Fixing the loopholes

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Emissions loopholes allowed under a weak text will increase potential for developed countries to avoid deep reduction in key industrial sectors at home and will reduce the potential for timely peak and decline necessary to avoid dangerous climate change.

This document recognises the difference between real loopholes (which allow overall emissions to rise which otherwise would not be the case) and political loopholes that may represent real reductions but still take away pressure from large-scale carbon lock-in in developed nations. Additionally there are loopholes in the making where the scale will depend on the rules. While there are differing assessments of the scale of individual or aggregate sizes of loopholes it is clear enhanced use of loopholes will weaken overall global effectiveness of targets proposed, reduce market-based and political incentives to energy and carbon-intensive sectors in industrialized nations to start to immediately decarbonise and/or effectively cheat the atmosphere.

Broadly there are five types of loopholes:

1. CDM offsets: Current CDM allows developed countries to achieve project-based emissions reductions in developing countries and put that against their domestic responsibility.
This type provides the largest source of emissions. Developed nations are projected to use at least 1.5 Gt CO2e of offsets yearly by 2020. The EU alone had announced to use almost 0.5 Gt per year til 2020. We assume the use of a similar amount both in CDM-equivalent project-based offsets in the US and in the remaining Annex I countries. Note that this is a very conservative assumption, as the EB of CDM has stated that there may be up to 6 Gt CO2e available annually post-2012.
CDM offsets are a hybrid between real and political loopholes as they in theory may deliver real emissions reductions in developing countries but are overall a zero-sum game.
NB: We have not included REDD offsets or potential sectoral targets in developing countries because we believe that REDD will not be ready until after 2015 for market-based mechanisms in Annex I and rather benefit from additional finance. Also, we believe that new sectoral targets – if implemented correctly – will be truly additional in developing countries and at least initially be based primarily on funding by rich nations.

2. Hot Air or AAU surplus: This type is the result of targets given mainly to Eastern European countries and Russia at the time of Kyoto which were far above even the reference scenario for 2008 to 2012. These represent between 8-10 Gt and may be carried over to the next period. Assuming an eight year commitment period (2013-2020), Hot Air could amount to 1 Gt CO2e per year. If carried over they would dilute the actions from A1 countries from now on because they haven't been used so far and would be used in the future, diluting future actions at home of the buyer countries.

3. LULUCF accounting within A1: In principle, if the rules are well drafted LULUCF could contribute to sustainable forest management and environmentally sound agriculture. However, because the present Kyoto rules are based on a Gross/Net approach and in case this rule is maintained post-2012, this accounting will turn out be a loophole that discounts the need for reducing industrial emissions. As things stand, however, rules are turning out to be biased and may not represent true emissions reductions via sinks (from the point of view of the atmosphere). Based on current accounting rules it is thus calculated that LULUCF can add another 1 Gt CO2e by 2020. "Climate Tracker", an independent research organization came to the same conclusions a few days ago.

4. Bunker fuels: It is estimated that by 2020, international bunker fuel emissions, which presently are not accounted for by any party under their commitments, will represent about 1.9 Gt CO2 for Annex I countries under BAU and accounting for a multiplying factor of 2 for aviation based on its additional non-CO2 global warming impact. If these are not included in a post-2012 treaty they must be considered a loophole. We estimate the bunker fuel loophole to be 'only' 1.3 Gt because we assume that the US climate bill will be implemented which includes international bunker fuels and so does the EU ETS with aviation.

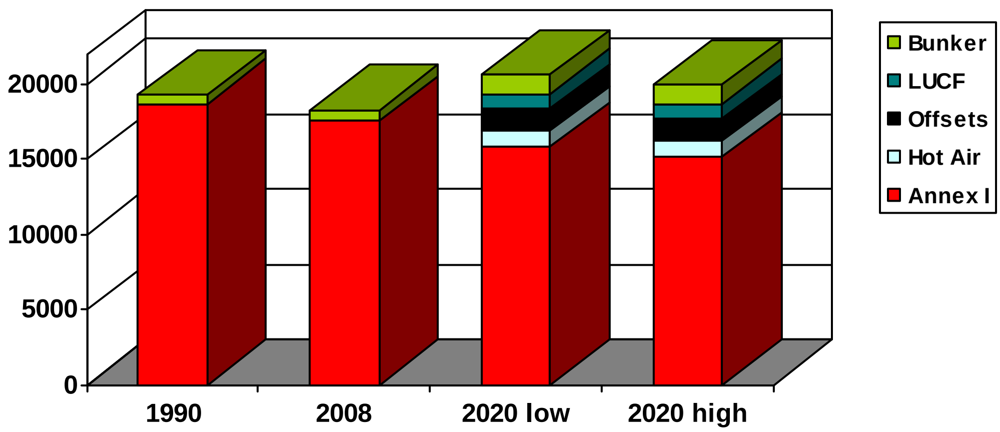
5. Starting points of new targets: There are at least three methodologies that can be used to define the starting points of new Annex I GHG reduction commitments. Those could start at 1990 (the existing base year under the KP) or alternatively at the point of their current emissions at 2012 or at the point of their specific KP target. With or w/o changing the base year this has different implications for different countries and the overall cumulative carbon emissions budget in the years 1990 – 2020. In the worse case, substantive emission increases in the years between 1990 and 2020 may go un-accounted. Details need to be calculated.

