



**CARBON FORESTRY  
PROJECTS IN  
DEVELOPING COUNTRIES:  
LEGAL ISSUES AND TOOLS**



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## PREFACE

There is growing scientific and political consensus that global warming is occurring and that the carbon produced by human activities plays a causative role. Forest Trends believes that whatever the future of the Kyoto Protocol, forestry carbon projects in developing countries have the potential to assist global warming efforts by offering low-cost, flexible means to meet emissions constraints while at the same time providing developing countries a source of capital to finance good forestry and other sustainable development activities.

Two major issues could severely limit the full effectiveness of this market mechanism. First, absence of stringent requirements for sustainable development components could result in projects that harm both the environment and the interests of local populations. Forest Trends has been working with the Center for International Environmental Law to develop environmental standards to be included in all carbon forestry projects and with Center for International Forestry Research to identify local and community perspectives on the emerging carbon market.

Second, high transaction costs may keep environmentally sound projects from being economically viable. Many corporations, governments, and indigenous groups are interested in this area but due to the complex and evolving nature of the issues must expend considerable time, effort and money to understand how to proceed. Since such matters require knowledge of environmental, contract and international law, the focus here is on assistance to such groups and their lawyers.

Forest Trends offers this paper, Forestry Carbon Projects in Developing Countries: Legal Issues and Tools both to provide practical material for those new to such projects and to stimulate discussion and critical comment. This paper is not intend to offer sophisticated legal advice but is a beginning point, raising issues, offering suggestions and pointing the way to more complex material.

We hope that it is helpful and look forward to comments.



Michael Jenkins  
Executive Director  
April 2000

# **CARBON FORESTRY PROJECTS IN DEVELOPING COUNTRIES: LEGAL ISSUES AND TOOLS**

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## **I. INTRODUCTION**

Increasing awareness of the need for action on global warming has produced a search for ways to reduce greenhouse gas (GHG) emissions and to sequester carbon to offset such emissions. At the present time nations around the globe are hotly debating whether to put into force the Kyoto Protocol<sup>2</sup>, a climate control regime that mandates GHG emission quotas for developed countries. Whether Kyoto will become binding is uncertain but some form of international climate control is likely to occur in the near future. To comply with such climate controls industrialized countries will need to develop systems to control their own domestic emissions. Domestic corporations that emit GHGs will be required to limit their emissions and will also very likely be able to gain credit by investing in climate beneficial projects in other countries. This paper focuses on the legal issues concerned with carbon offset projects involving forestry in developing countries.

Under Kyoto corporations may invest in developed countries through Joint Implementation (JI) or in developing countries through the Clean Development Mechanism (CDM). This paper concentrates on the CDM because of the significant opportunities for cost-effective projects beneficial both to investors and to the

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<sup>1</sup> Patsy Davis is an attorney with Forest Trends.

<sup>2</sup> Kyoto Protocol to the United Nations Framework Convention on Climate Change, December 10, 1997, FCCC/CP/1997/1.7/Add.1 [hereinafter Kyoto Protocol]

developing countries. At present there is a pilot project, Activities Implemented Jointly (AIJ), that encourages projects similar to those that, if Kyoto comes into force, will gain emission credits under the CDM. The theory of these projects is that the climate benefits must be “additional” to what would have occurred absent the projects. Thus measurements must be made that compare a baseline, i.e. what would have occurred without the project, with what is actually occurring because of the project.

There are an assortment of carbon offset projects, many of which are in the renewable energy sector, such as those using wind, small hydro and biomass energy technology. However, forestry projects are particularly appealing for a variety of reasons, not the least of which is that they are often the most cost effective. Such projects vary widely from those that plant new trees to sequester carbon to those that provide better forest management in order to reduce emissions by preventing events like forest fires that release carbon into the atmosphere. From a local development perspective carbon deals can add value to forests and forestlands and result in new income for rural populations.

The uncertainties in this area are legion but the need to hedge against the likelihood of government imposed emissions limitations is leading corporations that emit GHGs to examine possible pathways to compliance.<sup>3</sup> Though governments in developed countries have entered into such projects directly with governments of developing countries our focus here is on those projects in which investors from developed countries engage with host governments and/or private entities within the host country. The range of stakeholders is wide: investors, host governments, intermediary management organizations, and local and indigenous communities.

International forestry carbon projects are long term undertakings requiring sophisticated legal instruments. The task of the lawyer is to assist in designing the project and the documents supporting the project in a way that anticipates future international and domestic regimes while at the same time tries to ensure compliance by the parties and the governments involved. Clarification of and education about

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<sup>3</sup> Robin Bidwell, Chairman of ERM, an environmental consulting company, is quoted as saying that “big business, especially in Europe, is becoming convinced that whatever happens with the Kyoto deal, some form of domestic or pan-regional emissions restrictions are inevitable in the next five years.” Greenhouse gases-cost free. *Economist*. Jan. 22, 2000.

related legal issues can save time and effort while producing a more successful, better-designed project.

It should be emphasized that none of our materials represent legal advice. Rather our attempt is to introduce those lawyers and corporate officers who have had no prior involvement in such projects to some of the issues involved and to provide some resources to which they can turn for more comprehensive understanding by offering the following:

**Legal Background:** A brief discussion of pertinent international, environmental, and contract issues and a compilation of relevant legal resources.

**Pre Implementation Issues and Activities:** A description of the stages generally occurring prior to the final agreement and actual implementation of the project.

**An Annotated Sample Forestry Carbon Offset Agreement:** A sample contract based on a hypothetical project annotated with discussions of legal issues.<sup>4</sup>

## History of International Climate Change Negotiations<sup>5</sup>

At the Earth Summit in Rio in 1992 the United Nations Framework for Climate Change (FCCC)<sup>6</sup> was developed to begin the international process of combating global warming. In 1995 in Berlin the UNFCCC Conference of the Parties (COP- 1) established the pilot project, Activities Implemented Jointly (AIJ), to test whether carbon offset projects located in developing countries could assist in achieving this goal.

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<sup>4</sup> The sample contract is not meant to represent a standard contract. Some international institutions such as the United Nations Industrial Development Organization (UNIDO) and the International Chamber of Commerce have been working on drafting model contracts for international business deals but at present it is our opinion that a template would not possess sufficient flexibility to deal with carbon offset projects.

<sup>5</sup> For a general discussion of carbon issues relating to forests see Totten, Michael. 1999. *Getting It Right: Emerging Markets for Storing Carbon in Forests*. Washington, D.C.: Forest Trends and World Resources Institute. <http://www.forest-trends.org>

<sup>6</sup> United Nations Conference on Environment and Development: Framework Convention on Climate Change, 29 May, 1992, 31 I.L.M 894 (1992) [hereinafter FCCC].



In 1997 in Kyoto Japan (COP-3) the industrialized countries agreed to a Protocol mandating legally binding obligations to reduce their emissions of greenhouse gases by at least 5 per cent within the first commitment period of 2008-2012. For the Protocol to enter into force it must be ratified by at least 55 countries including developed countries that account for at least 55% of developed country emissions. The drafters, cognizant that such binding obligations would bring increased pressure on the developed countries, included three flexible market mechanisms through which developed countries could supplement their domestic actions: Emission Trading, Joint Implementation, and a new project based mechanism called the Clean Development Mechanism (CDM). The CDM, like AIJ, encourages carbon-offset projects in developing countries but, unlike AIJ, also includes as an objective supporting sustainable development in developing countries.

At the present time the Kyoto Protocol itself not in force and there has been little agreement on the CDM structure. The United Nations International Panel on Climate Change (IPCC), a collection of the leading climate change experts, is at present developing a Special Report on Land Use, Land Use Change and Forestry, that focuses on technical issues upon which decisions concerning the CDM will be based.<sup>7</sup> These issues involve measurement of sequestered carbon, development of standardized GHG accounting and reporting, and socioeconomic and environmental impact methods. This report was discussed in Bonn (COP-5) in November 1999 and the final CDM requirements are scheduled to be defined at the Hague (COP-6) in late 2000.

## **Carbon Offset Contracts**

Though the IPCC's Special Report focus on the technical issues in carbon offset projects is important there has been little evaluation of another source of transaction costs: the legal instruments defining such projects. In part this is due to the reluctance of parties engaged in AIJ projects to share documents containing proprietary information. Also the lack of credits under AIJ has meant there are only a limited number of projects available to study and those that do exist vary so widely as to their

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<sup>7</sup> For information about the IPCC see <http://www.ipcc.ch/>. The final draft, to be published in the summer of 2000, will be an invaluable tool for understanding carbon forestry issues.



activities and parties that it is unclear whether sufficient common contractual elements exist to make such examination profitable. Furthermore, there is the uncertainty about what will be the exact requirements of its replacement, the CDM.

Given these difficulties we still think that looking backwards at how the AIJ contracts handled those issues likely to be common to future projects and looking forward at those issues most likely to be incorporated into a future scheme such as the CDM will offer some assistance to drafters of future such contracts. The following are some reasons we believe the attempt worthwhile:

- **Control of transaction costs**

High transaction costs for AIJ/CDM projects benefit neither the investor, the host country nor the environment. Under AIJ these costs have been due in large part to the difficulty in developing tools to measure accurately the additional carbon sequestration provided by the project. But the legal costs of developing long term complicated international agreements are not minimal and can keep an environmentally productive project from being an attractive investment.<sup>8</sup>

- **Protection of the parties**

Such projects often involve a particularly wide variety of stakeholders, from sophisticated Wall Street investors to indigenous farmers. Though all parties share the interest of lowering greenhouse gasses in the atmosphere, each party has separate and at times conflicting agenda. Contracts can clarify expectations and systematize responsibilities to provide for a smoothly run, equitably compensated project.

- **Compliance with international legal and financial standards**

Though some carbon-offset projects have been implemented outside of the AIJ system, once a system of credits has been instituted it is certain that

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<sup>8</sup> Pricewaterhousecoopers offers a Global Law Department Survey that provides information regarding corporate spending on legal services worldwide. <http://www.pwcglobal.com/>

investors will seek the necessary approvals from the appropriate international accrediting body. Well-drafted contracts can help assure the compatibility of the project standards with governmental requirements and legitimize such projects to financial institutions.

- **Development of a clear legal definition of “carbon offsets”**

These contracts are important in helping to develop a clear legal definition of carbon offsets. The term “carbon offsets”, though often used as a term of art, has no uniformly accepted meaning. Central to any such contract is the establishment of the ownership of the right to claim authorship of the sequestration or emission reduction activities.

## **Conclusion**

Even if the Kyoto Protocol never comes into force, the political and economic global powers will in the near future develop some system for dealing with global warming. Responsible parties ranging from international energy corporations to indigenous groups must be prepared to take a role in formulating the optimal system and in understanding how best to protect their own interests. As Hamlet says, “If it be now, ‘tis not to come; if it be not to come, it will be now; if it be not now, yet it will come. The readiness is all”.

