# *The UN Climate Change Conference in Cancun*

## What the Cancun Agreement means for business

***An important step down a difficult road***

After the disappointment of COP[1] 15 in Copenhagen in December 2009, policymakers in the UN, the European Commission and the UK were all keen to manage down expectations of COP 16 in Cancun. Nevertheless it was still an important meeting. The role of the UNFCCC[2] and its ability to broker a deal between the many factions within its membership was in doubt.

The negotiations during the year had not gone well. Areas that governments agreed in Copenhagen were reopened for discussion, and the focus on action in developed vs developing countries remained as sharp as ever. But from the start, the Mexican Government and the COP President, Mexican Foreign Secretary Patricia Espinosa, showed a determination and a political savvy that at least inspired hope, if not confidence, in a successful outcome.

Under her leadership, the conference left behind past disappointments and the constraints of 'binding-or-nothing', with 'balance' becoming the buzzword throughout the corridors and rooms of the Moon Palace where negotiations took place: balance between the two negotiating tracks and balance between developed and developing countries' interests. A new UNEP report added impetus to the negotiations, highlighting the widening gap between what nations pledged in Copenhagen and what emission reductions are actually needed to avoid a 2$^{o}$C temperature rise. PwC's Low Carbon Economy Index also explores this issue and its implications for national policy.

***The Cancun Agreement***

After twelve long days and nights of meetings and negotiations, Minister Espinosa's gavel came down for the final time just after 6am on the morning of Saturday 11 December. The 'Cancun Agreement', a collection of 26 agreements supported by 193 countries, had been adopted. The result was celebrated variously as 'a historic compromise' and 'a commitment to multilateralism', but some have dismissed it as weak and ineffective.

The Agreement provides for action to reduce emissions by both developing and developed countries, embeds pledges from the Copenhagen Accord in a COP decision, sets out a framework for avoided deforestation and confirms the continuation of emissions trading and project-based mechanisms under the Kyoto Protocol. It establishes a Green Climate Fund to help disburse money needed to help developing nations combat climate change, a Cancun Adaptation Framework and a Technology Network to support the deployment of low carbon technology.

However, the compromise was evident in many of these decisions, as much by what wasn't addressed as what was. Much of the text lacks substance, leaving many of the more difficult issues for consideration during the coming year with a view to finalisation at COP 17.

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[1] Conference of the Parties
[2] United Nations Framework Convention on Climate Change

The role of the private sector in climate change is a critical one, not only for financing and technology but also for delivery of mitigation and adaptation policies. The irony is not missed then, that very little is said about business in the COP 16 documents. Further collaboration will be needed as governments start to tackle the actions from Cancun and beyond.

***The PwC Cancun policy brief***

In this briefing, we analyse the key outcomes of the Cancun Agreement and their implications for business, carbon markets and investment. We also explore the perspectives from China and Brazil, key countries in the context of climate change, and the road ahead to Durban, South Africa in 2011.

***The architecture of the Cancun Agreement***

The architecture of the Agreement mirrors the structure of the negotiations and provides vital clues to the underlying politics.

With support from the US and BASIC[3] nations, the LCA[4] negotiating track made good progress and was underpinned by a 'shared vision for long-term cooperative action'. Detail includes recognition of the need to reduce emissions to hold the increase in global average temperature below 2°C, but also potentially to strengthen the long-term global goal, based on the best available scientific knowledge, to a global average temperature rise of 1.5°C. There were also key outcomes in relation to adaptation and a new Green Climate Fund.

The Kyoto Protocol made much less progress, its continuity being one of the main rifts in Cancun. Many developing countries wanted to see an extension of the Protocol to ensure commitment by developed countries and longevity in the project-based mechanism markets (CDM[5] and JI[6]). However Japan, Canada and Russia resisted a second phase without the inclusion of the two largest emitters (US and China). Following intense consultation and weakening of text on points of dispute, compromise was struck in the final agreements (despite Bolivia's adamant objections), with assurance given to the continuity of emissions trading and the project-based mechanisms established under the Protocol and ambiguity on the future of the Kyoto Protocol. The baton is now passed onto Durban, with the need for a binding agreement even more pressing, as we approach the end of the first Kyoto commitment period.

***Emission reduction plans and targets***

The Cancun Agreement sketches out a framework for a possible future legally binding deal, but is very short on detail. Parties 'shall aim to complete' further commitments by developed countries to cut greenhouse gas emissions 'as early as possible' (but fails to set a target date) and 'in time to ensure that there is no gap between the first and second commitment period.'

