex I Parties might be linked. The first concerns implementation of the CDM created at Kyoto. CDM is obviously going to be important to the efforts that certain non-Annex I countries make in reducing the growth of emissions over the next few years. Thus, it is important to design this mechanism with an eye toward the kinds of incentives that would be most effective and most responsive to the interests of developing countries. In addition, a commitment on the part of Annex I countries to help launch the CDM will underscore their stated desire to support the voluntary involvement of non-Annex I countries in the implementation of the Convention.[8]

The developing countries are quite concerned about the structure of the CDM governance mechanism. If its creation is going to be seen as a confidence building measure that will lead to increased cooperation and participation of non-Annex I countries, its structure needs to be responsive to their concerns. That is why at the present time, they are putting so much emphasis on the design of the institutional arrangements that will oversee the allocation of CDM resources.

Another strategy for building confidence and expanding the participation of non-Annex I countries might be something called voluntary independent review (VIR) of what is already happening in developing countries. Such a review would open up on-going efforts to outside experts. It might also help to broaden international understanding, in an independently documented fashion, of the substantial efforts already underway. This would respond, at least in part, to the concerns expressed by the United States Senate that the developing world is not acting on its commitments to reduce emissions.[9]

The VIR reporting process might make greater use of independent experts than country reports required under the UNFCCC. On the other hand, it could likely be less comprehensive and/or less demanding than the national, sectoral and project review process that accompanies requests for funding to some multilateral and bilateral institutions. VIR would focus exclusively on activities directly related to the objectives of the Treaty and the Protocol. The goals of VIR would be to: (i) ensure that non-Annex I countries can learn from each other; (ii) guarantee that consistent information on efforts to reduce GHG emissions in non-Annex I countries is provided to the full range of multilateral institutions seeking such documentation; and (iii) provide skeptical policy-makers in Annex I countries with credible documentation of the substantial ef-

forts already underway in non-Annex I countries to meet the original objectives of the UNFCCC.[10]

4. Implementation of KP and BAPA—Strengthening the Emerging Legal Regime

It is not yet clear that a sufficient number of UNFCCC Parties will ratify the Kyoto Protocol to allow it to enter into force in the near future. Certainly, political circumstances in the United States make ratification by that country unlikely at present. If the United States does not ratify the Protocol quickly, others might use this as a reason for not doing so themselves. Whether the Protocol enters into force in 2002 (as part of Rio + 10), or even later, it is important to maintain the momentum achieved in Kyoto, and to provide clear and convincing evidence that the signatories to the UNFCCC intend to live up to their commitments.

The message from Kyoto is clear. All countries eventually have to accept legally binding commitments to ensure that the concentration of GHGs in the atmosphere is at an acceptable level. But the questions of fairness and how they get addressed within the framework of the evolving climate regime will determine at what stage the developing countries will join the industrialized countries. As we await the entry into force of the Kyoto Protocol, it is useful to remember that if nations act in their best interest and are not locked into inflexible negotiating group positions, progress will indeed occur.

5. Legal Analysis of Key Provisions of the BAPA

By its decision 7/CP.4, the COP adopted a work programme on the mechanisms under the Kyoto Protocol, with a view to taking decisions at its sixth session, including recommendations to the COP serving as the meeting of the Parties to the Protocol (COP/MOP) on principles, modalities, rules and guidelines (UNFCCC/CP/1998/16/Add.1).

This section provides a legal analysis of the BAPA and institutional design of the CIMs, i.e., the CDM, ET, and JI.[11]

Issues applicable to all CIMs

In reviewing and designing the mechanisms, it is helpful to understand key terms that are found in the Protocol and whose definitions affect the success of the mechanisms. These terms are the following:

Supplementarity

The Articles of the Kyoto Protocol pertaining to the CIMs, i.e., Articles 12 (CDM), 16 (joint implementation) and 17 (emissions trading), state that the reductions achieved by Annex I Parties through the mechanisms will be ***supplemental*** to domestic actions. These provisions seek to ensure that developed countries engage in domestic actions and change their national policies in order to lower emissions, and do not attempt to reach their emissions targets solely through actions in developing countries. What constitutes "supplemental" actions for Annex I countries, however, has not been agreed.

Some countries take the position that there should be a prescribed ceiling on the use of CIMs, e.g., allowing countries to use the mechanisms to achieve only a certain percentage of their target. Others would allow countries to decide for themselves what "supplemental" means. There are no apparent legal norms applicable to the question of supplementarity under the Kyoto Protocol. While there are treaties that require Parties to limit or modify their behavior in some form, there are none that involve the use of similar cooperative mechanisms in order to achieve that limitation or modification.

There are currently four main options on the table regarding "supplementarity," as it pertains to all mechanisms:

Option one focuses specifically on emissions trading and would make access to Article 17 contingent upon the satisfaction of a prescribed domestic effort, but has not provided a proposal on what would constitute a "satisfactory" effort.

Option two proposes a formula for limiting the extent to which a country can use the mechanisms by proposing ceilings on transfers and acquisitions. Under the proposal, net acquisitions by an Annex B Party for all three mechanisms together must not exceed the higher of two alternatives, which roughly allow for using the mechanisms for achieving 50 percent of a country's target or less.

Option three proposes that the overall "cap" on the use of the three mechanisms should not exceed 25-30 percent as a maximum. The proposal does not provide details on how this percentage would be calculated. It could be a percentage of the base year emissions, of the assigned amount, or the estimated reduction required to achieve the commitment.

Option four states that there should be no elaboration of the term "supplemental to domestic actions," which could mean there should only be a restatement of language in the Protocol or no statement whatsoever concerning supplementarity.

It should be noted that while proposals often refer to

"Supplementarity" is intended to ensure that developed countries change their national policies to reduce GHG emissions

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limits on transfers and acquisitions together, limiting the level to which a country may transfer emissions reductions and limiting the amounts that can be acquired are separate issues. Limits on transfers in particular will affect emissions trading. (See the "emissions trading" subsection below).

Fungibility

"Fungibility" refers to the interchangeability of the emissions reduction credits among the mechanisms. Under the Protocol, each mechanism was given a separate term for its type of credit or unit. Article 12 will generate "certified emission reductions units" (CERs), while Article 6, referring to joint implementation projects, will generate emission reduction units (ERUs). Article 17 is not based on projects and refers to transfers of "assigned amount units" (AAUs). Parties have not agreed on the extent to which these three types of units are freely exchangeable.

Unless the Protocol is amended to restrict combinations of CERs, ERUs, and AAUs that may be used to meet Article 3 commitments, excluding their fungibility would have no effect

Parties opposing the concept of fungibility have expressed it in various ways, such as stating that the concept of "fungibility" among the three mechanisms is "totally unacceptable." Others have stated that there is no link between Article 12, Article 6, and Article 17; and the three Articles are mutually exclusive. One focuses on the CDM by stating that only a Party included in Annex B to the Protocol may acquire CERs and they are not tradable or transferable to another Party.

Parties supporting fungibility argue for free substitution of AAUs, ERUs and CERs among mechanisms and freedom to transfer assigned amount units repeatedly. Most submissions are silent on the issue of fungibility. This may mean that they have not yet developed a position on the issue, or it could mean that some countries take "fungibility" as a given or an assumption that did not need stating.

An important question is whether excluding the concept of fungibility between AAUs, CERs and ERUs would prevent Annex B countries from using all three kinds of credits in any combination to meet their Article 3 commitments, having due regard to any "supplementarity" requirements. If not, the exclusion would have no effect.[12]

Adaptation fund/share of proceeds

The concept of an adaptation fund arose from the need to help those countries most vulnerable to adapt to climate change. Therefore, Article 12.8 states that a share of the proceeds from certified project activities be used to cover administrative expenses as well as to assist developing countries that are particularly vulnerable to the adverse effects of climate change meet the costs of adaptation. A number of developing countries have submitted proposals calling for an adaptation fund to administer the proceeds from the adaptation surcharge. They state that the generation of funding for adaptation through the adaptation surcharge must be additional to the current and future financing by Annex B Parties of adaptation activities under other provisions of the Convention and the Protocol.