## II. LEGAL BACKGROUND

This Chapter presents brief discussions of key legal issues concerning carbon forestry projects in developing countries.<sup>9</sup> An attorney involved with such projects will need to examine the laws of the countries involved but most important she must understand the ground rules, criteria and guidelines both for the UNFCCC's Activities Implemented Jointly (AIJ) and for the Clean Development Mechanism (CDM).

### 1. Activities Implemented Jointly (AIJ) Pilot Project

In 1995 in Berlin (COP-1) UNFCCC established a pilot project, Activities Implemented Jointly (AIJ), to give developed countries and investors experience with a variety of low cost projects located in developing countries that would either reduce GHG emissions or sequester carbon. Though no credits for such offsets were to be granted, these projects were to be experiments to examine such projects' viability as a way through which developed countries could achieve part of their emission reduction goals. Forestry projects were seen as particularly attractive because of their comparatively low cost. Because of the lack of credits the number of AIJ projects has been low<sup>10</sup>.

Both private parties and governments have implemented AIJ projects. The degree and form of government involvement in AIJ projects has varied widely. Developed countries have each designed individualized programs within the broad Berlin guidelines. The United States Government's participation has been comparatively minimal. The United States Initiative on Joint Implementation (USIJI), the U. S. agency authorized to evaluate and approve AIJ projects, gives private parties technical assistance to support planning for the project but no U.S. government funds

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<sup>9</sup> For a more detailed discussion of these issues see Chapter V, Bibliography, for a list of relevant articles.

<sup>10</sup> Most of the Land Use and Forestry Projects have been registered with the United Nations AIJ program. <http://www.unfccc.de/program/aij/aijproj.html>

have been used for project implementation.<sup>11</sup> Other governments such as the Dutch provide funds for the development of AIJ projects and provide a near-term profit motive.<sup>12</sup>

In Berlin certain requirements were set for AIJ projects:

- Such projects must obtain approval from the governments of both the host country and the investor's country. This has meant that under AIJ both the investor and the host governments must establish and authorize a government agency to set criteria and approve AIJ projects. The governments then report on these projects to the UNFCCC.
- No project can be financed from funds that the investor country would have expended in the host country either as sustainable development assistance (Official Development Assistance or ODA) or from its contributions to the Global Environment Facility (GEF) that were required under the FCCC. Whether ODA and GEF funds have been appropriately used has been of concern during the pilot period.
- Carbon reductions and sequestration would not have occurred in the absence of the project.

None of the AIJ projects were to earn credits. There was no termination date set for the AIJ pilot program but the assumption was that the CDM would supersede AIJ when the CDM entered into force in the year 2000. Since the CDM has not begun and its rules are still being debated, in November 1999 the international representatives at Bonn (COP-5) decided to continue AIJ for an indefinite period of time and the question of whether credits will be granted to AIJ activities, particularly those occurring after 2000, was left open.<sup>13</sup>

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<sup>11</sup> In September 2000 the USIJI Evaluation Panel will consider project proposals submitted by May 31 of 2000. The Evaluation Panel is CO-chaired by the US Environmental Protection Agency and the US Department of Energy, with representatives from the Agency for International Development, and the Departments of State, Interior, Agriculture, Commerce and Treasury. To contact USIJI program: [usiji@ee.doe.gov](mailto:usiji@ee.doe.gov).

<sup>12</sup> For information about The Netherlands' programs involving Joint Implementation see <http://www.northsea.nl/jiq>.

<sup>13</sup> FCCC/CP/1999/L.13

## 2. Kyoto's Flexible Mechanisms

In 1997 in Kyoto Japan (COP-3) the Parties defined three market mechanisms to be used as a cost-effective way to lower the GHGs in the atmosphere. Under Article 17 of the Kyoto Protocol *Emissions trading* allows a developed country to earn credits by lowering its emissions and to sell those credits to another developed country needing such credits to meet its own commitments. Under Article 6 *Joint Implementation* allows one developed country to obtain credit for reductions that they achieve in another. The *Clean Development Mechanism*, the focus of this paper, was formulated under Article 12 and is described in the next section.

## 3. The Clean Development Mechanism

Article 12 of the Kyoto Protocol provides the outline for the CDM. The details of the mechanism are still being debated and are to be established at COP-6 in The Hague in November of 2000.

“12.1 A clean development mechanism is hereby defined.

12.2 The purpose of the clean development mechanism shall be to assist Parties not included in Annex I (**most developing countries**)<sup>14</sup> in achieving sustainable development (**A major difference between the CDM and the AIJ is the CDM requirement that a project support sustainable development.**) and in contributing to the ultimate objective of the Convention (“to achieve... stabilization of the greenhouse gas concentrations in the atmosphere”<sup>15</sup>), and to assist Parties included in Annex I (**developed countries agreeing to legally binding reductions of GHG emissions below 1990 levels**) in achieving

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<sup>14</sup> The author's comments about Article 12 of the Kyoto Protocol have been inserted in bold typeface.

<sup>15</sup> 1992 United Nations Framework Convention on Climate Change, *supra* note 5, at art. 2.

compliance with their quantified emission limitation and reduction commitments under Article 3.

12.3 Under the clean development mechanism: (a) Parties not included in Annex I will benefit from project activities resulting in certified emission reductions; **(Note that in contrast with AIJ the CDM projects will provide credits)** and (b) Parties included in Annex I may use the certified emission reductions accruing from such project activities to contribute to compliance *with part (Emphasis added)* of their quantified emission limitation and reduction commitments under Article 3, as determined by the Conference of the Parties serving as the meeting of the Parties to this Protocol. **(Concern that the CDM may take pressure off developed countries' efforts to reduce their own emissions has led to vigorous debate over what "part" of the developed countries' commitments can be met with Cress.)**

12.4 The clean development mechanism shall be subject to the authority and guidance of the Conference of the Parties serving as the Meeting of the Parties to this Protocol and be supervised by an executive board of the clean development mechanism. **(A key piece of unfinished business from Kyoto is development of the legal and institutional framework for the CDM. The approach may be ultimately designed to be market based or may utilize a central independent fund.)**

12.5 Emission reductions resulting from each project activity shall be certified by operational entities to be designated by the Conference of the Parties serving as the meeting of the Parties to this Protocol, **(The question remains as to whether the CDM will require both certification of the project design and a subsequent certification of the offsets actually achieved from such design. This Section refers to "resulting" emission reductions implying a certification after the offsets have been achieved and 12.5 (c) and 12.6 mention "certified project activities" implying certification at the project's design stage. Under AIJ the host and the investor governments are**

responsible for approving the project design. This section gives to “operational entities” the power to certify. How many such operational entities there will be and whether they will be privately or publicly run are some of the many unresolved issues.) on the basis of:

- (a) Voluntary participation approved by each Party involved; **(Though this requirement gives the host country a major role in certification the role of the investor country is not clear. Will an investor from a given country need his country's approval of his project if he intends to sell the CERs to another country?)**
- (b) Real, measurable, and long-term benefits related to the mitigation of climate change; <sup>16</sup> and
- (c) Reductions in emissions that are additional to any that would occur in the absence of the certified project activity.

12.6. The clean development mechanism shall assist in arranging funding of certified project activities as necessary.

12.7. The Conference of the Parties serving as the meeting of the Parties to this Protocol shall, at its first session, elaborate modalities and procedures with the objective of ensuring transparency, efficiency and accountability through independent auditing and verification of project activities.

12.8 The Conference of the Parties serving as the meeting of the Parties to this Protocol shall ensure that a share of the proceeds from certified project activities is used to cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. **(The percentage of the proceeds necessary to cover such expenses has not been set. The investor will be particularly interested in the amount of such transaction costs.)**

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<sup>16</sup> The requirements of Article 12.5 of the Kyoto Protocol are discussed in detail at Chapter II-5, Legal Background: CDM “Technical” Issues.



12.9 Participation under the clean development mechanism, including activities mentioned in paragraph 3(a) above and acquisition of certified emission reductions, may involve private and/or public entities, and is to be subject to whatever guidance may be provided by the executive board of the clean development mechanism. **(Note: the explicit recognition of the role of private parties.)**

12.10 Certified emission reductions obtained during the period from the year 2000 up to the beginning of the first commitment period can be used to assist in achieving compliance in the first commitment period. **(Since the CDM has not yet come into force emission reductions from projects occurring after 2000 but before the CDM's activation may or may not be certified retroactively. Credits for emission reductions through the other flexible mechanisms can not be banked until the first commitment period, 2008-2012).**

#### **4. Inclusion of Forestry within the CDM**

In examining the role of forestry within the Kyoto Protocol it is important to distinguish between those forestry activities that sequester carbon through removing carbon from the air by reforestation and afforestation and those that reduce emissions through forestry management practices such as those that protect the carbon stored in trees from being released into the atmosphere through diseases, insects or fire. Exactly what forests should be included within the CDM is hotly debated.

In Rio in 1992 forests were clearly to be included as part of the climate controls efforts. The FCCC's objective was not limited to emission reductions but was "to achieve...stabilization of greenhouse gas concentrations in the atmosphere". The Parties further agreed to "promote and cooperate in the conservation and enhancement...of sinks and reservoirs of all greenhouse gases."

However the role of forestry projects in the CDM is less clear. Some argue against the inclusion of any such projects on the basis that Article 12, in contrast to

Article 6(1) describing Joint Implementation, does not explicitly mention Land Use and Forestry Projects. Others maintain that since Article 12 speaks of creating “certified emissions *reductions*” (emphasis added) sequestration activities are not intended to be included.<sup>17</sup> A third position is that the CDM are meant to include all forestry projects including reforestation and afforestation because of the history of the FCCC and the need to interpret of section of the Protocol in relationship with the total document. For example, Article 3 of Kyoto included deforestation, reforestation and afforestation in determining a country’s emission reductions. The decision on the role of forestry within the Kyoto Protocol is to be made at COP-6 at The Hague in November of 2000 and will be based not only on legal analysis but also on policy and political factors.

Existing carbon forestry projects include the following: preserving and protecting frontier forests, buying back logging concessions in biologically rich areas, reduced-impact logging, sustainable forest management, managing wildfire threats, bringing degraded lands into production, afforestation of pasture and marginal agricultural land, use of sustainably grown biomass to displace fossil fuels, agroforestry on farms, and urban forestry.