The first three of these loopholes undermine domestic action because having effectively lower domestic emissions targets will discourage long-term investment in cleaner infrastructure and technology. The two other of these loopholes are just heating the atmosphere because amounts are not accounted for. Bunker fuels needs to be dealt with both by A1 and Non-A1 countries.

These loopholes (excluding nr. 5 described above) may yield 4.8 Gt CO2e per year post-2012 and in target year 2020. 1990 emissions w/o LULUCF were approximately 18.7 Gt CO2e. Therefore, the quantified loopholes represent almost 26% of the entire 1990 base year emissions. Those 4.8 Gt CO2e need to be ADDED to the Annex I pledges unless clearly identified and distinguished from the domestic action to be undertaken by developed countries. Current Annex I pledges are in the range of 15% to 18% below 1990 by 2020. Those emissions "allowances" if fully used would either allow Annex I countries to maintain BAU investments in BAU coal and other long-lasting carbon-intensive infrastructures (transport, buildings etc) and/or enrich the atmosphere with GHG that are not accounted for (bunker fuels) and jeopardize an early peak and decline of global GHG emissions well before 2020 deemed necessary to stay in a credible trajectory towards well below 2 degree temperature rise compared to pre-industrial temperatures.

Based on present pledges by Annex I, accounting for these loopholes would increase domestic GHG emissions by Annex I by 7 - 10%, respectively. If international maritime and aviation are added to the 1990 base year emissions, Annex I would increase its domestic emissions by 4 – 7%. Ranges reflect uncertainty of pledges by particularly the EU (graph below)

Total Annex I GHG emissions excluding LULUCF in base year 1990 and resulting loopholes in 2020



Warning – ignoring problems now causes big problems soon

- If loopholes inflate the Annex I emissions allowances the carbon price will be reduced for the sectors affected (such as EU ETS) which in turn will mitigate investments in the energy sector such as new coal-fired power stations and create a long-term carbon lock-in. The argument by some that flexibility for 'cost-effective' global reductions is necessary to reduce compliance costs for Annex I and it will last only a few years to "bridge" towards a truly low-carbon economy, is a bogus argument as the lock-in effect will require maintaining this 'flexibility' for many decades to come.
- If loopholes are built into the system at Copenhagen, then the actual problem of climate change will not be resolved. What will then happen is that we will be facing the same problem a few years down the road, but far closer to the imperative peak and decline date. The problem will then be far more difficult and far more expensive to address.
- If loopholes are added it will be due to legalistic cunning, and once the trick is discovered a few years down the road, developed countries will find it much harder to negotiate with developing countries as they will have lost all their credibility.
- Loopholes are intrinsically situated in a "grey" regulatory area, and yet the needed investments and financing for clean technology does not work well in such grey environments as some investments are long-term and need clarity, transparency and predictability.
- Clean-technology investors have been clamouring for clear and transparent regulation. Answering their call with muddled half-measures that are legally complicated (and thus more expensive in legal fees) will discourage investment and eat into the profit margins to be had by financing clean technology.
- Loopholes can bite back: countries stand to gain from a transparent and simple regulatory system under which their foreign direct investment (FDI) in non-A1 countries will not be at threat of some double-edged legal loophole by these countries receiving the FDI.
- Loopholes for A1 may enter non-A1 at some point in the next round of negotiations, perhaps as early as the next commitment period once certain more developed and richer non-A1 countries will take up legally binding absolute caps as well.

