REDD+ ER transactions and the Paris Agreement

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This paper seeks to clarify emerging issues that developing and developed countries cooperating in REDD+ results-based programs face when engaging in carbon transactions, in light of the provisions under the Paris Agreement that all Parties are to achieve Nationally Determined Contributions (NDCs) as well as provisions on transferring 'mitigation outcomes'. It also discusses specific issues relating to the transfer of 'Emission Reductions' (ERs) under the Forest Carbon Partnership Facility's (FCPF) Carbon Fund that may affect countries' obligations under the Paris Agreement. The paper takes into account interviews with representatives of governments—including REDD+ countries and Carbon Fund Participants (CFPs)—to understand how they interpret relevant provisions of the Paris Agreement. Finally, it offers some possible options for consideration by CFPs to address the issues raised.

1. The issue

The post-Paris world brings new challenges to countries—in particular to developing countries that are now expected to communicate and achieve emission reductions. This new reality adds a layer of complexity in piloting REDD+ results-based payments, not only because developing countries must now consider how to achieve their NDCs, but also because there are a number of issues yet to be negotiated on how Parties account for the mitigation 'contributions' formulated in the NDCs. Most REDD+ results-based pilot programs will extend beyond the period in which the Paris Agreement is expected to go into effect. Many have, for example, an intended 20- or 30-year time horizon.

In recent years, countries have engaged in cooperative programs that pilot results-based payments for REDD+. The FCPF Carbon Fund is the most prominent of such initiatives. It pilots results-based payments for emission reductions generated through large-scale REDD+ programs. In order to trigger payments, the Trustee of the Carbon Fund enters into 'ER Payment Agreements' (ERPAs) that are defined by the FCPF Charter as agreements governing the "acquisition and transfer of ERs". According to the FCPF's Charter and ERPA General Conditions (GCs), ERs and their transfer include all rights, titles and interests attached to (transferred) ERs. Several countries have also engaged in bilateral partnerships that support REDD+ efforts through results-based payments (e.g. Norway, Germany). In contrast to the FCPF, these programs do not involve the acquisition and transfer of ERs.

With respect to these programs and in light of the provisions of the Paris Agreement, questions arise regarding ***the potential for, and implications of, both double counting and not counting emission reductions.*** Both situations present implications for the periodic 'global stocktake' called for by the Paris Agreement. A lack of guidance on how to account, within the context of the Paris Agreement, for ERs transferred between FCPF Participants may result in situations where emission reductions and removals are claimed, accounted, and/or reported towards achievement of *both* or *neither* of the generating country's or paying country's NDC. While guidance on double-counting will be negotiated in the context of the Paris Agreement over the coming years, a number of countries are progressing on REDD+ implementation and would like to (continue to) pilot payment-for-results. Many want to demonstrate 'proof of concept' in the near term. Therefore, (interim) solutions for the FCPF and other results-based programs must be found—taking into account the Paris Agreement, but also in the absence of full clarity on its implications—in order to continue progress on REDD+.

2. Relevant provisions of the Paris Agreement

The Paris Agreement states that all Parties are to prepare, communicate and maintain successive NDCs as part of the global response to climate change. The Agreement builds in significant flexibility in meeting the commitments. To achieve their NDCs, Parties may engage in "voluntary cooperation" (Art. 6.1) and "cooperative approaches", including "internationally transferred mitigation outcomes" (ITMOs, Art. 6.2) that are "voluntary and authorized by participating Parties" (Art.6.3). From the text of the Agreement, it is not clear what exactly these 'outcomes' might be. Proponents of carbon markets have interpreted ITMOs as quantified emission reductions. But how all these provisions will become operational is still in question. The Paris Agreement and its accompanying decision (1/CP.21) envision a number of additional rules to be developed and adopted at the first session of the COP serving as the meeting of the Parties to the Paris Agreement (CMA). The UNFCCC Secretariat has summarized a list of such tasks,[1] which include developing additional guidance, rules, modalities, and procedures for NDCs, the collaborative approaches defined in Article 6 of the Agreement, and other provisions found in the Paris Agreement.