## **5. CDM “Technical” issues.<sup>18</sup>**

Article 12 of Kyoto states that emission reductions under the CDM must be “real, measurable and long term” and “additional to any that would occur in the absence of the certified project activity.” Under the CDM carbon offset projects must also support “sustainable development” in the host country and assure “transparency and public accountability.” Of particular importance to forestry are those issues involving standardizing calculations of baselines, development of rigorous methods for measuring, monitoring and verifying carbon benefits and determining accurate methods

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17 Danish, Kyle, and Brenes, E. and Rotter, J.C. 1999. Legal Dimensions of AIJ Project Development Activities. In The U.N. Framework Convention on Climate Change Activities Implemented Jointly (AIJ) Pilot: Experiences and Lessons Learned. ed. Dixon, R.K., Dordrecht/London/Boston: Kluwer Academic Publishers.

See also, Gosseries, Axel, 1999. The Legal Architecture of Joint Implementation: What do we learn from the Pilot Phase? 7 *New York University Environmental Law Journal* 7: 49, 107.

of measuring socioeconomic and environmental impacts. Because high transaction costs may destroy investment incentives for private parties it is essential that these methods not be prohibitively expensive. The resolution of these issues requires technical knowledge but the decisions concerning them are ultimately political in nature. The IPCC report on technical issues will form the basis of final CDM decisions scheduled to be made at COP-6.

## **A. Additionality**

### **i. Financial Additionality**

Though government funds can be spent on projects, repackaging of federally or multilaterally funded projects from a government's Official Development Assistance (ODA) or the Global Environment Facility (GEF) is not acceptable.

### **ii. Environmental Additionality**

Projects must be able accurately to quantify what net reductions and sequestration occurred. Such additionality requires three basic measurements: the actual carbon on a project site, the baseline or amount of carbon that would have been emitted or sequestered without the project, and leakage or amount of carbon emissions increased or decreased outside the project area. Additionality requires not that climate benefits are likely to occur but that they can be scientifically measured to have occurred.

Credits are not intended to be granted to projects that would have been undertaken in the ordinary course of business. Thus a project that would have been established even if the Kyoto scheme was not in place would not receive credits even if it significantly lowered GHG emissions. The additionality requirement probably does not require projects to be unprofitable absent the carbon offset credits, but if a project is more than marginally profitable the additionality requirement would probably not be met.

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<sup>18</sup> This Chapter's brief descriptions of the relevant terms are only meant to be introductory. Lawyers will need to examine these issues much more in depth to understand both the complexity and the differing viewpoints raised. See Chapter V: [Bibliography](#).

**(a) Measurement of carbon**

At various times the amount of carbon on the project site must be accurately measured. Though existing above ground carbon on a small to medium project site can be measured with some precision, larger scale projects require more sophisticated measurements such as aerial surveillance and remote sensing. Below ground carbon is likely to be included in the carbon calculations.

**(b) Baseline/amount of carbon sequestered without the project**

The baseline, i.e. what would have occurred in the project area absent the existence of the project, is a complicated issue and a lawyer must make sure that the project designers clearly delineate the system chosen for making such a determination. A baseline may be static, i.e. determined at the beginning of the project and continuing steadily thereon or dynamic, i.e. recalculated during the lifetime of the project. The static baseline provides the investor with greater certainty as to the project's expected benefits while the dynamic baseline offers more accuracy.

**(c) Leakage/ the positive or negative GHG impacts of a project outside the geographic, temporal or subject area boundaries**

Leakage is of particular importance in CDM projects because developing countries do not have caps on their emissions. Leakage requires complex calculations and is best focused on while in the project design stage. In many instances causes of such potential leakage can be identified and actions taken to avoid it. In forestry projects one must always look at the underlying demand for land or timber. If the project's activities will replace any existing or future economic activity appropriate substitution can be made to try to prevent leakage. Another means of protecting against leakage at the design stage is to increase the project's boundaries thus including any impact into the plan of the project. Transnational leakage can occur particularly with products that are

exported to global markets and such leakage may require resolution through international agreements.

## **B. “Real”/Verification of Emission Reduction or Sequestration**

How certification that emission reductions and sequestration are “real” will occur under the CDM is unclear. The roles to be played by the “operational entity” and by the host and the investor country need to be clarified. Some form of the following steps is likely to be required:<sup>19</sup>

### **i. Ex ante certification of projects**

Under the AIJ both the investor and the host governments approve the project design prior to implementation and it is likely that the CDM regulations would also require some sort of project design approval.

### **ii. Monitoring and verification**

To assure that accurate measurements and recording are being done auditing during the course of the project is necessary and may require involvement of an independent party. Kyoto Article 12.7 gives the Conference of the Parties the power to “elaborate modalities and procedures with the objective of ensuring transparency, efficiency and accountability through independent auditing and verification of projects activities.”

### **iii. Ex post certification of the reductions**

To assure that the reductions have actually occurred CERs may not be granted until the emission reductions or sequestration have actually occurred and been measured and certified. The “operational entity” will be the certifying body.

## **C. Durability/Permanence**

Durability is of particular concern in forestry projects because unlike emission reductions that result in fossil fuel remaining in the ground sequestered carbon remains stored only during the lifetime of the tree and is constantly at risk of being

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<sup>19</sup> Goldberg, Donald, et. al. 1998. Carbon Conservation: Climate Change, Forests and the Clean Development Mechanism, Washington, D.C.: Center for International Law, CEDARENA.

released through natural or anthropogenic means such as fires, pests and drought.<sup>20</sup> The question of how to value a ton of LUCF reductions in comparison to a ton produced by an energy project is a difficult conceptual and practical issue.<sup>21</sup> Forestry projects have attempted to deal with issue in a variety of ways:

**i. Accounting approaches:**

(a) Under “real time” accounting ” an emitter must sequester a carbon equal to the amount of carbon it has emitted and for the same amount of time that the emitted carbon remains in the atmosphere. Since emitted carbon may stay in the atmosphere for over 100 years the project must retain its sequestration by lasting for a century. The INVESTOR would have to pay for the development of the forest but the sequestration must last 100 years to be of value. The issue with such an approach is where the liability for failure over the long period will lie with the implementing party or with investor. If, for example, a fire devastates the project forest will the implementers be willing or able to make up for such a loss to the investor.

(b) Under “ton year” accounting the residency life of carbon in the atmosphere is multiplied by the amount of tons emitted. Carbon emitted that stays in the atmosphere for 100 years would need to be offset by sequestration of an equal amount of “ton years” even if the project doesn’t last for 100 years.

**ii. Life cycle**

When trees reach full growth little sequestration takes place. Therefore in some projects the trees are planted, grown and logged; new trees are then planted and the cycle begins again. The issue in these types of projects may be the ultimate disposition of harvested timber. If the wood is put into long lasting products, such as furniture or building materials, the carbon continues to be sequestered.

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<sup>20</sup> See Gosseries, *supra* note 17 at 106 for a discussion of how the durability issue interacts with leakage.

### **iii. Long-term Agreements requiring maintenance of forests**

FACE, a Dutch consortium engaged in worldwide forestry projects, puts into its carbon offset Agreements the requirement that the forest owner must pledge to maintain the afforested areas for 99 years.<sup>22</sup> The enforcement of such a long-term commitment is problematic.

### **iv. Easements**

Easements are perpetual interests in real property voluntarily created and transferable under the laws of the nation where the property is located. Easements have been used to assure certain forestry practices. Local law should be investigated because the concept of a foreign entity owning a right in land in perpetuity may raise sovereignty concerns.

### **v. Long term sustainability activities**

The likely long term success of a forestry project depends in part on whether those people who had lived or worked on or near the project site are provided with new occupations or ways of life that makes their former way of using the land obsolete. Thus provision of alternative land use opportunities to the local population may be a significant part of any duration planning.

### **vi. Endowment**

One means of assuring long-term forest maintenance is by having the parties set up an Endowment to ensure cash is available for forest maintenance beyond the project term. In common law countries trusts are likely to be used while civil law countries are more likely to consider foundations.<sup>23</sup>

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<sup>22</sup> FACE Foundation (Forests Absorbing Carbon Dioxide Emission) contributes financially to the reforestation of about 150.000 hectares worldwide. FACE is an initiative of the Dutch Electricity Generating Board.  
<http://www.facefoundation.nl>

<sup>23</sup> Danish, Kyle, 1994. The Promise of National Environmental Funds in Developing Countries. *International Environmental Affairs* 7:150.



### **vii.Protected Area**

The parties may agree that at the end of a project the land will be turned over to the national government and maintained in perpetuity as a protected area.

## **D. Sustainable Development**

CDM, unlike AIJ, specifically mandates inclusion of a sustainable development component but does not define the term.<sup>24</sup> Some contend that the host government understands its own environmental and developmental needs and should be the sole judge of a project's contribution to such needs. Others argue that the CDM regulations should define sustainable development and require rigorous assessment methodology such as Social Impact Assessments.

Though many of the elements included in the concept of sustainable development can help in obtaining long term benefits from a carbon offset project, there is also a concern that the extra costs may make the project less interesting to an investor. Though additional funds from international organizations or from the GIF may be available to help with this part of the project, the attorney must also keep the financial additionality requirement in mind. The following are a few of the ways that that carbon offset project can support sustainable development:

- Protection of natural forests and biodiversity
- Economic benefits to the local community through direct benefit sharing, capacity building or technology transfer.
- Empowerment of indigenous people living on lands affected by a project by including them as part of the design and implementation of the project. Effective public participation requires access to information, participation in decision-making and access to justice.
- Soil erosion and watershed protection

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<sup>24</sup> For a discussion on whether CDM will be able to provide substantial sustainable development benefits that are consistent with domestic goals set by Brazil, China and India Austin, D., Faeth, P., Da Motta, R.S, Ferraz, C., Young, C., Zou, J., Junfeng, L., Pathak, M., Srivastava, L., and Sharma, S.. 1999. How Much Sustainable Development Can We Expect From the Clean Development Mechanism? Washington, D.C. : World Resources Institute. <http://www.wri.org>.

- Protection of timber and non timber forestry products
- Improved air quality

## **6. Bilateral and Multilateral Understandings between Countries**

Developed countries have entered into a variety of bilateral and multilateral understandings with developing countries concerning carbon offset projects.

### **A. Joint Statements**

Heads of state have made broad statements of agreement such as the one delivered by President Clinton and President Frei of Chile at the recent Summit of the Americas in Santiago in which the two Presidents “expressed their firm support for the principles and objectives of the Kyoto Protocol and their conviction that its market mechanisms will be a great help in mobilizing private sector resources to reduce greenhouse gas emissions” and also “recognized the potential of the Clean Development Mechanism to become an important resource for attracting private sector initiatives and investment in clean energy technologies, energy efficiency, forests and other activities that reduce, absorb or eliminate greenhouse gas emissions.”<sup>25</sup>

### **B. Memoranda of Understanding (MOU) and Letters of Intent (LOI)**

Investor governments and/or Multinational organizations have used MOUs and LOIs to join with host governments to state positions on carbon offset issues, establish frameworks for collaboration and in some cases make commitments concerning a specific project or projects. Less important than what such an instrument is called is whether it indicates the parties’ intentions to be bound. One indication of such intent is the inclusion of an arbitration clause. Such documents may include a designation of a government office in a host country which is

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<sup>25</sup> Summit of the Americas Santiago, Chile. (April 1998) See also, statement signed by U.S. Vice President Al Gore and Costa Rica President Jose Maria Figueres that “endorses the use of bilateral private sector partnerships to reduce greenhouse gas emissions.” (September 30, 1994)

empowered to grant approval of the project under the AIJ program, determination of what criteria the host country will use to grant project approval, procedures for the monitoring and external verification of emission reductions and means for protecting intellectual property.

