CLIENT ALERT

The Paris Agreement on Climate Change: A Practical Guide

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On December 12, 2015, after more than two weeks of talks, underpinned by over 20 years of international negotiations, nearly 200 signatory parties to the United Nations Framework Convention on Climate Change (UNFCCC) concluded the Paris Agreement (found here), a landmark international accord that will have lasting impact on global commerce and investments for decades to come.

The Agreement states an ambitious but nonbinding goal to curb the increase in global average temperature caused by anthropogenic greenhouse gas (GHG) emissions to "well below" 2 degree Celsius. That goal will be pursued through the collective implementation of each party's nonbinding action pledge, known as its Nationally Determined Contribution (NDC). Each NDC represents a nation's voluntary commitment to pursue actions, policies and regulations deemed necessary to achieve a self-determined goal to mitigate GHG emissions and adapt to a changing climate.

The political impact of the Paris Agreement is momentous. For the first time ever, unlike all prior climate accords, all signatory nations, developed and developing alike, have agreed to pursue achievement of global carbon neutrality later this century. The agreement sends clear long-term policy signals to the private sector that a robust transition to a global, low-carbon economy has formally begun. The International Energy Agency has already estimated that achievement of the pledged NDCs will require a monumental level of public and private sector investment ($16.5 trillion).

Be that as it may, the actual near-term legal effect of the Paris Agreement is narrow. The Agreement remains rooted in the existing legal authorities and decisions of the parties to the UNFCCC. There is no new mandate, enforceable emission-reduction obligations, or other prescribed outcome contained in the text.

What the Paris Agreement does set forth is a new international climate platform whereby signatory nations will hold each other accountable for their respective NDCs through a binding reporting and review process where all NDCs are evaluated under a common set of standards and criteria. The immediate import of the Paris Agreement—and the reason why private-sector entities should care about what it holds for the future—is (1) the overall policy signal of decarbonization, but also (2) the underlying standards that governments will develop and employ to meet their NDCs. The new metrics and accounting treatments, for example, could one day help governments align climate regulations with other financial market reforms. Moreover, the data may help companies evaluate and address measurable climate risks to their assets and liabilities.

Key Terms of the Paris Agreement

The Agreement has two main parts—a 17-page draft decision by the UNFCCC party nations and an 11-page annex that contains the actual Agreement. Consistent with existing decisions and treatments under the UNFCCC, each signatory is distinguished as either a developed or a developing nation, and the Agreement will still "be implemented to reflect" the principle of "common but differentiated responsibilities and respective capabilities, in light of different national circumstances." In addition to stating the ambitious 2-degree goal, the Agreement includes the following important points:

1. NDC Review and Ratcheting Framework

Each signatory nation will be solely responsible for implementing its voluntary NDC. Every five years each nation will be required to submit a new—theoretically more ambitious—nonbinding NDC.

The NDC submitted earlier this year by the Obama Administration, for example, aims to reduce GHG emissions in the U.S. by 26-28 percent below 2005 levels by 2025, and to make best efforts to reduce emissions by 28 percent. The U.S. states an intention to achieve the targeted GHG reduction by administering existing laws, including EPA's Clean Power Plan (CPP) and several other air and energy regulations. No party to the Paris Agreement will have authority to require the U.S. to implement the CPP, and the U.S. is under no binding obligation to achieve the larger amount of GHG reductions it has pledged as its NDC target.

All NDC submissions must include "the information necessary for clarity, transparency and understanding" and will be recorded in a public registry. Each signatory's NDC will undergo a technical expert review and multilateral consultation on implementation efforts. Beginning in 2018, and every five years thereafter, the signatory nations will conduct a collective "stocktaking" dialogue to evaluate the progress of the aggregate NDC effort.

2. Transparency in Accounting and Reporting

Historically, several nations had resisted reporting and verifying domestic GHG emission and financial data with other nations party to the UNFCCC. Now, each nation will regularly provide the following to the meeting of the parties:

- A national inventory report of "anthropogenic emissions by sources and removals by sinks of [GHGs] in accordance with "good practice methodologies" agreed upon by the signatories.
- All necessary information to track the progress made by the signatory nation to achieve its NDC; and
- Information on financial, technology transfer and capacity-building support provided to developing countries.

3. Use of Internationally Transferred Mitigation Outcomes (ITMOs)

An unexpected aspect of the Paris Agreement is its express endorsement of cooperative international market and non-market mechanisms.

Under Article 6, nations are authorized to negotiate "cooperative approaches" to achieve their NDC, including through the use of "internationally transferred mitigation outcomes" (ITMO). An ITMO—a new and important acronym in the climate lexicon—can potentially mean any sort of bilateral, regional or multilateral emissions credit trading scheme, linked networks of carbon pricing mechanisms, transfers of technology, or possibly the provision of climate finance. An ITMO would involve the negotiated transfer of some portion of one nation's NDC to another nation's NDC. The ITMO would only be subject to agreement between the parties involved and all necessary laws and regulations needed to design and implement the ITMO mechanism.

Nations that choose to use an ITMO, however, will be required to apply robust carbon accounting, and to make mutual adjustments to their NDCs to ensure against double counting of reductions. The parameters for ITMOs and accompanying carbon accounting standards will be subject to future UNFCCC guidance. In the interim, the G7 nations have launched the Carbon Market Platform to serve as a forum for governments and business to begin developing best practices and criteria for ITMOs.

4. Sustainable Development Mechanism

The Paris Agreement also establishes a separate sustainable development mechanism (SDM) that promotes GHG mitigation efforts above and beyond what a nation commits to under its NDC. All GHG emission reductions achieved under the SDM will therefore have to be in addition to those that would have otherwise occurred in the host party's jurisdiction.

The SDM is a successor-in-interest of sorts to the regulatory infrastructure established under the Kyoto Protocol's Clean Development Mechanism (CDM). It will be created and managed under the authority and rules of the UNFCCC Secretariat on the basis of: (a) voluntary participation authorized by each nation involved; (b) real, measurable, and long-term benefits related to the mitigation of climate change; (c) specific scopes of activities; (d) additionality, (e) verification and certification of emission reductions resulting from mitigation activities by designated operational entities; and (f) experience gained with and lessons learned from existing market mechanisms.

5. Public and Private Sector Climate Finance

The signatory nations agree to make "finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." Developed countries will provide "financial resources" to developing countries consistent with existing obligations but are "encouraged" to provide additional financial resources voluntarily.

Separately, the Green Climate Fund is encouraged to expedite deployment of financial resources and to continue to develop innovative programs with accredited financial intermediaries to leverage public sector financial instruments and catalyze private investment.

6. Sustainable Forestry

Under Article 5, the signatory nations are encouraged to "take action to conserve and enhance … sinks and reservoirs of [GHGs] … including forests" utilizing existing frameworks, results-based payments, and incentives. The Agreement refers to "joint mitigation and adaptation approaches" to pursue conservation and reduced emissions from the forestry sector. It is unclear what the language means, but it at least suggests that such measures may be eligible for use by developed nations to meet their NDCs through an ITMO or participation in the SDM.

7. Loss and Damage

Signatory nations are for the first time encouraged to cooperate to address "loss and damage" associated with adverse economic effects of climate change on developing nations. Developed nation signatories will have no economic liability for such loss and damage, and will not be obligated to provide compensation. However, cooperative actions are encouraged and may include joint development of early warning systems, emergency preparedness, comprehensive risk assessment and management practices, risk insurance facilities, climate risk pooling, and other insurance-based solutions.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.