The Paris Agreement calls for clear guidance to avoid double counting of emission reductions and removals by Parties, as well as public and private authorized entities (Art. 4.13, 6.2, 6.5). The accompanying COP Decision clarifies that "double counting is avoided on the basis of a corresponding adjustment by Parties for both anthropogenic emissions by sources and removals by sinks covered by their nationally determined contributions" (1/CP.21, para 37). The Paris Agreement also defines a mechanism that allows private and public entities to support mitigation projects that generate transferrable emission reductions (Art. 6.4). Mitigation activities developed under this new mechanism can generate 'emission reductions' which may be used by another Party to 'fulfill' its NDC. It continues to state that: "Emission reductions resulting from the [mechanism] shall not be used to demonstrate achievement of the host Party's nationally determined contribution if used by another Party to demonstrate achievement of its nationally determined contribution" (Art. 6.5). Finally, Art. 4.13 states that when accounting for NDCs, "Parties shall promote environmental integrity, transparency, accuracy, completeness, comparability and consistency, and ensure the avoidance of double counting."

3. Cooperative approaches and market mechanisms

The Paris Agreement has dramatically changed the international context for the transfer of emission reductions and use of market mechanisms. The fact that *all* Parties are to contribute mitigation actions has resulted in some developing countries' reluctance to the transfer of emission reductions due to a need to meet their own NDCs, i.e. some countries are concerned about selling off their abatement options. Others suggest that while they once supported markets for REDD+, public funds may now be given priority over market-based finance as it provides greater flexibility in using emission reductions to achieve their NDCs. As one developing country official stated in an interview, "we need to decide what portion [of emission reductions] is safe to sell while also achieving our target".

There are also a number of questions about how emission reductions that have been financed with international support should be accounted for. This is particularly relevant where countries have made reference in their Intended NDC (INDC)—and are expected to make reference to in their NDCs—to additional mitigation goals that are conditional upon international support. Many developing countries, when putting forward their INDCs stated a reduction goal to be achieved through domestic efforts (called an 'unconditional'

[1]Taking the Paris Agreement forward: Tasks arising from Decision 1/CP.21, March 2016. http://unfccc.int/files/bodies/cop/application/pdf/overview_1cp21_tasks_.pdf

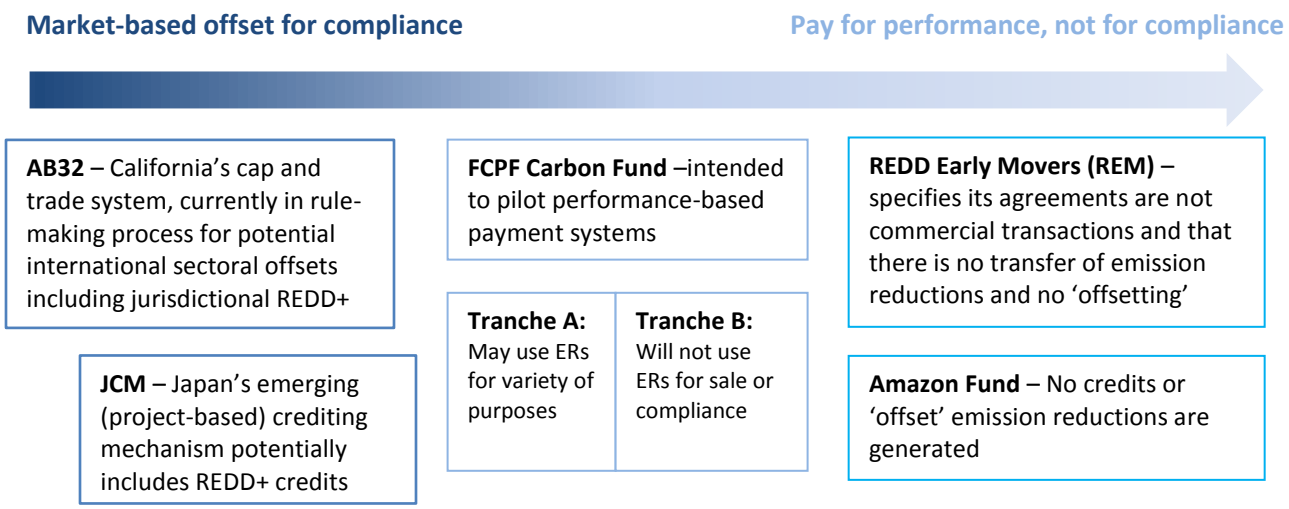
contribution) *plus* additional mitigation with international support (which many called a 'conditional' contribution). Among those countries that indicated such dual pledges, a number have also stated that they intend to use, or reserve the right to use, international market-based mechanisms to meet the emission reduction goals stated in the INDC. The Paris Agreement, however, does not distinguish between, or mention, these two concepts and only speaks more generally to NDCs. In discussions with both developing and developed countries, ***there is no consensus, or sense of clarity, on the flexibility countries have in meeting the conditional portion of their NDC.***