## **7. Laws of the Investor Country**

Given that most Buyers/Investors in such projects will be interested in carbon offset rights largely based on the demands placed on them by domestic laws and regulations, a lawyer must examine the laws of the Investor Country. Some developed countries have already developed laws limiting emissions of certain gases, others looking toward a time when international limitations may be imposed, are developing “early action” legislation. Most have some system under which a corporation can register its emission reduction efforts and have officially designated an agency within the government to deal with registration and certification. Though such laws focus on domestic activities many recognize the value of international projects.

### **A. Existing Emission Limitation Laws**

Many developed countries have limits on the emissions of certain gases through some form of taxes<sup>26</sup> or cap and trade system. For example, in order to reduce emissions Italy, Norway and Sweden have imposed taxes some equivalent to \$50 per ton of carbon.<sup>27</sup> In the United States of particular interest is Title IV of the Clean Air Act Amendments of 1990 under which limitations on sulfur dioxide emissions have created an Emissions Trading Market in SO<sub>2</sub>.<sup>28</sup> Though much can be learned from Sulfur trading, carbon trading is more complicated. The SO<sub>2</sub> trading is concerned with one industry while carbon trading will involve many different

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<sup>26</sup> Some private parties prefer taxes on the basis that the costs are fixed and predictable.

<sup>27</sup> Totten, *supra* note 4 at 9.

<sup>28</sup> Clean Air Act Amendments of 1990, Pub. L. No. 91-604, 84 Stat.1676 (1970) (codified as amended at [42 U.S.C. §§ 7401-7671q](#)) (1994).

economic sectors. Carbon trading can be global because carbon, unlike SO<sub>2</sub>, disperses into the earth's atmosphere so the emission reductions or sequestration can effectively occur anywhere.

## **B. “Early Action” Legislation**

Under the Kyoto regime delay in climate mitigation activities will create for the developed countries a much steeper trajectory to reach Kyoto's goals, resulting in more profound economic effects. Even absent Kyoto the earlier actions are taken to reduce the amount of GHGs in the atmosphere the greater the impact. Thus the United States Congress has been considering “early action” legislation to encourage corporations to initiate emission reductions or, at the least, to prevent them from being unduly penalized for such actions taken prior to the implementation of more comprehensive legislation.<sup>29</sup>

## **C. Registration of Emission Reductions and Sequestration**

Most developed countries have some form of voluntary registration for both domestic and international carbon offset activities. Whether the investor will benefit from such registration depends on whether the investor government is willing to give credit, if necessary retroactively, to such reductions and how closely the criteria for the registration fits with domestic emissions schemes. In the United States companies may register their domestic and international activities under Section 1605(b) of the 1992 Energy Policy Act but the United States Government does not involve itself in verifying and certifying actual reductions and/or sequestration.<sup>30</sup>

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<sup>29</sup> In the United States “Early Action” bills have been introduced in both the United States Senate and the House of Representatives. See, “the “Chafee” Bill (S.547, 106th Congress, 1st Session, March 4, 1999) and the “Lazio” Bill (H.R.2520, 106th Congress, 1st Session, July 14, 1999) The Bills would assure corporations that if legislation requiring domestic emission limitations was enacted some sort of credit would be given for activities occurring prior to such enactment. Both Bills include credit for international offsets achieved under the USIJI projects or for international credits that have been earned by corporation for use by the United States under an international climate plan. (cf. “Murkowski” Bill, S.882, 106th Congress, 1st Session, April 27, 1999)

<sup>30</sup> 42 U.S.C. 13385 (1992)

## **D. Government Approval**

Under AIJ governments the investor country must approve the project design. USJI requires the host government approval as a prerequisite for its own approval. Under the CDM it is unclear whether the country in which the investor is located will need to approve any offsets.

## **8. Role of Host Government under AIJ and CDM**

A major lesson learned from AIJ is the host governments' need for assistance in engaging in such projects. At present many international groups are searching for ways to provide capacity building in order to educate leaders in developing countries and to assist with building the institutional structure that such projects need.

### **A. Certification of Project Design and Offsets**

Both AIJ and the CDM require the host government's approval of the project, thus giving it a major role in any projects within its boundaries. Establishment of the governmental structure and criteria for any certification is an essential precondition to the development of any project.

### **B. Legal Agreements between the Host Country and the Investor**

Whatever the form of legal agreements entered into between the parties and the host country the following substantive issues should be included:

#### **i. Binding the Host Country to Transfer of Offsets**

Emission trading between Annex I countries will require the host government's involvement to assure that credits earned by private parties within its boundaries are sold only if subtracted from that country's assigned amount. Whether a country that is host to a CDM project must perform some official act to assure the validity of any offsets earned within its boundaries is unclear.<sup>31</sup> What, if any, "rights" does a developing

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31 Grubb, Michael. 1998. International Emissions Trading Under the Kyoto Protocol: Core Issues in Implementation. *Rev. European, Community & International Environmental Law* 7: 140.

country hold to carbon offsets earned within its borders. Since this is not a developed area of the law the host government, even if not required by the CDM or any other climate scheme, should be asked to agree to give up all claims, of whatever kind, to the emission reductions or sequestration acquired through the project. However, the language used should not exclude the possibility that the parties may decide to give the government a percentage of the carbon offsets as compensation for their involvement in the project.

The time of transfer may be important. CERs can be banked from 2000 on but will not be of actual worth until the first commitment period (2008-2012). Therefore, the CERs can not actually be “retired”, i.e. officially included as a way of meeting a country’s emission limitations, until that time. Prior to being retired such credits may well be traded by private parties or governments. No future event, such as a change in government, should allow any reversal of the commitment to the transfer.

Possible language might read:

“The HOST GOVERNMENT agrees that:

- for the purpose of this agreement the HOST GOVERNMENT accepts as a definition of carbon offsets “the mitigation, reduction, avoidance, sequestration of one ton C-eq.” And understands that under this definition offsets include both emission reductions and sequestration and that these offsets represent the right of a party to be recognized as the author of any such sequestration and reductions;
- insofar as the HOST GOVERNMENT has any present or future rights of any kind to those carbon offsets produced by the .... project it hereby unconditionally transfers any and all such rights to the Parties to the Contract;
- any procedures and reports required by any international body to confirm the transfer of such rights will be provided by the HOST GOVERNMENT in a timely manner;

- these offsets can be transferred or used in whatever way agreed upon by the parties including but not limited to, registration in any domestic or international plan, or use for compliance by a party with its national obligations;
- the time of transfer by the HOST GOVERNMENT shall be considered to be the time of the production of the carbon offsets and the HOST GOVERNMENT will have no rights to such offsets from that time onwards;
- the transfer of the HOST GOVERNMENT'S rights to such offsets as set forth in this section shall not limit the ability of the parties to the project to transfer of any such rights back to the government in this or any subsequent agreement.

**ii. Direct Assistance to the Specific Project.**

If the HOST GOVERNMENT is not a party to the project then the separate agreement should include some of the following:

- Assistance in obtaining necessary government licenses, customs clearances, visas, residence permits, licenses to enter, import and export licenses, permits, approvals, permissions and authorizations;
- Assistance in obtaining access to all necessary warehousing, export, construction and fabrication facilities and infrastructures, supply stations, means of transportation, goods and services;
- Assistance in obtaining access to transit for its equipment, goods, materials and supplies on terms no less favorable than the best terms granted to or agreed with any other bona fide arms-length user;
- Recognition and reservation of the rights of the parties to the project in all treaties, international agreements or other arrangements entered into by the government that in any way concern the project;
- Assurance that the parties will have free and unfettered banking and currency exchange rights, to retain, whether in host country



or elsewhere, repatriate or dispose of all of the proceeds from the export and/or sale of Certified Offsets;

- Agreement on limited or no taxation on the carbon offsets or other products, particularly if the value goes up;
- Granting of the rights, privileges and interests with respect to the Apportionment and registration of Certified Offsets under any similar or successor governmental or non-governmental GHG mitigation registries and tracking systems that now exist or may be established in the future;
- Agreement to assist the parties to obtain the necessary departmental, provincial and local government authorizations and licenses that might be necessary for the parties to carry out the activities contemplated in this project; for example obtaining guarantee that the carbon offsets will not be taxed or if taxed no more than at a given rate;
- Guarantee of the existence of legal stability during the project term the event that any treaty, international agreement, law decree or administrative order of the host government adversely affects the rights of any party to the project.
- A promise by the government that in the event of any taking of a party's interests or property the government will provide such party full and prompt compensation at the full market value of interest or property taken.
- Promise to maintain the project Site as a protected area.

### **iii. Enforcement**

The investor wants the host government both to enforce the Contract against any defaulting private party and also to live up to its own agreed upon responsibilities. Enforcement of international contracts in developing countries is often difficult because of sovereignty issues and a lack of strong legal institutions. With CDM projects there is an additional element of risk because the lack of caps on their emissions removes some of the international compliance pressure felt by developed countries. It

may be possible to apply international sanctions against the host government by either discounting offsets from the non-compliant host country or by not permitting the host country to participate in any future trading systems.<sup>32</sup> However some argue that the liability burden is more appropriately placed on the buyer. The answer may lie in “gold plating” CDM offsets by international certification.<sup>33</sup>

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<sup>32</sup> For an argument that liability for invalid credits should be placed on the buyer in CDM projects see, Kerr, Suzi, 1998. *Enforcing Compliance: The Allocation of Liability in International GHG Emissions Trading and the Clean Development Mechanism?* Washington, D.C.: Resources for the Future.

<sup>33</sup> Baron, Richard. 1999. *An Assessment of Liability Rules for International GHG Emissions Trading*. Paris: Energy & Environment Division, International Energy Agency. (October)

### **III. PRE IMPLEMENTATION ISSUES AND ACTIVITIES**

This outline of pre-implementation activities is not meant to be a comprehensive rendering of the steps necessary to prepare for a carbon offset forestry project but rather is to alert the attorney to possible times when she might be of assistance.

