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COP25's key outcome: adoption of the San Jose Principles on carbon market mechanisms – takeaways for business

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International climate negotiations attract big headlines each year as countries work to hammer out shared rules to deal with climate change. It's not just governments that are interested: private sector businesses and other organizations are also affected.

For instance, no element of international climate policy has garnered as much private sector attention as "carbon markets" − international mechanisms for trading emissions reduction credits. Carbon markets, if widely and properly established, could offer business rewards for carbon efficiency, a win-win proposition.

During the negotiations at the latest UN Climate Change Conference (COP25), an influential group of ambitious countries, frustrated with the lack of progress on this issue, adopted the San Jose Principles. This move is a significant indication of their commitment to robust market rules.

32 countries take the initiative

In late 2015, the 196 Parties to the United Nations Framework Convention on Climate Change (UNFCCC) met in Paris for the 21st Conference of Parties (COP21) and adopted a framework to address the looming climate crisis, known widely as the Paris Agreement. The Paris Agreement presented numerous innovations in the world of multilateral climate negotiations. Chief among them is Article 6, which provides the basis for an international market in emissions reductions.

Less than a year later, the International Chamber of Commerce[1] flagged the importance of developing rules for the Article 6 market mechanism and the effect that doing so would have on the private sector, stressing that business investment would depend on strong systems for measuring, reporting, and verifying emissions reductions. The deadline to finalize those rules was 2018, at COP24 in Katowice, Poland, pushed back to COP25 in December 2019 in Madrid. Yet the Parties have been unable to achieve the necessary consensus, with a few Parties holding out for more permissive rules that other Parties argue would limit their impact on global emissions.

Amid this impasse, a group of at least 32 ambitious Parties − including key European and Latin American countries[2] − have **taken the initiative to adopt strict market rules of their own**, regardless of what the Parties negotiate. Their announcement adopting the "San Jose Principles for High Ambition and Integrity in International Carbon Markets" at COP25 sheds light on what the private sector can expect of carbon markets in those countries.

The pledge

The countries that signed onto the San Jose Principles pledged to avoid double counting of emissions (when more than one source claims carbon emissions or credit for corresponding reductions) and to preserve the integrity of carbon markets in reducing global greenhouse gas emissions.

The countries pledged to implement a framework for the Article 6 mechanism that, at a minimum, incorporates these 11 principles:

- **Maintain high ambition:** Ensures environmental integrity and enables the highest possible mitigation ambition.
- **Push for progressive reduction:** Delivers an overall mitigation in global emissions, moving beyond zero-sum offsetting approaches to help accelerate the reduction of global greenhouse gas emissions.
- **No carry-over credits:** Prohibits the use of pre-2020 units, Kyoto units and allowances, and any underlying reductions toward achieving the goals of the Paris Agreement and other international goals.
- **No double-counting/balanced system:** Ensures that double counting is avoided and that all use of markets toward international climate goals is subject to corresponding adjustments (*ie*, that a traded reduction counts toward the goals of the *transferee* country but against those of the *transferor* country).
- **Meet the Paris Agreement global goal:** Avoids locking in levels of emissions, technologies or carbon-intensive practices incompatible with the achievement of the Paris Agreement's long-term temperature goal.
- **Meet the Paris Agreement national commitments:** Applies allocation and baseline methodologies that support domestic achievement of the transferring countries' "nationally determined contributions" (that is, their commitments under the Paris Agreement) and contribute to achievement of the Paris Agreement's long-term temperature goals.
- **Count CO_2 appropriately:** Uses CO_2-equivalence in reporting and accounting for emissions and removals, fully applying the principles of transparency, accuracy, consistency, comparability and completeness.
- **Track and share information centrally:** Uses centrally and publicly accessible infrastructure and systems to collect, track, and share the information necessary for robust and transparent accounting.
- **Incentivize progress:** Ensures incentives to progression, and supports all Parties in moving toward economy-wide emission targets.
- **Financially support developing countries:** Contributes to quantifiable and predictable financial resources to be used by developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation to those effects.
- **Build capacity to participate:** Recognizes the importance of capacity building to enable the widest possible participation by Parties under Article 6.

The private sector previously participated in the market mechanisms of the Kyoto Protocol, both directly and indirectly. Industry's keen interest in these developments strongly suggests that this trend will likely continue in future carbon markets. The Kyoto Protocol's market-based mechanisms allowed businesses, NGOs, and other legal entities to participate under the authority and responsibility of national governments.[3] By participating in the project-based Clean

Development Mechanism, for instance, the private sector acted directly in the carbon markets established under the Kyoto Protocol. Future carbon markets would likely make similar provisions for private actors to directly engage in the market.

Ambitious countries are not waiting for full consensus

A key trend is emerging − ambitious countries are not waiting for full consensus on carbon markets. Although the UNFCCC Parties have not finalized a uniform global standard for market mechanisms under the Paris Agreement, **ambitious countries will require more of private actors in their carbon markets and may act in concert to advance stricter standards**, such as the San Jose Principles. Some observers suggest that bilateral arrangements and multilateral "carbon clubs" will become more common absent a robust global standard for the Article 6 mechanism. [4]

In the absence of a single global standard, the private sector will have to contend with more variability in the marketplace. As the San Jose Principles take effect, heightened requirements will emerge in various European and Latin American countries. Private business will need to operate within that variability or, possibly, adopt higher benchmark standards for the sake of uniformity.

In either event, COP26 in Glasgow will give the world yet another chance to agree on uniform standards for all. The San Jose Principles provide a preview of what those standards could be if the Parties forge a mechanism aimed first and foremost at ambition and environmental integrity.

Learn more about the implications of the San Jose Principles by contacting any of the authors.

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[1] International Chamber of Commerce, *Business View on Market Mechanisms - Article 6(1)-(7) of the Paris Agreement*, Doc. No. 213/120 (Oct. 2016).

[2] The group currently comprises: **European countries −** Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Ireland, Italy, Latvia, Luxembourg, The Netherlands, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, the United Kingdom; **Latin American countries −** Costa Rica, Belize, Colombia, Paraguay, Perú; **Pacific Rim and Small Island countries −** the Cook Islands, Fiji, Grenada, the Marshall Islands, New Zealand, Trinidad and Tobago, Tuvalu, Vanuatu.

[3] *See* International Chamber of Commerce, *Business View on Market Mechanisms - Article 6(1)-(7) of the Paris Agreement*, Doc. No. 213/120 (Oct. 2016.

[4] Katie Kouchakji, *Climate emergency : COP25 talks fail to keep up with reality*, International Bar Association (Jan. 21, 2020).

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