Another concern of REDD+ countries is whether achievement of their unconditional target is necessary *prior* to receiving support for 'conditional' efforts—both the practicality of this, as well as potential technical issues around measurement and attribution, i.e. the ability to segment the conditional/unconditional target. Another issue not addressed in the Paris Agreement is whether there will be restrictions for Parties that are far from meeting their unconditional targets to transfer mitigation outcomes to other Parties. In addition, while many country mitigation goals under the Paris Agreement are for 2025 or 2030, emission reductions transferred anytime in the period up to 2030 could be used for compliance by an entity or country years down the road—implying that countries already need to concern themselves with these implications.

These questions may be considered in the broader context of financing REDD+ results. As REDD+ has evolved, so have Parties' views on the use of public vs. private finance, and market vs. non-market approaches. Objectives for piloting REDD+ results-based programs differ in terms of long-term goals (e.g. possible creation of future markets) versus shorter-term goals (piloting proof of concept of payments-for-results). These differences have resulted in a range of types of programs designed to make results-based payments, ranging from programs that demand the creation of units that are sold and purchased, to publicly-funded programs that do not involve the creation of units but require the tracking of units, to programs that make payments for measured emission reductions but do not require accounting for individual emission reductions.

The Paris Agreement is so generally formulated that any of these transactions could potentially fall under the 'cooperative approaches' of Article 6.2. Only the mechanism defined in Article 6.4 explicitly mentions the transfer of emission reductions. The omission of such reference in Article 6.2 suggests there is significant flexibility on how Parties may define ITMOs, at least until there are agreed rules and modalities.

A simplified illustration of the range of types of transactions that may occur between (or among) countries, with several examples, is provided below:



There are also a variety of contractual arrangements for REDD+ results-based payments, ranging from sales of emission reductions, service contracts that pay for environmental services, to grants that do not require any formal consideration in return for the payment. The table below illustrate the variety of transactions and tracking of REDD+ emission reductions in various existing arrangments:

	ER transaction type	**Tracking ER transaction**
Paris Agreement	Article 6.2 that introduces ITMOs does not presume transfer of title, and Article 6.3 suggests ITMOs are "voluntary and authorized by participating Parties". The Paris Agreement accomodates market and non-market transaction in bilateral and multilateral cooperation. Only the mechanism created by Article 6.4. suggest a transfer of emission reductions and removals.	Article 6 also states that Parties "shall apply robust accounting to ensure … the avoidance of avoid double counting"; the COP will provide further guidance on a "transparency framework" whose purpose is to "provide a clear understanding of climate change action … including clarity and tracking of progress towards achieving Parties' individual nationally determined contributions" (Art. 6.2).
FCPF Carbon Fund	Payment for results. Acquisition of title to ERs in a purchase contract that states "any ER Transfer shall include the transfer of all rights, titles and interests attached to such transferred ERs"[2].	The Methodological Framework requires a REDD+ country to have an ER transaction registry[3] or use one managed by a third party and, in either case, an independent audit of the registry that is made public.
NICFI Bilateral transactions (Guyana)	Payment for results, no purchase and transfer of title.	Emission reductions are reported by the government and verified by an independent third party; both reports are made publicly available.
Amazon Fund	Payment for results, no purchase and transfer of title—rather, a "diploma" is provided for each transaction informing the sum of the financial contribution (called a "donation") and its correspondence in reduced greenhouse gas emissions from deforestation; they "do not generate rights or credits of any nature"[4]	Grants (referred to as "donations" and to date received from Norway, Germany and Petrobras) and issued diplomas are recorded in a national tracking system and made publicly available in the Fund's annual report and on its website.[5]
REDD Early Movers (REM)	Payment for (ecosystem) service. REM rewards emission reductions through payments but does not require the transfer of title. It requires full accounting of emission reductions and issuance into a registry.	Emission reductions must be recorded and retired in a national (REDD+) registry.
Voluntary markets	Generally: Sales and purchase contracts. Creation of carbon asset can be traded; for example, VCS projects generate "Verified Carbon Units" or VCUs which are fungible and tradable.	All voluntary market standards require use of a registry system; for example, VCS VCUs are recorded in the VCS registry system[6], assigned unique serial numbers, and each VCU may be tracked online.