Numerous developing countries have proposed expanding this idea to the other mechanisms as well. They have supported the idea of contributing a specified percentage of the ERUs or AAUs or the value thereof toward helping meet administrative expenses and the adaptation needs of developing country Parties. Many made the proposal using slightly different language, but all support the idea that there should be some kind of "levy" on these types of transfers. However, it should be noted that Article 6 and Article 17 make no provision for levies on transfers of ERUs or AAUs. There are many questions that arise regarding the administration of such funds, but are not yet fully answered under Party proposals, such whether the "share" is to be represented by –C units received by the fund, or their value. It is not clear how this value would be calculated or, if units are contributed to a fund, how those units will be translated into monetary resources.[13]

One Party has stated that adaptation project activities and measures shall be guided by information from national communications and the three stage approach[14], which includes planning (studies of possible impacts, identification of particularly vulnerable countries, policy options) measures taken to prepare for adaptation, and measures to facilitate adequate adaptation, including insurance. They also spell out requirements for financial assistance, including consistency with all relevant international agreements and internationally agreed programmes of action for sustainable development.

Relationship to Article 4 of the Protocol

Protocol Article 4 allows for the joint fulfillment of commitments. While the origins of the Article were directed at the Protocol's only regional economic integration organization, some Parties have also discussed it in relation to other possible regional agreements or "bubbles." The Article states that if Parties to such a joint agreement fail to meet their group target, then each Party will be responsible for its own level of emissions. However, it does not address how group targets will be treated under the mechanisms.

Regarding the relationship between the mechanism rules and Article 4, several Parties have noted that Parties will "need to focus on whether a Party operating under Article 4 may or

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may not acquire any ERUs resulting from projects under Article 6, if another Party operating under the same Article 4 agreement, or if a regional economic integration organization to which the Party belongs and which is itself a Party to the Protocol, is found not to be in compliance with its obligations under Articles 5 and 7."

Article 4 provisions could most directly affect emissions trading. Article 4 does not raise issues of how the liability provisions are implemented for members of an Article 4 bubble if the group as a whole is not meeting its commitment, but some members in the group are meeting their adjusted commitments, or if the group as a whole is meeting its commitment but some group members are not meeting their adjusted commitments. Article 4 may also affect treatment of member Parties under the compliance regime and possibly under some other provisions of the proposed rule. Article 4 could affect, at least, the proposals for eligibility, supplementarity, liability, and compliance. However, no substantive submissions were received on how proposed rules for Article 17 would be applied if a Party were a member of an Article 4 agreement.

Relationship to WTO

While concerns have been raised about possible distortions of competition at international level, no substantive submissions have been received on this subject. One Party has proposed that the COP/MOP track the potential for distortion of competition and include standard checks in the guidelines. Guidelines to define unfair competition would be needed. It might be possible to define such guidelines in consultation with the World Trade Organization (WTO). Issues of litigation and the relationship between the COP or COP/MOP and WTO should be clarified.

Emissions Trading: Article 17

The concept of emissions trading is a way to achieve environmental benefits, while saving costs.[15]

Principles

In dealing with emissions trading, there are various views on rights and ownership. In some countries, the units are items to which both public and private sector can claim. Other countries have stated this should be limited only to the public sector. If they are seen as goods and there are subsidies and limits on sales, it implicates WTO trade rules. The Protocol currently allows AAUs to be transferred or acquired by Annex B Parties, but does not restrict the nature of the agreement between Parties engaging in such a transfer.

The nature and legal character of the unit to be traded will need to be defined, because it affects the acquisition, fungibility and transferability of the AAUs. Some Parties have called for ensuring that no right, title or entitlement is attached to AAUs that are transferred or acquired. Others have proposed stating that the Protocol has not created any asset, commodity or goods for exchange.

With regard to participation in the mechanisms, some countries have proposed that ratification, i.e., status as a Party to the Protocol, be a prerequisite to participation in the CIMs. If the units were also seen as "commodities", then the situation would arise where a Party would not be allowed to trade AAUs with a non-Party. If both countries are WTO members, this exclusivity may violate the WTO's most favored nation principle. This principle, expressed in the General Agreement on Tariffs and Trade (GATT) Article I, states that any trading privilege a Member extends to another Member must be extended to all Members. That is, all Members are most favored.

The nature and legal character of the units traded bear on whether WTO rules apply to the transactions

Limits on transfers (hot air)

In addition to the above-mentioned proposals to limit acquisitions, some proposals address the concept of limiting transfers. Some Parties have proposed a requirement to make access to Article 17 by an Annex B Party contingent on satisfaction of prescribed domestic effort in fulfillment of commitments under Article 3. This could mean that an Annex B Party is not eligible to transfer of AAUs unless it has satisfactorily implemented prescribed measures domestically.

Another option proposed a formula on supplementarity as it relates to transfers. There is no mention of a limit on transfers of AAUs in Article 17 or elsewhere in the Protocol. Some Parties argue that a limit on transfers is needed to ensure that use of an acquired assigned amount is supplemental to domestic action. Another effect, however, would be to limit transfers of "hot air" by Annex B Parties with economies in transition. Many countries with economies in transition have undergone severe economic slowdown since 1990, the year upon which emissions levels are based. This means that these countries' emissions are currently well below 1990 levels and they will have emissions credits to transfer to other Annex I countries in need of credits. The end result of this "hot air" transfer would be that countries could foreseeably buy these credits to meet their targets, although they would change little action domestically and the credits themselves represent no real change in policy. Some Parties,

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There are various proposals on eligibility of Parties to participate in emissions trading

however, have proposed to have no elaboration of the term "supplemental to domestic actions."

Participation by Parties

The rules on participation will spell out what a Party must do in order to make use of the Protocol's mechanisms. There are essentially two currently proposed approaches. The first approach establishes conditions a Party must meet before it is eligible to participate in emissions trading. The second approach assumes that a Party is eligible to engage in emissions trading unless it has failed to meet specified conditions.

Under the first approach, an Annex I Party listed in Annex B of the Protocol shall be eligible to transfer or acquire AAUs under the provisions of Article 17, if the Party has, inter alia, ratified the Protocol and is bound by a compliance regime adopted by COP/MOP.

Some countries have proposed that Parties be required to be in compliance with their Protocol commitments under Article 3 before they can participate in trading. Parties have debated whether this is appropriate because Article 17 was intended as a means to help an Annex B Party to achieve compliance under Article 3. Other Parties have proposed that Annex B Parties be eligible to participate in emissions trading only if they are in compliance with the reduction commitments established under the Convention as well as in the Protocol. The requirement to be in compliance with Articles 5 and 7 if the Protocol is widely supported. The more generic also propose that the Party be required to be in compliance with its reporting obligations under Article 12 of the Convention.

Under the second option, a Party may not participate in emissions trading under Article 17 if it is found either not to be in compliance with its obligations under Articles 5 and 7; or not to be maintaining a national registry. A national registry would be used to track the generation, transfer, and retirement of AAUs. It would present a Party's current holdings and actions.

The Umbrella Group has also proposed that if a Party's consistency with the above requirements is called into question by the review process under Article 8 or by other means, the issue will be expeditiously resolved either through a general procedure applicable to the Protocol or through a specialized procedure. The review in Article 8 is limited to the information provided by Parties under Article 7. This appears to imply that consistency with the above requirements must be included in the reporting guidelines to be adopted by the first COP/MOP or that a special procedure would need to be developed. A special procedure could be included as an appendix.

