



## Article 6 post-COP27

At COP26 in 2021 the rulebook for Article 6 of the Paris Agreement (which covered the creation of a market for carbon credits) was finally established, and the focus then shifted towards putting the crediting mechanisms and frameworks included in it into operation. However, despite the optimism in the lead-up to COP27, market participants were left with a bittersweet feeling, with the resolution of many key issues pertaining to Article 6 being pushed back to COP28 in 2023. Negotiations in the lead-up to and during COP28, alongside the recommendations of various initiatives such as the Integrity Council for the Voluntary Carbon Market (IC-VCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI), will have important implications for the development of wider carbon markets, including voluntary carbon markets (VCMs), and more generally, for the spectrum of policies that countries can implement to attract climate finance via carbon markets.

In terms of advancing the operationalization of Article 6 in COP27, the Parties agreed on key reporting templates, particularly the 'Initial Report' and the 'Annex to the Bilateral Transparency Report'. Some observers believe the finalization of these templates should enable countries to start developing cooperative approaches and signing bilateral and multilateral agreements under Article 6.2. Under Article 6.2, a host country has the right to authorise the transfer of Internationally Traded Mitigation Outcomes (ITMOs) which can be used either by credit-buying countries towards achieving their nationally determined contributions (NDCs), in market-based schemes such as the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA) or by companies to offset their emissions.

Perhaps the most contentious issue which remains unresolved is the optionality of host countries to revoke the authorisation for corresponding adjustments (CAs) of credits issued under Article 6.2 (but also under Article 6.4). This is particularly important for investors, project developers, and the wider market which need predictability to be able to attract the necessary finance for scalability and for carbon projects to be bankable. This issue also relates to host countries' concerns of over-selling cheaper credits at the risk of increasing the cost of achieving their climate targets. This has led a few countries such as India to rethink their strategies and limit the export of carbon credits to ensure that the credits are first used towards meeting their own NDCs, with the surplus allowed to be transferred abroad. What is also becoming increasingly clear is the importance of capacity building in host countries to enable the set-up of proper registries and accounting infrastructure. Particularly with regards to capacity building, multilateral development banks are expected to play a major role going forward with several initiatives and pilot schemes already under way. Another issue relates to the confidentiality of reporting, where the agreed text provides a participating party the right to 'designate information provided to the Article 6 technical expert review team during the review as confidential', which does not help the transparency of the verification process. Despite these outstanding issues, some countries are already inking bilateral agreements under Article 6.2, led so far by Switzerland, Singapore, and Sweden.

Other unresolved issues include the definition of the role of carbon removal, both engineered and nature-based, under Article 6. Particularly, Parties are yet to agree on appropriate accounting methods, monitoring, and reporting standards for carbon removal, including in relation to reversal and leakage



issues and the need to avoid negative environmental and social side effects. Another unresolved issue is whether credits generated from emissions avoidance projects should be included within the framework of Article 6 at all. On the upside, more clarity has been provided on the process to follow for transitioning legacy credits under the Clean Development Mechanism (CDM) to the Article 6.4 crediting mechanism, with a template for transition requests for project developers expected to be published in June 2023.

Another development concerning Article 6.4 was the clarification of the role of ITMOs which are not authorized and hence not correspondingly adjusted. Article 6.4 effectively establishes a new type of carbon credits, called ‘mitigation contributions’, which cannot be used to make offset claims at the national level (i.e. towards meeting countries’ NDCs). These mitigation contributions ‘may be used, inter alia, for results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host country’. It does indirectly reduce their scope by implying that these credits cannot be used for offsetting, even though the issue of regulating corporate claims in the VCM does not fall under the jurisdiction of the COP. However, there have been calls for national governments to play a more active role in providing a regulatory environment and clarifying the rules around the VCM.

The term ‘inter alia’ in reference to the usage of ‘mitigation contributions’ is of significance and has created debate among observers. The legal term, meaning ‘among other things’, suggests that carbon credits with no CA can be used in the VCM. This may create a two-tier system and rather than convergence, may lead to divergence, with buyers preferring to purchase ‘authorized’ and ‘adjusted’ credits, although these credits may not necessarily be of higher quality but may be perceived to be so. Also, the type of claims which can be made using these mitigation contributions will affect buyers’ demand as their prime motivation in using these credits is to offset part of their emissions rather than using them for results-based climate finance. Therefore, the ultimate decisions stemming from Article 6.4 will have indirect implications for the VCM both on the supply and demand for carbon credits though these will not be fully understood until the operationalization of Article 6.4 by the Supervisory Body (SB), which is not likely to occur before 2024.

In parallel, a number of new initiatives were announced at COP27. Of note are John Kerry’s Energy Transition Accelerator, which has the aim of developing a VCM to unlock private sources of finance to help developing countries phase out fossil fuels and accelerate investment in renewables; the creation of the Global Carbon Trust (GCT) as a platform that enhances transparency and liquidity in the market by ensuring defined credit standards are met and performance is delivered; and the Africa Carbon Markets Initiative which aims to produce 300 million carbon credits annually by 2030. It is important that the myriad of growing initiatives is complementary in nature and ensures additionality, and that the funded projects generate high quality credits. Additionally it is key that frameworks and guidance on how corporations can use these credits under these schemes is consistent with the existing standards, current initiatives, and Article 6.

2023 promises to be the year where further clarity is provided on how different mechanisms under Article 6 would be effectively put into practice. Participants in carbon markets will be closely examining the policy frameworks governing transactions under Article 6.2 and the next negotiations surrounding Articles 6.4, as well as further clarification by the major standardisation bodies and the various initiatives, such as the IC-VCM and the VCMI. Until some of the key uncertainties are resolved and some of the rules are clarified, carbon markets are unlikely to fulfil their maximum potential. In the short term, the prices of standardized carbon contracts traded on exchanges are expected to continue to experience high volatility, like that seen in December 2022, on the back of thin liquidity, higher interest rates, a very uncertain macroeconomic picture, and also a broader disappointment about COP27 which did not provide market participants with more clarity and did not fully capitalize on the momentum built in COP26. It is to be hoped that 2023 and COP28 can provide a more positive outcome and momentum towards the full operationalization of Article 6.

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