#### **1. The Initial Investment Decision**

As international economic and political powers design structures to prevent global warming, groups in developing countries from local businesses and NGOs to indigenous groups of farmers are beginning to understand the value of carbon offset projects and are designing and marketing such projects. At the same time developed country investors or corporations concerned about future exposure to emission limitations are deciding whether such projects are good investments.

##### **A. Reasons for Investing in Carbon Offset Projects**

Because there is at present no international system granting credits for climate beneficial activities there is no guaranteed return for investment in carbon offset projects. But the belief that international agreements and domestic pressure will eventually produce some form of domestic emission reduction legislation has led some companies in industrialized countries not only to examine ways of reducing their own emissions but also to develop compliance portfolios consisting of international carbon offset projects.<sup>34</sup> The cost of reducing GHG emissions in developing countries are very much more expensive compared to opportunities in developing countries. Beside the acquisition of carbon offsets at a low cost such projects offer such investors other advantages:

- Experience in a particular emerging market offering possible non-climate connected business opportunities
- A “place at the table” when international climate policy decisions are formulated

- A share in future environmental technology market
- Positive contribution to international environmental and development problems

## **B. Reasons to Invest in Forestry Carbon Projects**

Though most carbon offset projects are in the energy sector, forestry carbon projects should be considered because they are usually lower in cost than those in the energy sector and also provide unique opportunities:

- A “green” marketing image
- Inexpensive research on forestry environmental issues
- Economic benefits from timber or other non-carbon elements,
- Contribution to forestry environmental issues such as biodiversity and watershed protection.

## **C. Ways of Investing**

Investment in such projects may be done in a variety of ways:

- **Private investment**

An investor on his own or in a consortium with other investors may finance a single project. Several Utility consortia have pursued carbon emission offsets through forestry projects around the world. Utilitree Carbon Company (<http://www.eren.doe.gov/climatechallenge/initiatives.htm>), International Utility Efficiency Partnerships (IUEP) (<http://www.ji.org>), E7 Network of International Utilities (<http://www.e7.org>) Gemco (<http://www.gemco.org>)

- **Portfolio**

An investor may purchase shares in a number of carbon-offset projects assembled by a host or intermediary that develops, evaluates and markets individual projects. The World Bank’s Prototype Carbon Fund accepts money from governments and corporations, selects and develops offset projects, and then divides any carbon credits among the investors.

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<sup>34</sup> Royal Dutch/Shell is beginning to analyze its big investments to see if they will provide adequate returns if carbon offsets are priced at \$5, \$20 or \$40 a ton. *Economist*, *supra* note 3.

The guidelines for the Fund state that no more than 10% will be invested in land use and forestry projects. (<http://www.prototypecarbonfund>)

- **Trading in carbon offsets**

Private brokerage firms trade rights to GHG emissions reductions and sequestration and markets for such rights are beginning to be developed around the world. The Sydney Futures Exchange is forming such an electronic market.<sup>35</sup> Such rights are of varying worth based on how they were generated, the reporting procedures used, and whether there was reliable third party verification. Recent trades in the international “pre-compliance” market have ranged from \$1 to \$3 a tonne.<sup>36</sup>

#### **D. Sources of Investment Advice:**

- Cantor Fitzgerald (<http://www.cantor.com/ebs/>)
- Ecosecurities (<http://www.ecosecurities.com>)
- Environmental Financial Products (<http://www.envifi.com/main.html>)
- Natsource (<http://www.natsource.com>)
- Trexler and Associates(<http://www.climateservices.com>)
- ERM (<http://www.erm.com>)
- Sydney Futures exchange (<http://www.carbontrading.com.au/main.asp>)

## **2. Identification of a Site and a Project Concept**

### **A. Project Concept**

The parties should examine several possible projects to find one that best met their needs. One investor with large near term carbon liabilities might want to invest in a forest conservation project that may produce little or no direct income but will garner carbon credits rapidly. Another may want to invest in managed plantations that provide carbon credits slowly but at a profit.

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<sup>35</sup> Sydney Futures exchange: <http://www.carbontrading.com.au/main.asp>

<sup>36</sup> *Economist*, *supra* note 3.

Similarly an environmental technology firm that has limited emissions but significant expertise in solving international environmental problems may wish to participate directly in project design and implementation while a company that creates high emissions at home but has no particular expertise or interest in international environmental issues may wish to be a more passive investor. Awareness of the interests of the various partners is essential. A local farmer's group may be most interested in a project that will assist them in finding the most economically efficient use of their land.

## **B. Positive Project Attributes**

During the initial search for a project the parties should keep in mind the elements upon which successful projects have been based: credibility, simplicity, supportive political context, cost effectiveness, verifiable and measurable benefits, secondary benefits in sustainable development, reliable teaming partners, local community support, and reliability.

## **C. Organizations with Helpful Expertise**

- NGOs such as The Nature Conservancy or the Environmental Defense Fund.<sup>37</sup>
- Forestry companies
- E7 Initiative run by major electric utilities in Europe and North America
- Carbon consulting firms such as Trexler and Associates, ERM, EcoSecurities and Societe Generale de Surveillance.<sup>38</sup>
- In the United States the IUEP and Utilitree Carbon Co.
- PricewaterhouseCoopers<sup>39</sup>

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<sup>37</sup> Some NGOs have prepared criteria to assist in project design formulation: Academic Youth Ecological Club et. al., 1998; World Wildlife Fund, 1998; Federation Internationale Pour L'Isolment du Carbone, 1998, SGS, 1997.

<sup>38</sup> Such companies offer a wide range of services including project identification and match making, project design, financial and economic analysis, certification and risk analysis.

<sup>39</sup> Some large accounting firms are developing independent audits of carbon accounts.

### **3. Examination of the Host Country**

#### **A. Investment Milieu**

Prior to entering into any project the parties must determine whether the potential profit is worth the risk involved. To do so one must look at the cultural, socio-economic, legal, commercial and political climate of the host country. An ideal country would have strong legal codes, political stability, sound financial institutions, experience doing climate change projects, and a positive view of foreign investment.

#### **B. Potential Benefits to Host Country**

The host country and groups within the country are likely to want from such projects the following:

##### **i. Carbon Offsets**

Though under Kyoto developing countries are not required to limit their domestic emissions the host country may well want to acquire a percentage of the carbon offsets generated by the project either as a hedge against future international obligations and/or to sell on a developing secondary market.

##### **ii. Non Carbon Benefits**

Developing countries also value non-carbon benefits. Forestry projects are more likely to be successful with compatible with and supportive of national environmental and economic priorities and strategies. Improvement of local environmental quality may include promotion of biodiversity, soil conservation, and watershed protection. Technology transfers, capacity building and foreign investment may facilitate amelioration of the economic status of the country. Timber and agroforestry crops may offer new economic opportunities for the local community.

#### **C. Host Government's Concerns about the Value of Such Contracts**

Though carbon projects may benefit developing countries in the ways mentioned above, it is important to remember that such countries may also be

concerned about negative effects of carbon offset programs. Nathan Ari, concisely listed the reasons as follows: “ (1) that developed nations will “pick the low lying fruit” of easy emissions reductions; (2) that the US’s experience in global markets will give it an advantage in Joint Actions; (3) that Joint Actions may encourage some members to favor market mechanisms in general (and hence consider taking on emission reduction commitments); (4) that the fact that some nations (such as Latin America) are favored a host countries for Joint Actions may lead to fragmentation within the G-77 (and China); (5) that Joint Actions may lead to “eco-colonialism” as developing countries are forced to adopt western legal infrastructure to accommodate Joint Actions; (6) that both developing and developed countries will be pushed into a greater market orientation than they are comfortable with as they use the market mechanisms.”<sup>40</sup>

#### **D. Resources for Information about the Host Country**

Developed countries have increasingly sophisticated means by which an investor can find out about a developing country, its laws and its business practices. Some of the avenues available for United States corporations are:

- **State Department’s Country Commercial Guides (CCGs)**

CCGs are prepared annually by U.S. embassies with the assistance of several U.S. government agencies and present a comprehensive look at countries’ commercial environments, using economic, political and market analysis.

- **Department of Commerce Trade Information Center**

(1-800-USA-TRADE)

- **Law Firms**

If the investor requires outside counsel a variety of United States law firms have international practices and some firms offer business guides for particular countries. (<http://www.findlaw.com>) or (<http://www.martindale.com>) an investor may also wish to hire a Host country lawyer with both international and local expertise to be to assist in the understanding of a country and its laws. Such a lawyer may also

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<sup>40</sup> The author is grateful to Mr. Ari for sharing his unpublished work.



provide entrees to essential host government officials. International Bar Associations or Host country's embassies may assist in obtaining a referral to such a local lawyer.

- **Other General Sources**

- the country's embassy/consulate in the United States
- the United States embassy in the country
- the Chamber of Commerce in the country
- Government and ministries in the country
- Interamerican Bar Association
- United Nations
- World Trade Organization
- World Bank
- International NGOs such as:
  - The Center of International Environmental Law
  - The Sierra Club's Legal Defense Fund

#### **4. Linking International Investors and Local Partners**

A private investor may be considered a buyer looking for a seller. The "seller" is usually the party located in the host country directly responsible for the project's implementation. The seller may be a local environmental group, a forestry company, a group of local farmers, the host government itself or a combination of such groups. If neither the investor nor the host country partner have expertise in greenhouse gas measurement it may be wise to add as a partner an international environmental NGO. Such groups offer scientific and technical knowledge and also give more legitimacy to the project.

## 5. Execution of a Feasibility Study

The parties should enter into a simple agreement concerning their respective roles in a feasibility study. Such a study is necessary to determine whether a project is viable technically, politically and culturally.

The Agreement may be in the form of a letter that states the parties' commitments and requires a returned signature. The party that is paying for the feasibility study may ask for the right of first refusal to be a partner in a project if the results demonstrate that the project is likely to be successful.

Some developed country governments provide seed money for feasibility studies. In the United States the International Climate Change Project Fund (ICCPF) uses both public and private funds to assist US investor owned utilities and energy companies in pre investment project analyses.<sup>41</sup>

An essential part of a Feasibility Study is risk analysis and obtaining expertise from professional risk managers is essential. In a long- term forestry project there are multiple risks: natural, anthropogenic, political, economic, financial, institutional and market. The first approach to risk management is always a well-designed project. Capacity building, stakeholder participation and good forestry practices are some of the ways to protect against loss. In such project risk retention must be supplemented by external insurance mechanisms such as private insurance, cross-project guarantees and diversification of portfolios. Bilateral and multilateral institutions can be used in combination with commercial risk instruments to create comprehensive risk mitigation packages.<sup>42</sup>

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41 The International Utility Efficiency Partnerships, Inc. (IUEP) and the United States Energy Association (USEA) established the International Climate Change Project Fund (ICCPF). The Office of Energy, Environment and Technology of the U.S. Agency for International Development (USAID) provides funding to the ICCPF.