Participation by legal entities

Some Parties have proposed that an Annex I Party listed in Annex B may authorize legal entities to participate in emissions trading under its responsibility, if the Party is eligible to participate in emissions trading, and has established and maintains a national system or registry for accurate monitoring, verification, accountability and allocation of AAUs to authorized legal entities. It is not clear whether the intention is to go beyond accurate tracking of holdings by legal entities in the national registry to allocation of AAUs and verification of compliance with domestic obligations by legal entities. There are no obvious legal precedents regarding the designation of legal entities to act on behalf of the national authority. Therefore, some Parties have stated that acquisitions may have to be arranged directly between Parties, rather than through brokers or agents. The Party proposing this language has not indicated its underlying intent nor who would consider any objections that arise. The intent may have been a simple effort to ensure transparency.

Methodological and operational issues

Verification: This is the process by which the authenticity of emission reductions are checked. This process will be important for ensuring the legitimacy of transfers, as well for the environmental integrity of the Protocol. For verification, some Parties would require that each Annex I Party included in Annex B participating, or authorizing any legal entity to participate, in emissions trading, must establish a national system for managing and monitoring emissions trading. Internal verification must be carried out before reports are submitted to the COP/MOP. Others would have them arrange for periodic independent validation/certification of the national inventory by an accredited independent entity according to international standards agreed by the COP/MOP.

Other Parties would address verification by requiring Parties to maintain compliance with their obligations under Articles 5 and 7 and maintain a national registry. If there are indications that a Party may not meet the requirements for eligibility to transfer or acquire AAUs under the provisions of Article 17, the Party's consistency with the emissions trading eligibility requirements should be reviewable, initially by the Article 8 expert review process and subsequently, if appropriate, by a suitable procedure under the Protocol's compliance regime.

Several Parties have also mentioned the need to address the role of auditing firms, as well as the possible application of ISO 2000.

Another approach could be to have the secretariat verify the cumulative annual emissions and the cumulative annual allocation of AAUs as reported by the Party, and determine the quantity of assigned amount units the Party has available for transfer. Other approaches do not require verification of emissions or AAUs available for transfer except as part of the Article 8 review of national communications.

Procedure to limit transfers

This is the most complicated and controversial area of emissions trading in that the proposals seek to add some type of control or in order to check on Parties compliance and add legitimacy to the Protocol. The proposals address the situation when Parties that have transferred credits, which are intended to represent actual emission reductions achieved by a Party, are later found not to be in compliance with the Protocol. In this situation, some units will have been transferred that represent an emissions reduction that did not happen.

As a result of these types of transfers which may have occurred, when a Party exceeds its budget, Parties need to address these system failures, and as a result, the issue of liability arises. The term "liability," in it simplest form, refers to the determination as to which Party in a transfer will suffer a loss and be unable to account or claim a particular reduction credit against its target. This calculation in turn can affect the market value of a unit in terms of emissions trading. There are many options on the issues presented to the Parties for their decision making.

Buyer Liability: This approach has implications for the recipient (i.e., transferee) of the traded units. If an Annex I Party has not complied with its commitments under Article 3, the part of the assigned amount that has been "transferred" in accordance with Article 17 shall be invalidated for that budget year.

Seller Liability: This approach has implications for the supplier (i.e., transferor). A Party whose actual emissions for the commitment period exceed its assigned amount (adjusted for transfers and acquisitions of AAUs, ERUs, and CERs) after the compliance deadline will be subject to the provisions of the compliance regime adopted by COP/MOP. Penalties might include loss of eligibility to participate in emissions trading in the subsequent commitment period, and/or forfeiture of AAUs for the subsequent commitment period.

Shared Liability: Some Parties have proposed that there should be shared liability in cases where both the buyer and the supplier, or where, either or both are not in compliance. This requires due diligence by both Parties into the compliance of their partners. If a Party is found to be in noncompliance with its commitments under Article 3, a portion [x percent] of any of its AAUs that have been transferred to other Parties under the provisions of Article 17, shall be invalidated and cannot be used for the purpose of meeting commitments under Article 3 or further traded. Also, the portion [x percent] to be invalidated could be some multiple of the degree of noncompliance. The degree of noncompliance is the percentage difference between emissions in the commitment period and assigned amount.

Compliance Reserve: Under this approach, a certain amount of AAUs from each transfer would be set aside to ensure that the Party complies with its target. A portion [y percent] of every transfer of AAUs under Article 17 shall be placed in a compliance reserve in which event the units may not be used or traded. The secretariat, as part of the annual compilation and accounting of emissions inventories and assigned amounts under Article 8, shall include a report of the units deposited in the compliance reserve. At the end of the commitment period, such units shall be returned to the Party of origin if that Party is in compliance with its commitments under Article 3, in which case the units can be transferred or banked for future commitment periods. If at the end of the commitment period, a Party is not in compliance with its commitments under Article 3, an appropriate number of units deposited in the reserve account shall be invalidated, in which case they may not be further used or traded. The EU has proposed this approach.

"Trigger": This approach would set a "trigger" point during a commitment period to signal when a Party appears unlikely to meet its commitments under Article 3, and to limit that Party's ability to transfer or trade units. If a question is raised on a Party's compliance and the Party is subsequently found to be in noncompliance, any AAUs that have been transferred to other Parties under the provisions of Article 17 after the point in time at which the question was raised shall be invalidated and cannot be used for the purpose of meeting commitments under Article 3, or further traded. Such questions can only be raised in particular circumstances to be defined.

Units Surplus to Plan: This approach would limit trading to units proven to be "surplus" units not needed by a Party to meet its reduction targets. A Party would be required to have a "compliance plan," and trading would be

There are several proposals to fix liability in the event of noncompliance by Annex B Parties

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limited to surplus AAUs under that Party's plan. Each Party that wishes to undertake transfers must allocate its total assigned amount among the five years of the commitment period and notify the UNFCCC secretariat of these annual allocations prior to the start of the commitment period. A Party can at any time adjust its annual allocation for the remaining years of the commitment period by notifying the secretariat in advance of the year(s) in question.

Surplus Units: This approach differs from "units surplus to plan" in that it limits trading to units proven to be "surplus" after the first commitment period. This proposal means that there could be no emissions trading until after the first commitment period. If Parties have a short period of time to come into compliance, trading could occur then.

Also related to liability, some Parties have proposed that at the end of each commitment period, there should be a short time period during which Parties have the opportunity to cure any "emissions overage" or amount that their emissions have exceeded their target, e.g., through acquiring units of assigned amount. The proposal suggests that the period might be relatively short following the end of the commitment period. Thus, the period would need to be 2 to 3 years after the end of the commitment period. If a compliance deadline is adopted, say 2014, the period after the compliance deadline could be relatively short, perhaps three months.

Joint implementation: Article 6

Article 6 on joint implementation allows for transfers of ERUs between Annex I Parties, based on reductions achieved through projects. Article 6, however, differs from Article 12 (CDM). Projects under the CDM generate CERs, which represent a "new" unit. Articles 3.10 and 3.11, however, specify that any ERUs that a Party acquires from another Party will be added to its assigned amount, and any ERU transferred will be subtracted from the transferring Parties assigned amount. In other words, the units transferred under Article 6 are actually assigned amount units, renamed as ERUs, rather than a new reduction unit. The key institutional debate under Article 6 therefore is the level of administrative checks needed for legitimacy. That is, whether the Parties involved will make the decisions regarding certification or validation or an independent entity, subject to COP/MOP review, will make them.

There is no real distinction between ERUs and AAUs

Participation

For participation in Article 6 projects, some Parties have spelled out criteria for participating, such as having ratified the Protocol, being bound by a compliance regime to be adopted by COP/MOP, not being excluded from participation according to whatever compliance regime is eventually adopted; and, being in compliance with commitments under Article 12 of the Convention.

Other Parties have presumed eligibility but proposed that a Party can lose its right to participate. Failure to maintain a registry would limit a Party's ability to acquire or transfer ERUs. Failure to satisfy Articles 5 and 7 would limit acquisitions, but not transfers. This approach would leave participation criteria to the individual Parties. The proposal also includes a procedure for addressing queries under the review process in order to ensure environmental integrity.