[2] From ERPA General Conditions. Title to ERs in the General Conditions is defined as: …*the full legal and beneficial title and exclusive right to any Contract ERs and/or Additional ERs generated under the ER Program within the ER Program Accounting Area and contracted for under the ERPA*.
[3] Under the ERPA General Conditions, registry functions include: *to document and record, among others, the issuance, serialization, acquisition, holding, retirement, cancellation and/or transfer of ERs generated under the ER Program.*
[4] BNDES, Amazon Fund Activity Report 2014 (http://www.amazonfund.gov.br/FundoAmazonia/export/sites/default/site_en/Galerias/Arquivos/Relatorio_Atividades/RAFA_2014_ing.pdf).
[5] Donations to the Amazon Fund can be found at: http://www.amazonfund.gov.br/FundoAmazonia/fam/site_en/Esquerdo/doacoes/
[6] http://www.v-c-s.org/how-it-works/vcs-registry-system

4. Accounting for ERs under the FCPF

FCPF Carbon Fund Participants (CFPs) are a mix of donor governments, a regional organization (EC), a company (BP) and an NGO (The Nature Conservancy). Sovereign CFPs have expressed their intent to use markets (or not) in various ways in their INDCs, and for others there has been no articulation of how ERs will be utilized:

	CFP	**INDC position on use of international market mechanisms**	**Contribution (USD million)***
Tranche A	Australia	INDC is silent on the use of international markets	18.4
	BP	No INDC, no articulation of how ERs may be used	5.0
	TNC	No INDC, no articulation of how ERs may be used	5.0
	United States	"At this time, the United States does not intend to utilize international market mechanisms to implement its 2025 target"	14.0
Tranche B	Canada	"Canada may use international mechanisms to achieve its 2030 target, subject to robust systems that deliver real and verified emissions reductions"	5.0
	European Commission	The EC itself does not have mitigation obligations (but, alongside the EU Presidency, has competency to report on behalf of the EU and its member states regarding EU achievement of its NDC)	6.7
	France	"No contribution from international credits"	5.0
	Germany	"No contribution from international credits"	125.5
	Norway	"… there will be no use of international market credits towards the target" (although may be covered under the EU ETS and trade within the EU system)	171.3
	Switzerland	"Switzerland will realize its INDC mainly domestically and will partly use carbon credits from international mechanisms"	10.8
	United Kingdom	"No contribution from international credits"	84.5

*Amounts as of April 2015, the last publicly available information on CF contributions[7]

CFPs in Tranche B (comprising over 90% of the contributions to date) have agreed not to use acquired ERs for sale or compliance purposes and ERs are cancelled by the Trustee upon receipt from the ER Program Entities. CFPs in Tranche A have, in contrast, the liberty to use their ERs upon receipt and may:

- Cancel the ERs, similar to the treatment of ERs received by Tranche B CFPs. Cancelation could also be done by the CFP after having taken receipt of the ER in its registry or, based on an instruction to the Trustee, by the Trustee;

- Keep the ER and (for sovereign Tranche A CFPs) use it towards NDC accounting if their NDC states this is their intent (e.g. Australia); others may not do so (e.g. United States) if their NDC states no international offsets will be used;

- Keep the ER and (for non-sovereign Tranche A CFPs) not 'use' it, or use it for public relations or for compliance with a domestic regulatory system (which may or may not be accounted at the national level towards NDC achievement, unless otherwise stipulated in the ERPA).