The Parties 'accepted' the emission reduction pledges made by countries under the Copenhagen Accord, formalising the commitments in the UN process. There is still no assurance that these pledges, widely criticised as being

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[3] Bloc of four large developing countries – Brazil, South Africa, India and China
[4] Long-term cooperative action
[5] Clean Development Mechanism
[6] Joint Implementation

inadequate to keep the average global temperature rise at 2 degrees Celsius or less, will be fulfilled whether they are legally binding or not.

PwC estimated that the Copenhagen pledges will reduce carbon intensity – the amount of $CO_2$ produced for every unit of GDP – by around 2% a year to 2020. This is just half of what is required to meet a 450ppm greenhouse gas stabilisation target, which is what scientists believe is needed to limit temperature rise at 2 degrees. PwC estimates that the global carbon intensity needs to fall at an average rate of 3.8% to 2020.

The Agreement 'urges developed country Parties to increase [their] ambition'. In the current economic climate it is difficult to see countries, particularly those large emitters, doing this unilaterally. However a shift to 30% by Europe must be a possibility as part of the price for a legally binding deal in Durban that secures more ambitious commitments. More aggressive climate targets signalled by the EU (and UK) are not impossible and would position Europe with the front runners in the green growth race, but they will come at a cost.

A victory for the US came in respect of MRV[7] when all parties agreed that 'internationally supported mitigation actions will be measured, reported and verified domestically and will be subject to international measurement, reporting and verification in accordance with guidelines to be developed under the Convention.' Also developing countries will provide updates every two years on their progress against their climate change action plans.

***Carbon markets***

Meanwhile the CDM market continues on life support. The market and investors have been crying out for a clear signal on its future as Kyoto's 2012 deadline rapidly approaches. Cancun has confirmed that project-based mechanisms will continue, but unless other markets for CDM credits emerge, demand is likely to be limited by the restrictions imposed on the use of CDM credits in the EU ETS[8].

The text includes short-term improvements that address some of the governance and technical issues that have historically led to delays in the CDM registration process, as well as a mandate to shorten methodology approval timelines.

Additionally, the eligibility of carbon capture and storage (CCS) as an offsetting activity under the CDM was accepted: an important step for both the CDM and CCS. Agreement was possible after a significant change in position came from the AOSIS[9] countries, who have traditionally been opponents to CCS. Despite the turnaround, they do have genuine concerns over the safety of CCS which will need to be addressed. Importantly the text puts an end to the arguments that the CDM is not an appropriate mechanism for CCS and restricts the list of issues to be resolved at the next climate talks to a relatively small list of technical and methodological matters.

In respect of new market mechanisms, a highly-politicised issue, the text contained a number of important elements including an affirmation that opportunities to use markets should be guided by a series of principles and consideration at COP 17 of the establishment of one or more mechanisms. It was not unexpected that a full decision in Cancun on new market mechanisms would be delayed until next year as it is clear that some parties remain

[7] Monitoring, reporting and verification
[8] Emission Trading System
[9] Alliance of Small Island States

ideologically opposed to the inclusion of markets and promote non-market mechanisms such as carbon taxes, use of other policies, levies on bunker fuel etc.

***Climate finance***

The decision to establish the Green Climate Fund was anticipated and widely welcomed. It will be governed by a board with equal representation from developed and developing countries. The World Bank will serve as the interim trustee for the first three years. The fund will be used to disburse a significant part of the large sums of money to help developing countries respond to climate change.

Over the next 12 months a Transitional Committee will be established to design the fund. The group will develop recommendations to present to the COP in Durban, including legal and institutional arrangements, governance, financial instruments, access modalities and independent evaluation. The private sector will have a lot of expertise to contribute but how it can engage has not yet been made clear.

The proposed fund is good news but missing half the puzzle. It is designed to distribute the funds, not raise them. More work is needed on potential new sources of funds and the role of the private sector in meeting the goal of raising $100bn per annum by 2020 to support climate action. Surprisingly, the work of the High-Level Advisory Group on Climate Change Financing (AGF) was referenced but without mention of a continuing work plan past Cancun.

Where this money will come from remains a much talked about issue; a variety of public and private sources are required – there is no single solution. The absence of any mention of private finance in the agreement's text is one of those political compromises that Minister Espinosa asked for, to make a deal in Cancun possible. A number of the G77 remain unconvinced of the role of markets and private finance to address climate change. But private finance has got to have a big role if we are going to get anywhere near the $100bn goal. The private sector is up for this and the money is there, but it is going to require much better joining up between policies and funding from the public sector and investment by business. We are seeing moves toward this, for example with demonstration projects in CCS and CSP, and the plans to pump money into the forest carbon market through the FCPF Carbon Fund. But more of this joined-up thinking is required.