Project validation/registration

There are basically two options. One option would validate a project before ERUs can accrue. The proposed steps include having: (i) the approval of the Parties involved; (ii) all Parties involved in the project submit a statement of project approval to the secretariat; (iii) all legal entities involved in the project demonstrate that they are entitled to participate; (iv) project participants provide a determination of baselines to the independent entity; and (v) the project participants provide information to the independent entity on their procedures for monitoring. If this option is chosen, Parties will have to define what is meant by any legal entity "involved" or "participating," (i.e., would this include a bank that makes loans, nongoverment organizations (NGOs) that help implement, creditors with an equity interest, etc.)

Another option leaves project approval to the Parties involved and states that a Party may develop its own internal mechanisms and criteria for project approval based on its domestic circumstances. The Umbrella Group has also proposed that a project under the AIJ pilot phase will be eligible to be pursued as a project under Article 6 if the project meets the criteria established in the rule, under the mechanisms, and if the Parties involved in the project agree that it should be considered as an Article 6 project.

Poland has proposed requiring only the approval of the host country, even though Article 6 requires approval by both Parties. In fact, approval by the host country may be all that is needed. For some projects, the other "party" may be an investment fund such as the World Bank or a group of private investors. Also, an ERU may ultimately be traded and the Party using it may not be the same as the one which approved it. Therefore the original approval may not be meaningful.

Certification/issuance of ERUs

There are three options proposed for this step.

Option 1: The Party in which the project site is located shall issue ERUs and transfer them to Parties and/or entities participating in the project. Emission reduction units shall be distributed among the project participants according to their agreement.

Option 2: Certification and verification would be carried out on international level by the same independent authority, which is to perform this within the CDM mechanism, whereas on national level, this should be done by an NGO. Poland proposes that an "Operating Authority" approve a project under Article 6 upon request of a project participant and verify that it complies with relevant guidelines and principles. Such decisions on Article 6 projects need to be approved by the Executive Board of the CDM.

Option 3: Independent entities would certify the emission reductions resulting from a validated project upon request of a project participant, which would have to meet a number of criteria. Emission reductions shall be certified after they have occurred if the applicant submits the necessary monitored data proving that: the project has resulted in additional emission reductions by sources, or an additional enhancement of removals by sinks; and that these emission reductions or enhancements of removals by sinks are real, measurable and long-term.

Parties will need to establish a process to ensure that AAUs are retired. Under Article 3.11, when an ERU is issued, an AAU of the transferring Party should be subtracted. The entire problem would be avoided if a separate unit of an ERU was not established and only AAUs were transferred. It should be clarified to Parties that there may be no need for certification whereas there is a built-in means for ensuring that ERUs are valid. The host country of a JI project will not likely give away an AAU that it may need for reaching its own target until it is absolutely certain that the emissions reductions have been achieved. The fact that JI is a zero sum game actually lessens the need for heavy administrative rules.

Clean Development Mechanism: Article 12

Participation

There are basically two options with regard to Annex I Party participation.

The first option would spell out criteria that a Party must meet in order to use CERs to contribute to compliance of the Party. Some would make ratification of the Protocol a pre requisite, as well as binding Parties to compliance with the regime adopted by COP/MOP. Many Parties supporting this option would also require that a Party have not been excluded from participation in the CDM according to the procedures and mechanisms under any compliance regime established, and be in compliance with its commitments under UNFCCC Article12. There are proposals requiring that the Party satisfy some prescribed domestic effort in fulfillment of commitments under Articles 2, 3, 5, and/or 7.

Under the second option, an Annex I Party included in Annex B may not use CERs accruing from CDM project activities if that Party is found not to be in compliance with its obligations under Articles 5 and 7. If a Party's consistency with the eligibility requirements is called into question by the review process under Article 8 or by other means, the issue will be expeditiously resolved. Neither option mentions the necessity of a Party maintaining a registry. This is a requirement proposed for both of the other mechanisms.

Regarding non-Annex I Party participation, many Parties proposed the same requirements as mentioned for Annex I Parties. Some Parties have also proposed that no unilateral measures for CDM participation should preclude a developing country Party from participating in any CDM project activity, although it is not clear how this might be operationalized. One Party has proposed that a non-Annex I Party may formulate and develop projects under the CDM without previous agreement with an entity or Party included in Annex I.

One proposal would allow unilateral CDM projects by developing countries

While numerous submissions agree that private and/or public entities can participate in the CDM with the approval of the Parties involved in CDM projects, they differ in qualifying such approval. Some would subject it to whatever guidance may be provided by the Executive Board; the Party in which the entity is resident, being eligible to acquire or transfer certified emission reductions; compliance with CDM rules and guidelines, and relevant provisions in the Protocol; and compliance with any rules or guidance for participation in CDM project activities established by the host Party and the Party in which the entity is resident.

Many developing countries have stressed that submissions state that Parties are responsible for the involvement of their private and/or public entities in CDM project activities. The Parties participating in the CDM project activities must be responsible at all stages and in all aspects for the project activity in which they are participating. Any costs, risks or liabilities that have not been expressly accepted by the non-Annex I Party before approval of the CDM project activity shall be assumed to be the responsibility of the participating developed country Party.

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Projects

There are many proposals on the table regarding what project activities the CDM will seek to accomplish.

Some of the proposals would require reflecting Protocol language, that projects should provide "reductions in emissions and/or an enhancement of removals that are additional to any that would occur in the absence of the 'certified' project activity and assist the host Party "in achieving sustainable development."

Other proposals seek more specific goals, such as requiring that CDM projects should be based on the best available long-term environmental option, taking into account local and national needs and priorities; and should lead to the transfer of state-of-the-art, environmentally-sound technology, in addition to that required under other provisions of the Convention and the Protocol. Some have specifically stated that CDM projects should not support the use of nuclear power.

Sink projects would not be eligible for the CDM until several methodological issues are resolved

Some Parties would call for conditions to be placed on the use of sink enhancement projects, if these are allowed. They would state that projects aimed at enhancing the anthropogenic or non-anthropogenic removals by sinks of GHGs are not eligible for funding under the CDM until the outcome of methodological work on Articles 3.3 and 3.4 is reached, the COP/MOP decides on the eligibility of CDM projects to enhance anthropogenic removals of GHGs by sinks or methods are developed allowing for reliable process assessment.

Regarding the relationship of AIJ to CDM activities, one proposed option would have a project activity commenced after 11 December 1997, including any project activity under the AIJ pilot phase, be eligible for consideration as a CDM project activity if it meets certain criteria. Others have proposed that activities implemented jointly under the pilot phase would be automatically converted into CDM projects. Many proposals agree that, following project validation or registration, resultant reductions in emissions by sources and/or enhancements of removals by sinks from the year 2000 onwards will be eligible for retrospective certification.

Project financing

Some countries have proposed that developed country Parties shall fund CDM projects in developing country Parties and may involve private and/or public entities for such funding. They also note that funding for CDM projects shall be additional to official development assistance (ODA), Global Environment Facility (GEF) and other financial commitments of the developed country Parties. Other Parties have proposed that, where assistance in arranging funding of CDM project activities is not necessary, participants may finance projects unilaterally, bilaterally, multilaterally, or in any manner they wish.

Some African countries have proposed that the COP establish a "CDM Equitable Distribution Fund" to provide financial assistance to CDM project activities where necessary. Annex II Parties would fund it and CERs resulting from CDM projects made possible by this fund would be distributed to the Annex II Parties in proportion to their contributions. The Executive Board should administer this fund. Under this proposal, non-Annex I Parties may propose CDM projects individually or jointly. The Executive Board would award grants to projects in accordance with criteria established by the COP/MOP. Criteria can take into account geographic distribution of existing and planned CDM projects, the comparative need of regions or countries to receive assistance in achieving sustainable development, and the contribution of the proposed project to the global effort to limit and reduce GHGs emissions. Grants would not necessarily have to offset the full cost of a CDM project.