The right principles

- **Carbon clarity -**it is important that text has straight-forward language and clear distinction showing domestic actions and foreign investment in technologies and abatement through the carbon market. It is also important to clearly distinguish between public and other funding/investment unrelated to carbon markets in order to give carbon clarity.
- **The right system in place in the LCA** (tackling double counting, limits to offsets, limiting/coherent LULUCF system, int. accounting rules for A1/all, coherence across both protocols/tracks).
- **Cap the project-based CDM and other equivalent offset mechanisms** with [20%?] of the emissions reduction target of Annex I expressed in % of target by 2020 below 1990 and demand clear and strengthened additionality. Do NOT cap CDM based on the 'efforts' taken to meet targets by developed targets as this plays with BAU and invites for gaming.
- **Strengthen LULUCF rules based** on mandatory accounting for all human-induced LULUCF activities and emissions to create a true balance between credits and debits.
- **Move to a clear Net/Net approach** to close the inflated baseline of a Gross/Net approach.
- **Create a "carbon-debit" account** for non-human induced carbon losses in land use sectors such as fires, pests, droughts etc in case of those events in individual Annex I

countries which needs to be “zero” before the individual country is allowed to account for carbon sinks in the commitment period.

- **Cancel or retire all AAU surplus/Hot** Air from the first CP of the KP for all following commitment periods from 1.1.2013. In this context avoid any new targets for individual developed countries to perpetuate new Hot Air until 2020. In case full cancelling fails, cap the carry-over to [20%] of all Hot Air available post-2012 while ensuring mandatory re-investments of the revenues into domestic clean technologies (Green Investment Scheme).
- **Include all international aviation and maritime emissions** into the accounting scheme. Promote a global sectoral approach for this sector.

Legal text suggestions

1. Requiring amendments to the Kyoto Protocol

ARTICLE 3.1 bis

Article 3.1 as amended establishes the level of ambition for developed countries within the global carbon budget for the 5-year commitment period 2013-2017, and setting a limit to offsets.

1 bis. The Parties included in Annex I shall, individually or jointly, ensure that their aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases listed in Annex A do not exceed their assigned amounts, calculated pursuant to their quantified emission limitation and reduction commitments inscribed in the third column of the table contained in Annex B and in accordance with the provisions of this Article, with a view to reducing their overall emissions of such gases by 23 per cent below 1990 levels in the second commitment period 2013 to 2017. At least three quarters of this reduction should be achieved through domestic actions. (AWG-FCCC/KP/AWG/2009/10/Add.1/Rev.2, Option 1)

NEW ARTICLE 3 tris
Banking of AAUs across commitment periods

#. A surplus of AAUs amounting to 10Gt CO2e over the 5 years of the Kyoto commitment period is likely to accumulate. This represents an extreme threat to the market and environmental integrity of the Copenhagen agreement. Countries must develop an approach to address the surplus issue to ensure the environmental integrity of post 2012 emissions caps in line with the necessary carbon budget as defined in Article 1, paragraph 1 above. Currently there is no official proposal on the table for a KP amendment that would tackle the problem. The paragraph below has been tabled as a proposal for a CMP decision, and should be turned into an amendment.

3 tris. The carry-over (banking) of Kyoto units from the first to the second commitment period shall be limited to [X]% of surplus of Kyoto units from the first commitment period of the Kyoto Protocol (FCCC/KP/AWG/2009/10/Add.3/Rev.3)

NEW ARTICLE 7.4 bis

#. This amendment could be used in order to regulate the use of AAU trading, e.g. IET, for compliance in the second commitment period, and may thus also provide an approach to deal with the surplus issue.

7.4 bis The Conference of the Parties serving as the meeting of the Parties to this Protocol shall, prior to the second commitment period, decide upon modalities for the accounting of assigned amounts for that commitment period. (FCCC/KP/AWG/2009/10/Add.2, para 34)

2. To be integrated into the treaty coming out of the AWG LCA

This provision limits the use of international offsets. See also the Carbon Markets Article for restrictions.

5. Developed country Parties shall achieve at least three-quarters of their quantified emission reduction or limitation commitments through domestic emission reductions efforts. (FCCC/AWGLCA/2009/14,Section III.A.,NP 50, para. 17)

This paragraph defines credited mitigation actions that should not be defined as NAMAs, as they will count towards developed countries mitigation targets. This is part of the system that limits & manages offsetting.

4. Developing countries may also pursue actions that are undertaken over and above those identified in subparagraph 11 (a) and 11 (b) above based on emission reduction targets and may be eligible for emission trading schemes. The Conference of the Parties will develop the modalities and guidelines for participation in carbon markets. (FCCC/AWGLCA/2009/14, section III B, Non-paper 51, Para 11 (c))

This paragraph prevents double counting of emission reductions or finance, as it comes to applying market mechanisms.