42 Mundy, Arm & Eyre, 1999. *Risk Mitigation in Forestry Under Kyoto, a report to Forest Trend* (draft) available by request from Forest Trends, Washington, D.C.

## 6. Obtaining Sufficient Financing

The parties may wish for supplementary funding for project implementation. Though under the AIJ the financial additionality requirement prohibits the use of government funds from a developed countries' development assistance money (ODA) or from its required contributions to the FCCC's Global Environment Facility (GEF) funds from these sources may be used to finance aspects of the project not directly related to carbon offset production. Under the Kyoto Protocol the Clean Development Mechanism may assist in arranging funding but in what way remains unclear.

Some avenues of obtaining funds or tax advantages are:

- The investor country government: Some developed country governments such as The Netherlands have assisted private corporations in funding forestry projects.<sup>43</sup>
- Private sector financial institutions
- Other corporations or consortiums of corporations
- Multilateral development institutions (MDBs)
- United States:
  - Export Import Bank
  - Overseas Private Investment Corporation
- Host Government incentives for providing particular sustainable development benefits

## 7. Preparation of the Project Proposal Contract

Upon the completion of a successful feasibility study it is advisable to draft a contract outlining the roles of the parties in the preparation of a project Proposal. At this stage the partners may mutually commit to engage in the project if the project Proposal is approved.

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<sup>43</sup> <http://www.facefoundation.nl> <http://www.northsea.nl/jiq>.

## 8. Design of a Project Proposal/ Project Design

- **Hiring of an organization with environmental expertise**

If the parties have no history in developing such projects they may wish to hire either a consulting company with expertise in the area or an environmentally focused NGO to formulate the project design. The lawyer, who acts as an advisor during the development of the design, should make sure that whatever group is hired has the most up to date understanding on issues such as additionality, and how best to quantify and verify reductions and sequestration.

- **Socio-economic and environmental impact statements**

Such investigation may be advisable or, depending on the yet to be developed CDM rules, necessary.

- **Involvement of local constituencies**

In order to have a transparent and participatory project, leaders from the local community should be involved as active participants in the project design, implementation and monitoring.

## 9. Examination of Existing Understandings Among Countries

The parties entering into a carbon-offset project must find out whether the investor country and the host country have entered into any bilateral or multilateral understandings concerning carbon offset projects. Such agreements may be in the form of Joint Statements between countries' leaders, Memoranda of Understanding and/or Letters of Intent.<sup>44</sup>

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<sup>44</sup> See Chapter II-6, Legal Background: Bilateral and Multilateral Understandings Among Countries.

## 10. Development of Agreements between Host Country and Investors

Even when the parties to the project are all private entities and the land upon which the project is based is owned privately, the AIJ and CDM requirement that the host government approve the project gives the host government a major role. The decision to be made is the best way for the parties to bind the host government.

### A. Initial General Cooperative Agreement

A broad cooperative Agreement between the host government and the investor, similar to the MOUs or LOIs discussed above, may be a necessary first step in engaging the host government in such project. Such an understanding may be about carbon offset projects generally or may give a broad outline of the specific project.

### B. Host Country to Obligations Specific to the Project<sup>45</sup>

The parties must decide whether to include the host government as a party to the project. If so then the government's rights and obligations should be included within the Comprehensive Agreement. However, if the host government is not to be a party then a variety of types of separate agreements can be used to bind the government to such obligations.<sup>46</sup> Such a contract may be a joint venture or partnership or the parties may agree to act as the host government's contractor to implement a CDM project bearing the risk of the project and receiving payment only after execution. Still another approach would be a general concession contract under which the host government grants the parties the right to develop a public project. The United Nations Commission on International Trade Law (UNCITRAL) describes one form of concession contract as a project "where the government grants a concession for a period of time to a private party for the development of a project. The consortium finances or arranges for financing for the project, constructs

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<sup>45</sup> For those rights and obligations that need to be included in any agreement with the host government see Chapter II-8: Legal Background: Role of Host Government under AIJ and CDM.

<sup>46</sup> For a discussion of inter-governmental agreements having similar features to those envisioned under CDM contracts, see Worika, Ibibia Lucky and Brown, Michael, and Vinogradov, Sergei 1999. Contractual Aspects of the Clean Development Mechanism and other Flexibility Mechanisms under the Kyoto Protocol. *CEPMLP Internet Journal* 4:4. Dundee: Centre for Energy, Petroleum & Mineral Law & Policy. (<http://www.dundee.ac.uk/cepmlp/journal/html/vol4-4.html>)

the project, and operates and maintains the facility during the life of the concession. Meanwhile, through sale or charge for the use of the facility or its products, the consortium recovers returns on its equity and pays off its debts. At the end of the concession period the project is transferred to the government.” This would in effect be a “lease”, a concept that might be appealing to developing countries.

## **11. Approval from Investor Government**

Under AIJ both the host government and the investor government must approve the project design. USJI requires the host government approval as a prerequisite for its own approval. Under the CDM it is unclear whether the country in which the investor is located must certify the project design.

## **12. Approval by the CDM’s “operational entity”**

(See Chapter II: Legal Background: The Clean Development Mechanism)

## **13. Negotiation of the Comprehensive Agreement**

## **IV. ANNOTATED SAMPLE FORESTRY CARBON OFFSET AGREEMENT**

The sample contract will have at the beginning of each of its Sections a discussion of issues relating to that Section combined with suggestions of ways in which some of these issues have been or might be handled. We are thus trying to balance the advantages of having an example of actual contractual language while offering a broader understanding of the legal issues. As has been pointed out earlier, this agreement has been designed to raise issues and is not put forth as a legal advice.

### **HYPOTHETICAL CARBON OFFSET PROJECT UPON WHICH THE ATTACHED AGREEMENT IS BASED**

This sample contract was developed to illustrate actual contractual language while offering a broader understanding of the legal issues. The contract will have at the beginning of each of its Sections a discussion of issues relating to that Section. The hypothetical situation upon which the sample contract will be based is similar those existing in several AIJ projects. It should be noted that as such contracts become more numerous and larger the “Investor” may be more appropriately referred to as the “Buyer” of offsets and the implementing party, i.e. the developing country and/or the company or group performing the local project activities, will be referred to as the “Seller.”

A Company (INVESTOR) emits a significant amount of carbon at its plant located in a developed country (INVESTOR COUNTRY) and, in anticipation of future domestic and international emission regulations, is looking for a cost effective carbon offset project. The INVESTOR has been exploring business opportunities in emerging markets, has a interest in being seen by its customers as environmentally friendly and would like to have an informed voice in future carbon policy debates.

The INVESTOR has been informed by its Counsel that at the present time no credits can be guaranteed from such projects but believes that the combination of the project’s non-carbon advantages plus the possibility of future credits are sufficient reasons to proceed. In search of expertise the INVESTOR turns to an International Environmental Non Government Organization (INGO) that has a history with such projects. A particular forestry project is chosen because of its comparative low cost, its environmentally positive co-benefits and its location in a country (Host Country) of particular business interest to the INVESTOR. The INVESTOR funds a Feasibility Study part of which examines the likely environmental and socio-economic impact of such a project. The

results seem promising and the INVESTOR asks a Host Country NGO (HNGO) to join the Project as the implementing Partner.

The objective of the Project is to preserve and extend certain forestland owned by small landholders that is being converted into agricultural land. Though there was consideration given to including the group of farmers as partners in the Project a decision was made instead to include the farmers as non voting members of the board and use the HNGO, that has had in the past excellent relations with the farmers as the local implementer. A Project involving Reforestation, Afforestation and the prevention of Deforestation is designed and approved by both the INVESTOR and the HOST GOVERNMENTS.

All parties will be involved in governance of the Project. INVESTOR will provide most of the funding. INGO will provide some funds, act as the FUNDS MANAGER, and provide technical advice. The HNGO will act as the onsite MANAGER.



COMPREHENSIVE AGREEMENT FOR **[NAME OF PROJECT]**

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COMPREHENSIVE AGREEMENT FOR  
[NAME OF PROJECT]

The INTRODUCTORY PARAGRAPH gives the name of the Project, the Parties to the Agreement and the date upon which the Agreement is signed and becomes legally binding.

This COMPREHENSIVE AGREEMENT (AGREEMENT) FOR [NAME OF Project] (hereinafter Project), together with the Appendices hereto, is made and entered into this [DATE], by and between INVESTOR, a ...Corporation duly organized under the laws of ...with its principal place of business in... INGO, a non-profit organization, duly organized under the laws of... with its principal place of business in ... and HNGO, a non profit organization, duly organized under the laws of Host Country and having offices at...(All of which are cumulatively referred to herein as “the Parties”,)

**RECITALS**

This ARTICLE provides background information and represents no contractual obligations. The Recitals should identify the type of project, the Parties to the Agreement, the relevant environmental laws, any Agreement between the Host and the Investor Governments concerning carbon offset projects, and any Agreement concerning this Project between the Host Government and the Investor. Both the Host Government and the Investor Government will have officially approved this Project prior to the signing of this Agreement. The Agencies giving such approval and the date on which they were given should be included in this Section. The USJI requires the Host Country’s approval before it will grant its own approval.

If the Clean Development Mechanism (CDM) procedures have been established one clause should mention Article 12 of the Kyoto Protocol which defines the CDM and another should give the date on which the operational entity of the CDM certified the Project.

If the host government is not a Party to the Project, reference should be made in the Recital Section of this Comprehensive Agreement to that Agreement under which the Host Government has agreed to be bound to transfer whatever ownership it holds in such offsets. (See Chapter II-8: Legal Background-Role of Host Government under AIJ/CDM for language).