The Association of Small-Island States (AOSIS) has sought to ensure that modalities and procedures for project eligibility shall ensure that CDM investments take place in Parties that are often marginalized by purely market-based instruments. These should include portfolio approaches that allow investments in small scale and geographically remote projects to be funded in a cost-effective manner.

Share of proceeds

Many submissions reflected Protocol text that would have the COP/MOP ensure that a share of the proceeds from certified project activities is used to cover administrative expenses of the CDM and to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. However, opinions vary as to how the share of proceeds is to be defined, including as a percentage of the number of CERs issued' or as a percentage of the value of the CERs issued. Some have proposed that they be defined "on the basis of the CERs, although it is not clear what "basis" means. Some would restrict the share of proceeds to a limited amount.

One proposal would use a percentage of the value of each CDM project, but it is not clear if this means the value of investment in the project or the market value of the CERs. Another envisions the share to be a stipulated percentage

of the differential of the costs incurred by the Annex I Party in reducing GHGs through a project activity in a non-Annex I Party, and of the projected costs that would have been incurred had the GHG reduction activity taken place in the Annex I Party funding the project activity. This proposal would involve determining a baseline of emission reduction costs in Annex I Parties.

Project validation/registration

As a first step, Parties have proposed that the prerequisite for certification of CERs related to that project activity and their issuance is the "validation," "registration" or "presentation" of a project activity. A designated operational entity would prepare a report on the project activity for the Executive Board. The Board shall accept or reject the project, based on the report's recommendation or decision and other relevant information, and inform the participants whether the project may begin.

The three differing terms apparently represent differing levels of administrative requirements. Validation appears to be a more rigorous procedure than registration, as it implies the satisfaction of specified criteria. Presentation appears to be less rigorous than registration. The text currently contains a wide range of proposed criteria for deciding whether a project activity shall be validated, registered, or presented. Some criteria are widely accepted, such as requiring projects to be approved by each Party involved, (i) contribute to the sustainable development priorities of the non-Annex I Party, (ii) be compatible with national priorities as determined by the host Party, and (iii) provide a baseline that meets the approved criteria.

As for other criteria, some Parties propose that the project only meet the criteria for CDM projects established by a host Party and by the Annex B Party involved. It may not be necessary for Annex B Parties to explicitly indicate their approval of a project, as this would be implicitly done through their acceptance of a CER transfer and through their subsequent use of those CERs for compliance purposes.[16]

Others would specify that the project be expected to yield real, measurable and long-term benefits related to the mitigation of climate change, and to lower emissions from the level that would have occurred in the absence of the project activity. India would have the project demonstrate that its funding is additional to ODA, GEF and other financial commitments of the Annex B Parties, while Uzbekistan would have it provide an agreement on the sharing among participants of the CERs that will accrue, the payment of administrative expenses, and the contribution to adaptation assistance.

Determination of sustainable development

There are also several options proposed regarding the determination of whether a proposed project activity contributes to the sustainable development priorities of the non-Annex I Party.

Some would have the decision made solely by the non-Annex I Party or specified by the non-Annex I Party in a letter of endorsement. The Party would develop its own internal mechanisms and criteria for project approval based on its domestic circumstances.

Other proposals have sought to draw from sources outside the UNFCCC process and would have the decision made by the non-Annex I Party using procedures developed by UNEP and Commission for Sustainable Development (CSD) as they become available or by using international guidelines, indicators and/or standards developed by the Parties to meet the sustainable development objectives of the Protocol as a whole by, for example, utilizing the best available environmental technologies.

One Party would require that the decision be made by the non-Annex I Party and confirmed in a written statement indicating how the project activity and its results are consistent with all relevant international agreements relating to sustainable development to which the Parties involved are a Party. The non-Annex I Party must also demonstrate how the project would assist in achieving sustainable development taking into account its economic, environmental, and social conditions according to its own priorities and needs; and the need to minimize adverse environmental, social, and economic effects taking into account existing guidance for sustainable development, and how it contributes to the ultimate objective of the UNFCCC.

The operational entity shall assess whether the baseline of the proposed project, upon which the environmental additionality of the project activity is calculated, meets the approved criteria. This shall involve an assessment of the credibility of the baseline, the major risks regarding the emissions reduction, and potential leakage effects of the project. Project baselines should be credible, verifiable, and, wherever possible, consistent and comparable. Many developing countries propose that baselines should be determined on a project-by-project basis.[17]

Some countries have proposed that if public funds are used, the project participants shall prove that the funding of the project activity will not result in a diversion of, or

There are various proposals on how it may be ensured that CDM contributes to sustainable development in the host country

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competition with, ODA and GEF funding. Furthermore, the Group of 77/People's Republic of China (G-77/PRC) have proposed that the validation, registration, or presentation shall be undertaken by entities with no operational or financial links with CDM project activities and which have not been involved in the identification, development, or management of the project.

Project monitoring and verification

A number of Parties have proposed that participants shall develop a monitoring plan containing information on their procedures for accurate, systematic, and periodic monitoring of the project in accordance with the approved criteria. Participants would also ensure that the monitoring plan is properly implemented, that all relevant data are collected, recorded and stored. It may be useful to include a requirement that monitoring information should be made available to an operational entity or other group, as specified by the Executive Board, in cases where there is concern about the accuracy of the verification report prepared by the operational entity selected by the project participants.

The CDM Executive Board should be able to reverify verification reports prepared by Operational Entities

There are also proposals on the table for means of periodically verifying the emission reductions achieved by the project in relation to the baseline. Parties disagree as to whether such verification shall be performed independently by a designated operational entity selected by the proponents of the CDM project or host Party. It should be of recognized technical capacity to assume the responsibility involved. Parties will also have to decide whether the verifying entity shall report to the project participants, including the Parties involved, as well as the Executive Board and the operational entities.

It may be useful to include a requirement that the verification reports are public information. It may also be useful for the Executive Board to have the option of selecting another operational entity to prepare an independent verification report. This may be beneficial for randomly checking the verification performed by operational entities or investigating concerns raised about the verification of specific projects.

Certification/issuance of CERs

For certifying emission reduction, the EU has proposed a number of steps, such as: (i) a participant in the project applies for the certification of the emission reductions resulting from the project during a specific period of time; (ii) the project activity has been validated and continues to meet the requirements for project validation, and (iii) the applicant submits the necessary monitored data proving, inter-alia, that the project has resulted in emission reductions by sources that are additional to any that would have occurred in the absence of the project activity.

There are four options currently proposed as to who will certify emission reductions and issue CERs.

- by a designated operational entity, upon request of a project participant;
- by the Executive Board on the basis of a verification report submitted by a designated operational entity;
- the host Party government in accordance with its own procedure, and reporting to the Executive Board;[18] and
- an "UNFCCC body" still to be identified.

Once the emission reductions have been certified and the specified share of proceeds has been remitted to the Executive Board, the appropriate number of CERs would be distributed to project participants, including the Parties involved, as agreed among them. Most Parties agree that each CER shall have a unique serial number, from which it is possible to identify the project activity, country of origin, the year of certification and the certifying entity. The CERs shall be deposited to the registry accounts of the recipients and shall be trackable through the registry system.

Some Parties have suggested that certificates should be issued for the CERs, presumably as a confirmation of their validity and ownership. It is not clear why this would be needed, given a reliable registry system, and it would increase transaction costs and the potential for forgery.

Institutional Issues

COP/MOP: In addition to methodological and procedural issues, Parties have also given the COP/MOP the responsibility for, inter alia: defining the terms of reference for establishing the Executive Board; determining the modalities and procedures governing the operation of the CDM; designating operational entities or establishing guidelines as a basis for delegating this function; and deciding which functions they will carry out. Other proposals would have the COP/MOP disqualify operational entities from certifying emission reductions if the Executive Board concludes that the requirements for the certification of the emission reductions have not been fulfilled; determines the basis for private and public sector participation in CDM projects; and establishes rules and procedures for preparation and distribution of the provisional

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agenda of Executive Board meetings, and for presentations to be made to the Executive Board by Parties, and accredited observers.