7. The supreme body shall at its 16th session define modalities and procedures which prevent double-counting between supported NAMAs and credited mitigation actions in developing countries; and mitigation targets, offset provisions and financial commitments for developed countries, to ensure environmental integrity. (FCCC/AWGLCA/2009/14, section III E, Non-paper 42, Para 14)

This article defines the commitments of developed countries, which are subject to reporting through the enhanced national communication process, to be those established under the mitigation and finance article. These include the emission reduction targets, the need to put in place zero emission strategies (the NGO treaty calls them zero carbon action plans) as well as the financial and other support obligations.

3. Each developed country Party shall incorporate in its national communication, submitted under Article 12 of the Convention, the supplementary information necessary to demonstrate compliance with its commitments under this Protocol, including, inter alia:
The status of the implementation of their commitments;
The emission reductions achieved, including any significant changes from estimates;
The aggregate effect of the implemented policies and measures in terms of emission reductions achieved and their contribution to maintaining a Party’s long-term emission pathway;
The use, if any, of international offsets or international emissions trading mechanisms;
Projected GHG emissions trends for 2015, 2020, 2030, 2040 and 2050, including scenarios without measures, with measures and with additional measures;
An account of the support provided to developing countries with respect to their actions, including: allocation and transfer of finance for means of implementation over and above ODA],
Technology transfer, including development, deployment, application and diffusion;
The agreed full incremental costs of technology transferred to developing country Parties;
Support for capacity-building according to indicators.
Action taken to reduce the drivers of deforestation. (Non-paper No 28, Annex 1, Para 4; Non-Paper 51, para. 46)

The paragraph below clarifies that carbon market funding cannot replace MRV funding.

1. Actions by developing countries in the context of sustainable development and the eradication of poverty must be supported and enabled by technology, financing through public sources and capacity-building. (FCCC/AWGLCA/2009/14, section III. E. NP 42, option 1, para 1) Parties shall ensure that market-based approaches are only complementary to and can not substitute agreed levels of developed countries’ financial support commitments from public sources. (FCCC/AWGLCA/2009/14, section III. E. NP 42, option 1, para 11)

The following paragraph defines principles for applying carbon market mechanisms.

2. Any market-based approaches, if applied, shall:

Ensure that participation by Parties is on voluntary basis;

Ensure a net global mitigation benefit, in accordance with the global carbon budget, pursuant to paragraph 1 of the Article 1 on Shared vision;
Ensure environmental integrity, additionality of mitigation actions and the prevention of the double-counting of emission reductions;
Ensure that developed countries meet the preconditions for using carbon credit units for compliance, as defined in article X para Y of this Protocol. (X&Y refer to the article which shall define additionality provisions.)
Restrict the use of carbon market instruments for higher cost mitigation opportunities;
Ensure the availability of non-market financial support for developing country mitigation actions and ensure that mitigation actions are country-driven;
Provide incentives for co-benefits;
(FCCC/AWGLCA/2009/14, section III. E. NP 42, option 1, para 6),

The paragraph below requires the COP to define modalities and procedures for implementation of the new mechanisms by COP 16, including establishment of the Carbon Market Regulatory Agency, measures to prevent double-counting of emission reductions or financial flows and ensuring environmental integrity, including through introducing discount factors.

12. The Conference of the Parties shall define modalities and procedures for the implementation of the new mechanisms at its 16th session, including:
(a) Requirements for the measurement, reporting and verification of emissions in a conservative and independent manner;
(b) Guidelines for issuance and accounting of units;
(c) Eligibility criteria for participation in the sectoral mechanisms;
(d) Eligible sectors under the sectoral mechanisms;
(e) Requirements for determination of sectoral boundaries and the treatment and minimization of potential leakage;
(f) The duration of crediting / trading periods and the carry-over of units between periods;
(g) Procedures and mechanisms, including facilitative measures, in the event that a participating developing country Party does not achieve a reference level;
(h) Preventing double-counting of emission reductions between any of the mechanisms; between supported NAMAs and credited mitigation actions and between mitigation targets, offset provisions and financial commitments for developed countries;
(i) Ensuring sustainable development and environmental integrity of the implementation of the mechanisms, including through establishing discount factors for application to issuance, to manage unavoidable uncertainties related to baseline setting.
(j) Establishing a Carbon Market Regulatory Agency as an expert body to ensure a transparent, integrated and well regulated carbon market, as well as further institutional arrangements.
(FCCC/AWGLCA/2009/14, section III. E. NP 42, para 47)

For more information please contact Stephan Singer +320496550709 ssinger@wwfepo.org