[7] https://www.forestcarbonpartnership.org/CF12

- Transfer the ERs to other Parties, in which case the right to count the ER towards the NDCs is passed on to the Party that holds the ER, unless otherwise stipulated in the ERPA.

A question may arise on the accounting for ERs acquired by CFPs in Tranche B, and those purchased by CFPs in Tranche A that confirm they will not use the ERs against the goals communicated in their NDCs. In particular, transfer of ERs may result in 'stranded ERs' in the context of the Paris Agreement, where neither buyer nor seller uses the ERs towards achievement of an NDC, i.e. it would not be *accounted* in any Party's achievement of its NDC (although the reduction itself should be *reported* in the host country's GHG inventory). The Carbon Fund, through its Methodological Framework, places stringent restrictions on the use of ERs as follows [emphasis added]:

> *Criterion 38: "… any ERs from REDD+ activities under the ER Program sold and transferred to the Carbon Fund are not used again by any entity for sale, public relations, compliance* ***or any other purpose****."*

Furthermore, the ERPA General Conditions operationalize the criterion above by stating the following [emphasis added]:

> "*Contract ERs and Additional ERs, as well as any underlying reduced tonnes of CO_2e,* ***may only be used or claimed once****. The Program Entity shall not use such Contract ERs and/or Additional ERs, as well as any underlying reduced tonnes of CO2e, for sale or public relations (as far as such latter use implies or suggests the Program Entity's continued ownership of or right to claim such ERs)*."[8]

These provisions seem to indicate that the Carbon Fund, following the Methdological Framework (MF) and applying the ERPA GCs as currently drafted, would not allow the REDD+ (seller) country to use ERs generated and sold to CFPs for achievement of its NDC once the ER has been transferred to the Trustee. The GCs do however specify in the same clause that, in certain circumstances, the Program Entity may use ERs to demonstrate compliance with 'domestic' mitigation goals:

> *The Program Entity may only use or claim the transferred […] ERs for compliance with domestic commitments if and in so far as the Trustee, following consultations with Carbon Fund Participants, has provided its express prior written consent.*[9]

It is not clear whether NDCs would qualify as 'domestic' or whether they would fall under international commitments.

The situation above calls for solutions that address both the potential for double counting and for 'stranded ERs'. The following approaches could be considered:

1. **Title transfer options**

Several alternatives related to title transfer may be considered. These include:

- The FCPF Trustee takes receipt of the title to an ER and transfers it back to the REDD+ country (after holding the title for a 'legal second'). This could possibly happen without the actual receipt of ER in

[8] Carbon Fund ERPA General Conditions, Article V, para 5.02(g)
[9] Ibid.

the registry of the Trustee. Such arrangement would be in line with all legal documents of the FCPF. It fulfils the requirement to demonstrate the ability to transfer title (MF) and the actual transfer of beneficial title to ERs (FCPF GC and Charter). The ER Program-specific ERPA can provide for specific arrangements, e.g. the return of the title to the ERs that overrule the current provisions of the GC. This option is more relevant for Tranche B, although Tranche A CPFs may also exercise this option.

- The Program Entity would only transfers ERs for Tranche A CPFs to the Trustee. This solution would not require additional changes to the MF (which does not require the actual title to ERs, but the mere "demonstration of the ability" to transfer Title to ERs). It would, however, require a modification of the Charter of the FCPF, which defines an ERPA as an agreement governing the transfer of ERs. The GC would not need to be changed as they can be modified by the ERPA.

- The Carbon Fund could decide to piloting results-based payments without transferring any ERs and adjust the Charter of the FCPF to reflect this change. Neither a modification of the MF nor of the GC would be required (see previous bullet).

- Finally, the Trustee could receive ERs and either cancel or transfer ERs to CFPs (without return to the REDD+ country). In this instance, countries could consider how reporting to the UNFCCC may be managed to ensure all ERs (including those unused towards any NDC) may be counted during the global stocktake.