Executive Board: There are several proposals on the table with regard to the status of the Executive Board, as well as its duties and level of oversight. Most agree that it should be fully accountable to the COP/MOP and shall carry out all instructions and all other functions assigned to it. Parties differ as to whether the Board should exercise authority and guidance over all aspects of the CDM, or supervise and be responsible for the daily management of the CDM, as well as whether it should be a separate standing body of the COP/MOP, or an independent body.

There is also a range of methodological and procedural tasks proposed for the Executive Board, such as:

- defining the areas from which projects can be included in the CDM and define the types of projects that can be included under the CDM;
- supervising CDM project activities to ensure that these are in conformity with the Convention, the Protocol and all relevant decisions by COP/MOP;
- ensuring that information on baselines used for project evaluation, including standardized baselines, is publicly accessible;
- providing guidance for public and/or private entity participants;
- reviewing reports submitted by operational entities and provide synthesis reports to the COP/MOP;
- issuing CERs on the basis of verification reports submitted by designated operational entities; determining the percentage of CERs that will be part of the Adaptation Fund and the manner in which the CERs will be transformed into financial resources;
- assisting in arranging funding of CDM project activities as necessary; and holding its meetings open to all Parties and accredited observers.

In relation to institutional issues, Parties have proposed that the Executive Board shall, inter alia: accredit operational entities based on guidance from the COP/MOP (the Umbrella Group), provide guidance for the involvement of private and/or public entities in CDM project activities (the G-77/PRC); and review and audit operational entities, and revoke the accreditation of operational entities which fail to comply with modalities and procedures determined by the COP/MOP (the European Union [EU] and Umbrella Group). Nigeria has proposed that the Board administer the "CDM Equitable Distribution Fund." This could result in a conflict of interest. This may be avoided by the fund having a separate board.

Regarding the composition of the Executive Board, Parties disagree as to whether the members shall comprise an equal number of representatives from Annex I and non-Annex I Parties, a fair and geographically equitable membership, or an equal number of persons, but not less than two, nominated by each of the five United Nations regional groups. It has also been proposed that the COP/MOP shall select a Chair and a Vice Chair of the Executive Board from among its members, with one of those officers being from a non-Annex I Party.

In addition to these proposals, there should be procedures to ensure there is no conflict of interest for board members, for example, through financial interests in projects. It may be useful to establish a code of conduct for board members and any staff. Some Parties have suggested the Executive Committee of the Secretariat of the Multilateral Fund for the Implementation of the Montreal Protocol as a possible model for the Executive Board. In this case, the Board would be comprised of seven members each from Annex I and non-Annex I Parties, each member serving two-year terms with the ability to serve consecutive terms. The Chair and Vice-chair of the Executive Board would alternate each year between the two groups.

Operational Entities: Most proposals, in some way, state that operational entities shall be designated by the COP/MOP or subject to modalities and procedures specified in applicable decisions of the COP/MOP. They disagree on whether they will either be accredited by the Executive Board based on selection criteria or supervised by the Executive Board, with regard to their activities and decisions. Several proposals have also addressed the need to avoid conflicts of interest and would have the entities be institutionally and economically independent from, and not entitled to participate in, the identification, project development, or project financing of any CDM project.

It is necessary to ensure that Executive Board members and Operational Entities have no conflict of interest in relation to the CDM

There are also two options for designating operational entities. The first would designate them only if they provide for the necessary expertise and the necessary means to validate project activities, to certify emission reductions, and work in a credible, independent, non-discriminatory and transparent manner, and ensure, where appropriate, that the certification is based on internationally agreed standards. The other option would allow the Parties to designate their National Operating Entities, and inform the Secretariat of the Convention and the Executive Board. The procedure to appoint the National Operating Entity's will be the attribution of each Party, who can create a new entity or choose an existing entity for this role.

There are several examples of compliance measures in global environmental treaties

Compliance measures

Using monitoring activity

Compliance with the Kyoto Regime will require decisions on which actors can participate in compliance monitoring and how they can carry out this function. Both the Convention on Trade in Endangered Species (CITES) and the World Heritage Conventions provide for participation by non-governmental organizations, as follows:

World Heritage Convention: To support compliance with the World Heritage Convention, monitoring of natural sites which were World Heritage sites was carried out beginning in 1984 by the International Conservation Union (IUCN). This monitoring was initiated in 1984, taking advantage of the offices of the World Conservation Monitoring Centre in England, and drawing upon a network of 6,000-7,000 IUCN volunteers which had been in place for other IUCN related purposes. By 1993, this monitoring effort also began to include State actors.

Convention on International Trade in Endangered Species (CITES): CITES also expressly provides that NGOs can be responsible for tracking exports and imports, and for maintaining the CITES trade database. TRAFFIC is a division of the World Wildlife Fund active in monitoring illegal wildlife trade, as is IUCN. CITES member countries have the obligation to seize illegal shipments and return them to the exporting state. Thus, the principles of one state being aware of treaty-violative activity is established under CITES.

Long Range Transboundary Air Pollution Convention: The 1979 Convention was established to address the transboundary threat from acid rain. Practically all European States took part in the negotiation of the Convention. The original Convention contained little in the way of binding commitments. In 1987 the Sulphur Protocol to the Convention entered into force pursuant to which State Parties agreed to a 30 percent reduction by 1993 of their sulphur emissions from a base year of 1980.

A potential problem from this type of provision, is that the country which had already undertaken a reduction approach before 1980 would have to expend more funds altogether, than a country that had done nothing up to 1980. Later, a Protocol on Nitrous Oxides was added to LRTAP. Most recently, in 1998, the Parties added a new protocol on Persistent Organic Pollutants agreeing to ban production in certain cases.

The Parties agreed to submit reports on the measures used to achieve the ban to the Secretariat for the Convention.

Compliance measures linked to trade provisions and sanctions

Basel Convention: The Convention provides the following measures:

- Parties cannot export hazardous wastes to States which have banned hazardous waste imports.
- Waste may not be transported unless the exporter has received the prior informed consent of importing party.

Where there are violations of Basel Convention, illegal shipments are deemed

"criminal" and such illegal exports must be:

- taken back by the exporter or generator or by the State itself, or if impractical:
- otherwise disposed of in an environmentally sound manner.

Montreal Protocol: The Montreal Protocol has also addressed how to enhance compliance with its key goals. The Protocol requires that Parties carry out the following:

- Parties must ban imports from non-Parties of Montreal Protocol "controlled substances;"
- Parties must ban exports of controlled substances to non-Parties unless the importing country has submitted data showing that it is in full compliance with the phase-out schedule;
- Parties will undertake to discourage export to non-Parties of technology for producing controlled substances; and
- Parties will refrain from providing financial assistance to non-Parties that would facilitate production of controlled substances.

To help achieve some of these goals the Protocol established an Implementation Committee, which contains both a dispute resolution element, as well as an implementation element. This dual function is an "important innovation in international environmental law" (Hunter, 1998).

Under the Montreal Protocol, the establishment of the Implementation Committee encouraged Parties to the Protocol to be able to police themselves. Further, where there were examples of non-compliance, the Protocol sets up a dispute resolution mechanism among the Parties. It also allows non-Parties certain rights of monitoring on non-compliance disputes. This provision could be useful to developing countries to the Kyoto Protocol, who are concerned that they will have difficulty determining whether Annex B Parties are complying with their emission reduction limitations.

Convention on International Trade in Endangered Species: As noted above, CITES provides greater roles of non-

governmental entities in helping to enforce the aims of the convention, than almost any other international environmental treaty.

CITES also contains the potentially broadest punitive sanctions against countries violating its provision. Article VIII, "Measures to be taken by the Parties" states that:

The Parties shall take appropriate measures to enforce the provisions of the present Convention and to prohibit trade in specimens in violation thereof. These shall include measures:

- to penalize trade in, or possession of such specimens, or both; and
- to provide for the confiscation or return to the State of export of such specimens;

This broad language has enabled some countries to cite NGO reports of illegal trade and to threaten broad sanctions against countries violating endangered species trade requirements.