**WHEREAS**, All parties to this Agreement wish to implement a Project in host country that will sequester carbon and reduce carbon emissions and that also will be sustainable from the point of view of ecology, local acceptability and economic feasibility;

**WHEREAS**, in 199\_ the investor government established within the...Department of said Government the...Bureau to promote voluntary international private-sector cooperation on projects to mitigate world-wide emissions of greenhouse gases, in furtherance of the objectives of the *United Nations Framework Convention on Climate Change* ("FCCC") and furthermore granted to that Agency the authority to give investor government's approval of such projects;

**WHEREAS**, in 199\_ Host Government established the...Bureau within its ...Agency the authority to review and give approval to those carbon offset projects, located within the boundaries of the Host Country, that have been established in furtherance of the objectives of the FCCC and furthermore granted to that Agency the authority to give the Host Government's approval of such projects;

**WHEREAS**, INVESTOR has committed to undertake substantial voluntary greenhouse gas mitigation strategies within Investor Country, and wishes to assist with similar efforts internationally;

**WHEREAS**, **INGO** is principally dedicated to the protection and conservation of endangered flora and fauna in Investor Country and to assisting environmental NGOs such as HNGO in other countries;

**WHEREAS**, **HNGO** is principally dedicated to biodiversity conservation and the sustainable management of endangered tropical hardwood forests in Host Country;

**WHEREAS**, the Parties have determined, that the estimated [# OF ACRES] acres [herein after “Project Site”] is an optimal location for demonstrating greenhouse gas mitigation through the process of carbon sequestration and other strategies, and have thus undertaken various actions to develop a greenhouse gas mitigation project on this Project Site;

**WHEREAS**, the Host Government and entered into a Memorandum of Understanding dated [DATE] with the Investor Government, included herein as Appendix..., concerning their mutual interest in support of carbon offset projects;

**WHEREAS**, INVESTOR, the INGO and the HNGO entered into a Memorandum of Agreement (“MOA”) dated [DATE], with the Host Government, included herein as Appendix \_\_, to express the rights and obligations agreed upon by the Host Government concerning this Project;

**WHEREAS**, all Parties intend to have a proprietary interest in their apportioned certified offsets generated from the Project;

**WHEREAS**, On... date the ... Bureau of the Investor Country gave its approval to the Project PROPOSAL and on ... date the... Bureau of the Host Government gave its approval of the same Project PROPOSAL, the Parties hereby desire to establish and implement the Project;

**NOW, THEREFORE**, in consideration of the mutual promises, obligations and undertakings set forth herein, it is agreed by and among the Parties as follows:

## ARTICLE I – DEFINITIONS

ARTICLE ONE should include definitions of all key terms used within this Agreement. Definitions are a legally binding part of any Agreement.

Particular care should be taken with the definition of carbon offset. The term “carbon offset”, though often used as a term of art, has no uniformly accepted meaning. Note that under the definition used in this Agreement offsets include both emission reductions and sequestration. Though Afforestation and Reforestation involve the planting of new trees to sequester, i.e. absorb carbon from the atmosphere, other types of forestry projects such as improved forest management may, by removing the danger of forest fires, disease or pest infestation, protect trees from destruction and thereby reduce emissions.

Also note that under this definition carbon offsets are recognized neither as commodities nor services but rather as representing the right of a party to be recognized as the author of the sequestration and the reductions. This definition clarifies the distinction between offset rights; i.e. what is produced by the Project and Credits, i.e. rights defined and given value by international and/or domestic law.

Another important term is certified offset. At present an Agency within the Host Country so empowered, or an internationally respected third party with expertise in carbon issues might informally certify such offsets. Under the CDM the Executive Board of the CDM will designate an “Operational Entity” to perform such a function.

1. Definitions: For the purpose of this contract the following definitions shall apply:
  - 1.1 A carbon offset is right to be recognized as the author of the mitigation, reduction, avoidance, sequestration of one ton C-eq. in any calendar year in accordance with the Project Monitoring and Verification Protocol.
  - 1.2 Certified Offset is “an offset that has been (1) demonstrated to the [name of an independent third party] by the PROJECT MANAGER pursuant to the ground rules any existing or future international climate regulations and (2) certified by the [independent third party].”

## ARTICLE II – OBJECTIVES

ARTICLE TWO should include those objectives mentioned in Article 12 of the Kyoto Protocol, as the objectives of the CDM, i.e., the mitigation of GHGs, the generation of certified offsets and the promotion of sustainable development in the Host Country. Since there is no consensus about what “sustainable development” means any project activity that might fall within the definition should be included such as: protection of natural forests and biodiversity, economic benefits to the local community, inclusion of indigenous people as part of the Project’s design and implementation, soil erosion and watershed protection, protection of Timber and non timber forestry products and improved air quality.

- 2.1 Objective: The Purpose of this Agreement is to implement the Project in order to:
- (a) Mitigate GHGs in Earth’s atmosphere, principally through afforestation, reforestation and the prevention of deforestation;
  - (b) to generate certified offsets for the Parties;
  - (c) to promote ecological and socio-economic sustainability in the Host Country;
  - (d) and generally to carry out the activities contemplated by the Project, consistent with the Plan of Operation.

## ARTICLE III – PLAN OF OPERATION

The Plan of Operation is a largely technical instrument that has been created by environmental experts with a lawyer acting as consultant and will include the project activities, schedules and a timetable. This Article legally incorporates the Plan into the Comprehensive Agreement. Though changing laws, regulations and techniques will require some changes to the Plan of Operation, the Project Design is what will have been certified by a governmental or private third party, and therefore strict adherence to the Plan is an important part of being able to receive credits for the offsets arising from such a design.

- 3.1 All parties will fulfill their roles in implementing the attached Plan of Operations and no changes may be made to such Plan without the Project Board's approval
- 3.2 The Project Activities shall consist of those items set forth in this Agreement and the Plan of Operation as contained in Attachment ... of this Agreement.
- 3.3 No changes shall be made to the Plan of Operation unless approved by two thirds of the Project Board.

## ARTICLE IV – TERM

ARTICLE FOUR identifies the amount of time necessary to complete the project. The length of a project raises the issue of the Kyoto requirement that sequestration be "durable". (See discussion in, Chapter II-5: Legal Background-CDM "Technical Issues") Though parties to some forestry projects have contracted to continue the Project for 99 years the enforcement of such long-term commitments is problematic.

- 4.1 Project Term. This Agreement shall enter into force upon its execution by the Parties hereto, and shall continue from the date of execution hereof through the date of [DATE].



## ARTICLE V – PROJECT SITE

One way to approach the issue of leakage, i.e. the positive or negative GHG impacts of a project outside the geographic, temporal or subject area boundaries, is to extend the geographic boundaries of the project. Since there may be less likelihood of disaster injuring or destroying all of a project if the project is geographically spread out a larger area may also be a means of risk management.

- 5.1 The Area upon which the Project is to be implemented (Project Site) is an area situated at..., as further defined in the Plan of Operation.

## ARTICLE VI – OWNERSHIP OF LAND AND DURABLE GOODS

- **LEGAL OWNERSHIP:** During the feasibility study, the Parties will examine the HOST country's land tenure laws and customs and do a title search to verify legal ownership of the Project Site. In all Land Use and Forestry projects some agreement with the Host Government concerning the rights to the land is necessary. Clarity on this issue is important even if the land involved is privately held.
- **MULTIPLE USE RIGHTS:** Multiple use rights are common in developing countries but may be confusing to those unacquainted with host country laws and traditions. A recent development is to give a statutory definition to those rights that are at present defined largely by contractual terms or by customary use. One example of such a land tenure law, the 1998 Carbon Rights Legislation Act passed by the Parliament of New South Wales in Australia, was developed in response to the increased awareness of the value of carbon in forests. This Act allowed the registration of a carbon sequestration right, separate from registered timber rights and from the actual ownership of the land. Under this system the carbon sequestration rights and the timber rights are 'profit a prendre' rights which means that the owners of these rights can "take" or use the benefits related to the right independent of the landowner.
- **LEASES:** Enforcement concerns are raised in those projects using long term leases requiring positive actions by the landowners. Such leases may include substantial "damage provisions" if the responsibility is not sustained. Examples of this are tree-planting projects that require the landowners to maintain the forests for many years after the project ends.

- **PURCHASE:** Some projects involve outright purchase of privately owned land either to be included in the HOST country's environmental protected area or to be given to a local non-profit to manage.
- **EASEMENTS:** The project may acquire an easement that restricts the landowner from engaging in certain timber practices. Easements may require land management and preservation activities, and even replanting activities in case of loss by fire, disease or insects. Payment for an easement should be related to the lost opportunity costs of foregoing whatever activities, agricultural or otherwise, that absent the easement, the land would have been most profitably used for. However payments may not be sufficient to assure long term maintenance and the more sustaining answer may be through long-term capacity building and technological transfers. For example, the PROJECT MANAGER may provide training in forest management skills that in turn may lead to job opportunities which will reduce the need for poaching by the local community.
- **INDIGENOUS GROUPS:** Concern over the displacement of indigenous groups living or working on the land is always a factor in determining how best to use the land. Legal research into the rights of such groups may indicate an undocumented but legitimate claim to the land. Any such rights should be recognized and compensation agreed upon. Given the uncertainty of the legal system in some developing countries and the lack of organized indigenous leadership some form of incentives for prompt compensation may be advisable. Regardless of the legal status of any such groups the success of a project requires their involvement in both project design and implementation and should never involve involuntary resettlement.
- **TERMINATION OF Projects:** any contract should include an understanding of the rights to land and durable goods when the project terminates either at the end of the project Term or for any other reason.
- **SAMPLE AGREEMENT.** In this Sample Agreement the local party to the project, the HNGO, will buy the easements from the local farmers who own the land. The project designers will have examined the HNGO's reputation and history to determine whether this group is likely to be a long lasting organization able in the future to enforce such an easement. In most cases neither the INVESTOR nor the International NGO should own the easement since the concept of a foreign entity owning a right in land in perpetuity, if not illegal under local law, may raise sovereignty concerns. Separate easement agreements shall be entered into with the local farmers and must clearly delineate the ownership and transfer of the carbon-offset rights.

- 6.1 The PROJECT MANAGER shall, where necessary, work with the owners of the Project Site to assure proper registration of their rights in the appropriate Government office.
- 6.2 The PROJECT MANAGER shall assure that all owners of land in the Project Site sign the attached agreements under which an easement will be granted to the HNGO and that the landowners are paid monies for such an easement as set forth in the attached schedule.
- 6.3 The PROJECT MANAGER shall have rights to any equipment necessary for the implementation of the Project with the understanding that no such equipment may be used for any other purpose without the written approval of the Project Board.
- 6.4 At the end of the PROJECT Term the Project Board shall determine the ownership of any remaining equipment.

## ARTICLE VII – PROJECT GOVERNANCE

The use of a governing body such as a Project Board to overlook the implementation of the Project is one way of providing ongoing flexibility for carbon offset projects. The uncertainty of future international and national laws, changes in corporate succession and in governments, alterations in the natural environment, the long term nature of the projects and the cultural diversity of decision makers make predicting the future needs of a carbon offset project difficult. To cover all contingencies would require an Agreement of great length and even with such an Agreement unanticipated necessary changes would be likely.

All the parties should be represented on a Management Board that should meet regularly to approve policies and budgets. The inclusion, as non-voting Members, of representatives of the local community can be one way of assuring community participation. Achievement of the transparency and accountability required under Kyoto's Article 12.7 requires informed and effective public participation. Board membership will give the community access to information about the project and provide a means by which they can be knowledgeable about and involved in the planning and implementation of the project.