***REDD+***

The Cancun Agreement outlines plans to create a framework for the REDD+[10] mechanism that will see developed nations provide finance to help developing countries protect forests but it makes no explicit mention of how the scheme will be funded.

The use of carbon markets to generate the requisite investment has been a contentious issue and inclusion of provisions to finance REDD+ activities through a market mechanism could have put the entire deal in jeopardy. So the final text does not address this issue explicitly, but rather governments are to explore financing options before the next round of climate talks in Durban.

PwC believes that appropriately designed carbon market mechanisms have the potential to drive private sector investment at scale and should play a central role in the policy framework for REDD+. The voluntary market will not be adequate to drive this investment; the demand and price levels are not sufficient. Demand for REDD+ credits from

[10] Reducing Emissions from Deforestation and forest Degradation

compliance markets in developed countries is needed. At present, REDD+ credits are unlikely to be allowed into the EU ETS until at least 2020, although perhaps a shift to 30% could open a door for their inclusion before then.

The Cancun Agreement addresses national vs. sub-national REDD accounting which has been a thorny issue for negotiators. A key concern is that allowing sub-national accounting of emission reductions from deforestation could simply shift logging activities outside a project boundary, if there are no mechanisms in place to account for this 'leakage'. However, it is unclear how the private sector would engage in a national level REDD+ mechanism that did not credit activities to reduce emissions at the project level. The text manages to find a way through this by allowing for national systems for monitoring and reporting, whilst also permiting sub-national monitoring and reporting as an 'interim' measure. It also recognises that countries may not have the capacity to administer these systems for some time.

An outstanding issue is whether to introduce monitoring and reporting standards to safeguard indigenous rights and biodiversity. This was rejected by some forest nations (including Brazil), who claimed these rules were too onerous on developing nations hosting REDD projects. However, it was agreed that countries receiving compensation should be required to detail what environmental and social safeguards they are taking; how the reports will be compiled, monitored or verified or consequences for non-reporting were not agreed.

Outside of the negotiations, the REDD+ agenda remained an area of intense activity with various multilateral, bilateral, NGO and private sector side-events and announcements throughout the conference. PwC supported the World Economic Forum and the Mexican Government in a series of dialogues with policymakers and business leaders on sustainable land use initiatives (including REDD+). A statement on REDD+ was issued jointly with CMIA[11] and IETA[12], exploring the central role that appropriately designed carbon markets could play, as part of the overall policy framework for REDD+, to help drive private sector investment at scale (particularly as current prices and demand in the voluntary market are not adequate). We hope that these discussions continue and that appropriate mechanisms to attract private sector capital to REDD+ are included in a final deal.

***Adaptation***

Cancun recognised that 'enhanced action and international co-operation' on adaptation is urgently needed, resulting in the establishment of the Cancun Adaptation Framework to increase financial, technical and constitutional support in relation to adaptation in developing countries.

This framework includes the creation of an Adaptation Committee to support implementation of actions and provide technical support through knowledge sharing, partnerships and guidance on how to spend climate finance.

Also included is the establishment of a work program in preparation for a decision to establish (or not) an international insurance mechanism at the COP in 2012. Countries and relevant organisations have been asked to submit their ideas for consideration at the June 2011 Bonn meeting.

The adaptation framework opens up the possibilities for a greater role for the private sector with the provision of adaptation services and involvement in an insurance mechanism.

[11] Carbon Markets & Investors Association
[12] International Emissions Trading Association

***Prospects for a deal in Durban***

The first Kyoto commitment period ends on 31 December 2012, so the need for a agreement on what comes next is becoming increasingly pressing. The quote on the T-shirts worn by many of the younger delegates in Cancun, sums up the challenge for policymakers in Durban: 'You have been negotiating all my life. You cannot tell me you need more time.' In particular, parties need to ensure that there is no gap between the first and second commitment periods and therefore Durban looks like it has a lot to accomplish. Coming away from Cancun, delegates seemed more optimistic about a deal in Durban. But exactly what sort of deal is another question. Realistically it will probably need to be weak to secure agreement from the key nations, so it will be important to build in the potential to ratchet up climate action quickly, in the event of more pessimistic or pressing scientific evidence.