Financial mechanisms

The GEF is administratively housed within the World Bank, and has three Implementing Agencies — United Naitons Environment Programme (UNEP), United Nations Development Programme (UNDP), and the World Bank. It can have certain other entities serve as Executing Agencies; the Asian Development Bank acts in this capacity.

The GEF acts for purposes of the financial mechanisms to implement the Convention on Biological Diversity and the Climate Change Convention, functioning under the guidance of the Conference of the Parties to the two conventions. GEF projects should be in conformity with the policies, program priorities, and eligibility criteria decided by the Conference of the Parties of each Convention.

GEF operates with an Assembly, a Council and a Secretariat. All participating countries, (over 160), are in the Assembly. The Council is the main governing body. It comprises representatives of 32 constituencies; 18 members are from recipient countries; and 14 from non-recipient countries (developed countries). Some constituencies represent a mix of recipient countries. The Council Chair is shared between the chief executive officer of the Secretariat, and an elected Chairperson. The position alternates with each meeting between recipient and non-recipient countries.

The GEF Secretariat provides operational overview and reports to the Council and Assembly. It ensures the Council's decisions are implemented, and oversees implementation of the GEF work program. It ensures that the operational policies of the Council are implemented in the actions of the Implementing and Executing Agencies. GEF also uses a Scientific Technical Advisory Panel (STAP) to provide scientific and technical guidance to the GEF.

The Montreal Protocol

The Parties to the Montreal Protocol established means to provide to developing countries, technical and financial assistance, including the transfer of technologies. The principal details to the financial arrangements were set out after the Protocol was ratified, in the London Amendments to the Protocol, Article 10.

The Executive Committee (EC) of the Fund is comprised of seven developing and seven developed country representatives. The Chair is annually rotated between the two groups.

The Executive Committee reviews all projects over $500,000 to ensure the projects meet the EC approved criteria. It monitors the Fund's activities and reports annually to the Parties. A permanent secretariat services the EC. Like the GEF, the Montreal Protocol Fund is authorized to call upon the World Bank, UNEP and UNDP to carry out Montreal Protocol projects. To obtain assistance from the Fund, countries must prepare a country report showing how they will eventually stop producing ozone-depleting substances.

5 Postscript: Further developments at the 13th Meeting of the Subsidiary Bodies (SB-13) to the UNFCCC, Lyon, September 2000:

Background to SB-13

With COP-6 only two months away, there was hope that delegates would be able to make substantial progress toward the BAPA at the 13th Meeting of the Subsidiary Bodies to the UNFCCC. Representatives of approximately 160 governments attended this meeting. In their effort to further clarify how the Protocol will be implemented, and further elaborate provisions under the UNFCCC, negotiators have been following an intense schedule of workshops, informal consultations and formal sessions over the past two years, mostly recently, in June 2000, in Bonn.

SB-13 was the last formal round of negotiations before COP-6. Major differences remain after SB-13.

During the first week of the meeting France was saddled by a truckers' strike in protest of rising gasoline prices. Despite dismay of the environmental community, the Government decided to satisfy demands to lower the cost of fuel prices. To many, this was not an auspicious start to SB-13. Nevertheless, SB-13 saw some progress in some key areas.

Compliance

Of the various issues to be addressed, the text on "Procedures and Mechanisms Relating to Compliance" has shown considerable advancement, with most Parties now seeming to have accepted that there will be a Compliance Committee consisting of two branches – a facilitative and an enforcement branch. A number of issues are still to be decided, such as the precise balance of the membership, and the full range of consequences of non-compliance. In addition, there is still bracketed text concerning the scope of compliance and whether it covers more than just the mechanisms (Art. 6, 12, and 17). Resolution of these issues requires especial close collaboration among the working groups focussing on compliance, the mechanisms, and Articles 5, 7, and 8.

Participation of developing countries in the CDM makes their participation in compliance regimes imperative

Work on Articles 5, 7, and 8 has progressed in part due to Draft Conclusions by the Chair of the working group and a paper entitled "Methodological Issues: Guidelines under Articles 5, 7, and 8 of the Kyoto Protocol: Possible Elements for a Decision or Decisions Related to Articles 5, 7, and 8. SBSTA/2000/L.7/Add.1). This work must focus on the issues pertaining to setting up systems for national reporting for estimating GHG accounting (Article 5), the annual inventory of emissions by sources and removals by sinks (Article 7), and the role of expert review teams in this process (Article 8).

At the same time, within the compliance discussion, there is some added clarity on the system's focus toward Annex I parties, and there are proposals on membership on the branches, as well as voting procedures. It has also been fairly well supported that members will serve in their individual capacity, but be nominated through the Parties. In addition, some have argued that the role of developing countries must be addressed in the compliance regime. They make this contention because of the possibility that, if developing countries make a transition to Annex I, they should be included in the compliance regime. They also contend that if developing countries are party to CDM transactions, their participation in a transaction that raises compliance issues would have to be addressed-

Land use, land use change, and forestry

Some progress was also made on issues pertaining to LULUCF. This progress was due, in part, to the effort of the Secretariat to produce before SB-13 a consolidated synthesis text of Parties Submissions on this issue. This effort helped to sharpen the contentious points. Key among these points remains the definition of a "forest" (Art. 3.3.), whether to allow "direct human-induced" activities to be included (Art. 3.4), how to address the issue of "permanence" of carbon sequestration in forests, how to address the ratio of sinks versus sources, and whether to give credit for carbon stock in national reservoirs.

At this stage, some Parties, such as the JUSCANNZ group Colombia, Peru and Chile favor including LULUCF activities in the CDM. The EU, small island States and People's Republic of China have expressed different views urging exclusion. Their concern is that such activities are not as verifiable as source reductions, and that such activities could result in industrial countries buying their way out of obligations at home, through forest purchase in the South. Advocates of LULUCF counter that the same arguments can be made for source projects, and that there are ways to address these issues in the LULUCF context. These include appropriately discounting for loss of carbon stock and putting in place appropriate monitoring tools to review extent of forest cover.

In addition, a series of conditions are being negotiated as to whether and how LULUCF projects could be included in the CDM. One suggestion is to create a positive list of eligible LULUCF activities. Colombia has introduced an interesting proposal on how to address the issue of permanence. Brazil has argued that forest conservation and rehabilitation of degraded lands should be considered "adaptation" activities and receives funds from the Kyoto Mechanism's proceeds. Further, the small island States expressed concern that attention to LULUCF deviates attention from the areas where emission reduction is needed most, noting that net contribution from LULUCF gases is approximately 15 percent of residual greenhouse gases.

Kyoto mechanisms

While LULUCF issues are complicated, they are relatively concise in contrast to those contained in the 150 plus pages of the Chairman's consolidated text on the Mechanisms (Art. 6, 12, and 17). Here, as was the case prior to Lyon, major issues remain in bracketed text. These include the issue of equity among per capita emissions. Noted, inter alia, in the Guidelines to implement Article 6, the G-77, and PRC have expressed the desire to see developed country emissions "contract" on a per capita basis and ultimately move towards "convergence" with those in developing countries. They also seek to address the issue of supplementarity, namely how much emission reduction should be achieved domestically, and how much should be achieved through the mechanisms. The EU and others have proposed a cap on the use of mechanisms.

Further, developing countries have added that there should be a fee charged for transactions under Article 6 and 17 to be used for an adaptation fund to help developing countries. Without this fee, the CDM will be at a competitive disadvantage to Article 6 and 17 projects. In addition to fees, the consolidated text extensively addresses eligibility participation in any of the mechanisms, including review of whether the potential participant is in compliance with other Articles of the Convention and Protocol.