2. ERPA provisions on how ERs may be counted towards future NDCs

The ERPA may include provisions that clarify how ERs sold may be used in the future to count towards NDCs. In line with the previous section, the ERPA could specify whether ERs will be returned or kept by the Trustee (and forwarded to the CPFs). The ERPA could also include the following options to address the issue:

- The Trustee could agree to cancel the ER in its registry for the benefit of the Program Entity and the REDD+ country. This would not require a change neither to the MF, nor the GC or the FCPF Charter. It would allow the REDD+ country to use the ER against its NDC without creating an incident of double counting or the stranded ER.
- The ERPA can also specify the use of ERs, such as:
    - Tranche A: The ERPA could restrict the future use of purchased ERs by CFPs in Tranche A as regards future transfers (e.g. sales), i.e. the contract may state that the REDD+ country is allowed to use the ERs towards achievement of their NDC and that onward transfer of ERs may not be used to account for an NDC (but may be used for other purposes).
    - Tranche B: The ERPA may simply state that, as regards reporting under the Paris Agreement, the REDD+ country may use the ER towards achievement of their (conditional) NDC and that the purchasing CFPs will record the transaction as finance provided.

3. Price differentiation

An option may also be pursued where Tranche A conducts a more 'market-oriented' transaction—including title transfer and no provisions as to guaranteeing 'use' by the REDD+ country for achievement of its NDC—but offers a higher price for the ERs. The price could be set through negotiations between the Trustee (on behalf of the CFPs) and the REDD+ country. Such strategy would differentiate between ERs that are being paid for but the right to account for them remains with the REDD+ country, and those where REDD+ countries forgo the right to use ERs against their own NDCs.

These options are not mutually exclusive, i.e. several may be jointly implemented. CFPs may also wish to consider staging in various options—for example, allowing certain flexibility up to a particular date after which more market-oriented provisions may be applied.

5. Conclusions

The intention of this paper was to discuss the implication of the Paris Agreement for the FCPF and other results-based payment programs. After Paris, all countries will have to formulate NDCs, which may in many cases cover the forest sector. In such cases, developing countries may become reluctant to transfer forest-related ERs to developed partner countries. Potentially overlapping accounting frameworks and the transfer of emission reductions between Parties or entities within countries can also lead to a situation where Parties do not accurately account for such emission reductions—either by not accounting for them, or accounting for them more than once.

While the CMA is mandated to develop rules and modalities to avoid double counting, participants in results-based payment programs such as the Carbon Fund may want to find solutions on how to manage ER transactions that avoid emission reductions being counted either twice, or not at all, against NDCs. This paper proposes several potential solutions, which are summarized in the table below. These solutions would allow the Carbon Fund to continue the piloting of results-based ER transactions while giving CFPs and REDD+ countries security that the right to account for ERs is assigned and undisputed among the participants in the ER transacition.

	Strategy	Legal Implications beyond agreement in ERPA
Transfer of Title	Trustee takes receipt of title and transfers it back to REDD+ country. No physical transfer of ER necessary.	No change to existing legal documents necessary.
	Trustee only takes receipt of ERs on behalf of Tranche A.	Change to the FCPF Charter necessary.
	Trustee does not take receipt of ERs/title.	Change to the FCPF Charter necessary.
	Trustee takes receipt of ERs/title. REDD+ country would not be authoritzed to use ER to meet NDCs.	No change to existing legal documents necessary.
Other ERPA Provisions	Trustee cancels ERs in its registry; country could be authorized to use ER to meet NDCs.	No change to existing legal documents necessary.
	Tranche A CFPs may agree in the ERPA to restrictions regarding the further use of ERs.	No change to existing legal documents necessary.
	Tranche B CFPs may agree in the ERPA that the REDD+ country is authorized to use ERs to meet (conditional) NDCs.	No change to existing legal documents necessary.
Pricing and Commercial Solutions	Full transfer of ER/title, but at a higher price than being paid for ER for which the REDD+ country retains the right to use it against its NDC.	No change to existing legal documents necessary.