One of the key issues is whether or how to bring the two negotiating tracks (AWG-LCA and AWG-KP) together. This has been strongly opposed by developing countries as they cling on to the distinction between Annex I and non-Annex I countries to ensure they do not have to sacrifice growth to tackle climate change. But other countries are equally opposed to the extension of a treaty without commitments for at least the large emerging economies.

A deal, whether it be a second commitment phase under the Kyoto Protocol or something new under merged tracks, will require movements in position (no matter how small) by countries like the US and China.

***Perspectives from China and Brazil***

China and Brazil are key countries within the context of climate change due to their developing country status, economic weight and experience and involvement in the carbon markets to date (under CDM and REDD).

One of the most significant signs of climate change mitigation in 2009 was the increasing willingness of major emerging economies such as China and Brazil to make commitments on climate change. Ahead of the Copenhagen UNFCCC meetings last December, China announced its targets to lower its carbon intensity by 40-45 percent from 2005 levels by 2020 and Brazil committed to a 36-39 percent reduction below projected (or business-as-usual) emissions by 2020. These targets were swiftly followed by action.

We set out below the countries' perspectives of the Cancun Agreement and its implications for business, national policy and future agreements.

**China**

The Chinese government is reported to be happy with the outcome of the negotiations in Cancun. It compromised on the approach to monitoring and reporting of developing country actions – an issue which caused ill feeling in Copenhagen. However, China remained firm on the principle of 'common but differentiated responsibility' maintaining the focus on the need for developed countries to take action first. This is in spite of having the highest national greenhouse gas emissions. In doing so, China ensured that negotiations of the successor to Kyoto Protocol will continue with the emphasis on binding emissions targets for developed countries. The head of the Chinese delegation, Mr. Xie Zhenhua, emerged from Cancun optimistic about the prospect of reaching a meaningful agreement at Durban.

At home, China is currently finalising its next five-year economic development plan and there are strong indications that carbon intensity reduction could become a binding domestic target. Provincial governor and state-owned enterprise owners would be assessed not only by economic growth rates but also environmental indicators including carbon intensity and water use. The government is also piloting a cap-and-trade system on energy consumption and emission reduction in specific cities and provinces and specific industries.

**Brazil**

Brazil exited the economic recession relatively unscathed and therefore well-positioned to capitalise on low carbon growth opportunities, particularly in the biofuels markets and the development of REDD+ mechanisms.

One step in consolidating the government's initiatives towards a low carbon economy came during COP 16 on December 9th with the launch of a decree which detailed the action plans to be implemented in order to achieve Brazil's emission reduction target (36-39%). These focus on several sectors and activities, such as prevention and control of the deforestation rates in the Amazon and Cerrado biomes; increasing the supply of renewables energies; implementing low carbon initiatives for agricultural activities; and reducing emissions from the steel sector.

The Brazilian government welcomed the final decision on REDD+ at Cancun. Brazil's targets for reducing deforestation rates (by 80% for the Amazon and 40% for the Cerrado biomes in 2020) are a critical part of its National Policy on Climate Change. Further detail on key aspects of REDD+ is required, particularly around long-term financing options. Nevertheless REDD+ will be key to enabling Brazil to implement its projects and activities at scale.

***Concluding remarks***

Overall, while the 'Cancun Agreement' is not a legally binding agreement with emissions reduction targets for developed and developing countries, it has given hope for such a deal at COP17 in Durban next year. Perhaps most importantly, Cancun helped to restore confidence and legitimacy in the UN process. It has also set the scene for an acceleration of action on avoiding deforestation through REDD+, on adaptation to climate change and on climate finance. The texts are imperfect and lack the substance that many were hoping for, but this was the compromise to get an agreement. Filling the gaps in the text is a task for next year.

As for business, although there was very little reference to the private sector in the COP16 documents, it is widely recognised that their role is a critical one in the fight against climate change. With a step up in action and investment, businesses can drive transformation in their sectors and policy progress.

When Christiana Figueres, Executive Secretary of the UNFCCC addressed the business day at Cancun she told delegates about the dinner to welcome ministers to the COP. It had been held on the beach near a nesting ground of turtles and, as a sign of hope, each had been given a baby turtle to launch into a new life in the ocean. That sign of hope has perhaps been justified by the progress at Cancun. But, like their turtles, ministers and negotiators may have to stick their necks out if they want to get anywhere in time for Durban.

Cancun was a stepping stone; at least governments managed to avoid stumbling. But there is still a huge amount to do to deliver a deal in Durban.

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