The role of private sector entities in emissions trading, and the importance of safeguards for proper accounting and registries, have been hotly debated. Many developed countries envision a system whereby transfers and acquisitions of serialized units are made between registries, but the underlying business transactions could be left to private sector entities. Should questions arise, the private entities would be answerable to the governments whose units are in question. They argue that the serialized units will never leave the registry, which ensures transparency. Developing countries in particular have raised many questions on how this "trading" would work in practice between private entities, since the Protocol only recognizes sovereign states. Some have stressed that a system that relies solely on registries would only allow Parties to review trades after the fact, meaning a Party's achievement of its target could not be fully known until the end of the commitment period. They have also expressed concern that typical markets problems, such as fraud, could arise. Others, concerned about "hot air" trading, have called for provisions prohibiting a Party from transferring its entire assigned amount.

Issues of governance within the mechanisms also remain unresolved. These include the membership and structure of the CDM Executive Board, and the relationship between mechanisms Executive Board[s] and the COP/MOP. Considerable and difficult discussion also addressed the correct way to set the baseline for eligible projects. Added to this issue is the new language to establish a new threshold criterion for when projects would be eligible for CDM financing. Proponents of this language contend it would ease the complexity in setting the correct project baseline.

Policies and measures

There was some progress on this issue related principally to the policies and measures Annex I Parties should take to meet their Protocol Article 3.1 commitments, reflected in part through a paper entitled "'Best Practices' in Policies and Measures Among Parties Included in Annex I to the Convention". (SBSTA/2000"CRP.9)

G-77 and PRC have urged that the scope of any decision on Policies and Measures be limited to Annex I Parties. The Canada, Japan, and United States indicated a desire to see developing countries included, and for this reason, bracketed "Annex I" in the text of this document. For some Annex I Parties, such as the United States, whose Congress has indicated that it wishes to see "meaningful participation by developing countries", the inclusion of developing countries in the Protocol's policies and measures is politically important. Obviously, developing countries continued to argue that before they adopt policies and measures, there should be some clear progress toward commitments by Annex I Parties.

Policies to reduce GHG emissions may impact other countries, e.g., OPEC

Some Annex I Parties have also opposed reference to Developing Countries proposal that Policies and Measures activities take place under a "consultative process". This opposition is based on the view that such decisions are essentially sovereign. In addition, for somewhat similar reasons, there are disputes about how and whether to address measurement of "demonstrable progress" through Policies and Measures in reaching Article 3.1 goals. In addition, there is dispute over whether Policies and Measures must be reviewed in such a way to determine potential impact on developing countries and done in a way to minimize impact on developing countries. This is especially problematic in relation to Organization of Petroleum Exporting Countries (OPEC) countries, because of the OPEC contention that they should be compensated for the economic impact of movement away from fossil fuel.

Technology transfer, financial and administrative issues, capacity building and "adverse effects"

A series of other issues addressed, but not resolved, include whether to set up an additional fund to facilitate technology transfer and Article 4.5 of the UNFCCC. In this context, Parties considered a "Draft Framework for Meaningful and Effective Actions to Enhance the Implementation of Article 4.5 of the Convention" (SBSTA/2000/CRP.8/Add.7). Under this Framework, the potential role of the CDM and JI would be a supplemental means to finance the flow of environmentally sound technologies (EST), also to be financed by an EST investment fund. MDBs would be encouraged to enhance their programming and lending as well.

Another related funding issue is whether GEF resources should be directed toward adaptation activities once CDM is underway. Currently, GEF addresses mitigation measures, but many developing countries have been discuss-

With CDM coming into force, the mandate of the GEF may change

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Hopefully, the results of COP-6 will enable the Protocol to enter into force 10 years after the Rio Earth Summit

ing whether GEF could help them achieve more, especially to address the adverse effects of climate change through adaptation measures. A number of countries also address issues pertaining to national communications.

Not all countries have been able to complete their communications, and it was recognized that more technical and financial assistance could be required agreement.

The ability of developing countries to adapt to the adverse effects of climate change, as well as their capacity to implement the UNFCCC and Kyoto Protocol could prove key to a successful outcome in the Hague. Capacity building in particular has been the subject of protracted discussions, with most disagreements stemming from issues related to funding. Developed countries have been supportive in principle to finding ways to help developing countries adapt to the adverse impacts of climate change. However, the term “adverse effects” also applies to another issue. Some oil exporting countries continue to push for compensation for the impacts of developed countries’ efforts to reduce their emissions—such as reduced demand for oil, which remains unacceptable to developed countries.

To achieve a successful outcome in The Hague, additional closed high level meetings to further discuss the issues are scheduled for October 2000, as well as regular bilateral and group consultations including at the head of state level.

Many governments have recently made public their desire to iron out the outstanding key issues by COP-6. Some countries hope this would accelerate the ratification of the Protocol by enough developed country Parties to allow it to enter into force by 2002—10 years after the UNFCCC was opened for signature at the Rio Earth Summit. Finally, pertaining to venue of the next COP, a matter decided in Lyon is that COP-7 will take place in Morocco 29 October – 9 November 2001.

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Notes

1 Editor's note: Of course the application of "polluter pays" is not necessarily inconsistent with or a barrier to reaching "mutually beneficial arrangements leading to net reductions of GHG emissions."

2 Editor's note: In particular, of no new commitments from non-Annex I Parties.

3 Editor's note: JI, CDM, and FI are collectively referred to throughout this volume, as "cooperative implementation mechanisms" (CIMs).

4 Editor's note: See also the paper by Halsnaes (this volume).

5 Editor's note: It would also be important, through proper design of operational features of the CIMs, to ensure that the partners, in particular, developing countries, benefit from such cooperation.

6 Editor's note: For example, due to economic contraction in the transition economies.

7 Editor's note: For that matter, it could be argued that Annex I countries are likewise unaware of actions and policies of non-Annex I countries (e.g., elimination of energy subsidies, and promotion of renewable energy from their own resources) which have the effect of significant delinking of their GHG emissions from economic growth. Enhanced knowledge of such efforts may help Annex I countries appreciate the stand of non-Annex I countries with respect to "voluntary commitments" and "meaningful participation."

8 Editor's note: Many non-Annex I countries have expressed strong objections to voluntary involvement in the sense of voluntary commitments for GHG abatement. It is likely that, portraying the CDM as a means of encouraging voluntary involvement in this sense, may actually enhance the apprehensions of non-Annex I Parties with regard to this mechanism.

9 Editor's note: Both industrialized and developing countries are committed to promoting measures to reduce the growth in their anthropogenic GHG emissions in all relevant sectors (Article 4.1[c]) in line with the principle of "common but differentiated responsibility" (Article 3.1).

10 Editor's note: For such a VIR, it should suffice that the countries' policies and actions under review should plausibly slow the growth in their GHG emissions, despite being premised on other objectives (e.g., promotion of renewable energy or energy efficiency to reduce foreign exchange outflow for oil imports). It is also necessary to ensure that the outside experts are indeed independent and competent.

11 However, since developing countries submitted fewer proposals on joint implementation (Article 6), which involves only Annex I Parties, we limit the discussion on Article 6 of the Protocol.

12 Editor's note: Articles 6, 12, and 17, envisage the use of CERs, ERUs, and AAUs respectively, to meet the Article 3 commitments. Without amendment of the Protocol, it is difficult to see that, in practice, they would not be interchangeable, hence fungible

13 Editor's note: Parties will have incentives to misrepresent the trading price of –C if the levies are specified as monetary shares. In-kind (shares of –C units) levies may be sold by the Adaptation Fund for money in an international market for –C.

14 As set out in Decision 11/CP.1 (UNFCCC/CP/1995/7/Add.1, pages 36-37).

15 This is also the principal economic logic of JI and CDM.

16 Editor's note: However, the COP/MOP may decide that third Parties, or the non-Annex I host country may also, or instead, hold CERs.

17 Editor's note: For a detailed discussion of concepts of, and practical issues involved in, baseline determination see the paper by Deshun and Rogers, in this volume.

18 Clearly, the host government may have a conflict of interest.