If a project uses such a Board the Agreement should define how the Board establishes policies and procedures for managing and financing the project. A general outline of such a plan should include:

- titles of who will be on the Project Board;
- the Board policies and procedures such as which Parties may vote, number of votes required for approval of decisions, timing and number of Board meetings, place for meeting, number of members required for a quorum, attendance requirements, and Board meeting minutes;
- the duties of the Board such as the review and approval of Annual Plans, PROJECT MANAGER decisions, amendments, and certified offset apportionment;

an ability to define or modify the project structure due to circumstances such as changes in the international regulatory regime, transitions in governments, corporate successions, and alterations to the natural setting.

### 7.1 The Project Board

The Project Board shall consist of the Principal Contacts for (ALL PARTIES) to the Project. Partners contributing less than US\$.... to the Project shall be non-voting members with voice rights on the Project Board. The Board shall also have at least two non-voting members representative of the Community in which the Project is based. The Project Board shall meet at least

once a year and on other occasions as deemed necessary by a majority of the Project Board. At least two-thirds of all voting Project Board members must be present for a quorum. The PROJECT MANAGER shall give notice of all meetings, ordinary and extraordinary, in writing at least ninety (90) days prior to the date of the meeting. The Project Board shall determine the site for Project Board meetings. The PROJECT MANAGER shall keep minutes of the meetings in English and (local language), which minutes shall be distributed to the Parties within thirty (30) days following a meeting. While consensus shall be the goal, decisions of the Project Board shall be by approval of at least two-thirds of all voting Project Board members who are present at the Meeting. In lieu of extraordinary meetings, the Project Board may act by written resolution, signed by at least two-thirds of all voting Project Board members. Duties of the Project Board include, without limitation:

- (a) the review and approval of the apportionment of certified offsets;
- (b) the approval of any revisions and amendments to the Plan of Operation;
- (c) making decisions on any Project management matters expressly delegated to the Project Board in this Agreement.

## 7.2 Public participation and Consultation

Prior to making any decision that would significantly impact on the Population living or working in the vicinity of the Project Site the PROJECT MANAGER must advertise and call a meeting to explain the options being considered and must report back to the Board any relevant community concerns and suggestions.

## 7.3 Publicity:

Within one week of the Board Meeting the Board shall use the best possible means to communicate to the Local Community any changes in the Project that will effect the Population living or working in the vicinity of the Project Site.

## ARTICLE VIII – ROLES OF THE PARTIES

The number of Parties and the duties of each Party will vary with each project but in most projects the local Partner, be it a business or a NGO, is the PROJECT MANAGER and as such is responsible for day to day management with the Project Board having the oversight duty. The Agreement needs to establish the line between the rights and responsibilities of the MANAGER and those of the Board.

### 8.1 Roles of the Parties

8.1.1 HNGO is hereby denominated PROJECT MANAGER. The legal address of the PROJECT MANAGER is...

8.1.2 During the Project Term the PROJECT MANAGER shall, in consultation with the Project Board, be principally responsible for managing and implementing the Plan of Operation in a timely and professional manner. The duties of the PROJECT MANAGER include:

- (a) staff, contracting consultants,, managing the work of the Project Implementation Team;
- (b) assuring that all reports necessary to implement the Project are developed and presented to the Project Board;
- (c) obtaining Project Board approvals;
- (d) maintaining regular contact, but not less often than annually, with the Host Government and with technical scientific advisors and the local communities to facilitate the Project;
- (e) designing, managing and implementing the Project's offset creation strategies and sustainable development activities contemplated by the Project; calculating and submitting for the Project Board's review and approval the Apportionment of Certified Offsets; managing the accounts for creation, certification and Apportionment of offsets to the Parties; and

maintaining all necessary and appropriate records in connection therewith;

- (f) Developing offsets reports, Project filings and Project Documents and submitting them to the Host Government and/or to whatever governmental or non governmental entity the Board may choose, and, when called for, obtaining appropriate certification as to the truth and accuracy of such offset reports, Project filings and other necessary Project Documents;
- (g) serving as custodian of all Project records to be kept at the Project Site, and the availability of such records to the Project Board;
- (h) maintaining disbursed Project Funds in a Project Account and expending Project Disbursements in accordance with this Agreement;
- (i) engaging, coordinating and managing the work of accountants, scientific experts and other service providers as necessary to implement the Project, and providing the direction necessary regarding such work to ensure its quality, accuracy and timeliness;
- (j) maintaining and renewing all rights, Agreements, powers, leases, and franchises, and making all payments, filings and records pertaining thereto, as necessary for the conduct of its business and the performance of its obligations under this Agreement;
- (k) obtaining and maintaining in force at all times during the Project Term, such property, general liability and other insurance on its property and business as is in accordance with good commercial practice in the Host Country and satisfactory to the Project Board;
- (l) not changing the nature or scope of the Project without the written consent of the Board;

- (m) defending the Apportionment and transfer of offset Registration Interests
- (n) mindful of the socio-economic and environmental impact statements performed by the....., on....., as attached, shall perform those activities as put forth in the Plan of Operation, to assure this Project shall have positive environmental and socio-economic impacts on the community in which the Project is based.

8.2 The INVESTOR shall:

make payments according to the installments and on the due dates as set forth in Attachment ... and shall place such funds into the PROJECT Funds Account; and consult with the Funds MANAGER and the PROJECT MANAGER regarding the financing and implementation of the Project.

8.3 The INGO shall:

- (a) make payments according to the installments and on the due dates as set forth in Attachment... and shall place such funds into the Project Funds Account; and
- (b) act as the PROJECT FUNDS MANAGER, and in such capacity it shall be responsible, in consultation with the Project Board, for providing in a timely and professional manner the financial management services set forth in this Agreement. Such duties shall include receiving Project Funds from the Parties; tracking, managing and maintaining the Project Funds Account; disbursing funds to the PROJECT MANAGER on such dates and in accordance with the Operating Plan; and seeking and facilitating technical support for the financial administration of the Project as requested by the PROJECT MANAGER.



## ARTICLE IX – FINANCING

ARTICLE NINE shall either define the method by which the Project is financed or incorporate that financial mechanism described in the Plan of Operation. Any financial scheme should identify the Parties responsible for providing funds for the project, the amount of money the Parties will contribute, and the means to ensure that the appropriate amount of money exists to support the project in its entirety.

To ensure the long-term viability of the project sources of funding other than from the Partners may be needed. Loans may be available from traditional international and local banking. Under Article 12.6 of Kyoto the CDM may also “assist in arranging funding of certified project activities as necessary.” The project itself may well have a variety of profit making activities. In forestry projects income may come from such related businesses as timber, ecotourism or a commercial biodiversity enterprise. As discussed in Legal Background the rules for Additionality are still being developed but the Parties must be alert to the project’s potential profitability absent any carbon crediting and the use of developed countries’ funds.

The Nature Conservancy, an International Environmental NGO, has had particular success with setting up endowments to provide funds for the fulfillment of a project. If an endowment is to be used then the decisions must be made as to who are to be the Trustees for the Fund, where the money will be held and how such Endowment funds can be used. Endowments and Trusts have often been used as instruments for managing funds for environmental purpose in developing countries.

The budget for and the financing method shall be prepared in accordance with the guidelines established by the Plan of Operation and as revised from time to time by the Board.

## ARTICLE X – COVENANTS

ARTICLE TEN contains provisions governing the conduct of the Parties throughout the term of the agreement.

- Due Diligence: (a legal term under which parties are held responsible for fulfilling their responsibilities under the Agreement in a reasonable manner);
- Assignability of Obligations and transferability of rights;
- Professional Performance of Obligations;
- Provision of standard for Preparing and submitting documents;
- Reliance on Information; and
- Requirement that each Party provide the support needed to complete their obligations under the agreement.

10.1 Covenants. Each Party independently and separately hereby covenants to perform as follows:

10.1.1 Due Diligence. Each party shall perform its obligations under this Agreement, and shall conduct the Project on the basis of customary commercial practice and arm's length arrangements, with due diligence and efficiency, within the due dates and time lines established herein;

10.1.2 Assignment of Duties and Obligations and Transfer of Rights. A Party shall not terminate, amend or grant any waiver of, or assign any or its duties or obligations under, any provision of this Agreement except by written agreement of all of the Parties; provided, however, that any PARTNER may assign all or any portion of its interest herein to any third party subject to approval of the other Parties which approval may not be reasonably withheld;

10.1.3 Professional Performance of Obligations. All obligations to be performed under this Agreement by each one of the Parties shall be performed in a professional and efficient manner, and shall be of good quality, and errors, incompleteness, or lack of accuracy or truthfulness

shall not materially interfere with any obligations to be performed under this Agreement;

- 10.1.4 Materials Prepared and Submitted. A Party responsible for preparation and submission of materials to the Host Government, the CDM or any other governmental or non-governmental entity, shall prepare and submit such materials in a manner that meets the requirements of this Agreement and Law;
- 10.1.5 Reliance on Information. To the extent permitted by Law and this Agreement, all service providers, and each employee, representative and agent of any other Party working on the project shall have the rights to rely on information provided, and preparations and representations made by such Party or its duly authorized employee, representative or agent;
- 10.1.6 Support. Each Party will provide its appointees and the persons engaged to assist such appointees, with the support necessary to ensure timely and full performance of such appointees' responsibilities and obligations under this Agreements,

## ARTICLE XI – OFFSETS RECOGNITION AND TREATMENT

This ARTICLE deals with the carbon offsets created from the Project. The following provisions should be included:

- Background information on the FCCC Joint Implementation Pilot Phase, highlighting the uncertainty of future acceptance and credit awards;
- Monitoring of Offsets,
- Verification/Certification of Offsets,
- Apportionment of Certified Offsets,
- International Credits - indicating the possibility of receiving credit under the FCCC or a future protocol
- THE PARTIES' CLEAR OWNERSHIP OF RIGHTS TO OFFSETS A central point such contracts should be an establishment of the Investor's title to be recognized as the author of the sequestration or emission reductions. Thus this Article must be drafted in conjunction with the Article VI under which Project defines its relationship with the ownership of the land and forests out of which the offsets will be produced.
- DEFINITIONS OF OFFSETS TO ASSURE VALUE UNDER FUTURE CLIMATE CONTROL SCHEMES: Carbon offsets represent the right of a party to be recognized as the author of the sequestration and/or emission reductions. Central to understanding the legal issues in this area is an awareness of the uncertainty as to what Offset Rights; i.e. what are produced by a project, will be valuable as Credits, i.e. rights defined and given value by international and/or domestic law.

Any attorney involved in a project that is developed prior to the formulation of an internationally agreed upon system for granting credits will be in the position of trying to draft a contract and assist with project design so as to put the project in the best position to be accredited under CDM or any similar system so that all of the project's offsets will be credited or at least those achieved after the CDM is brought into force. The value of carbon offsets, whether under the CDM or any similar climate mitigation structure, will ultimately require a system under which there will be:

- i. Common standards and methodologies. Only through standardization can transparency and repeatability be assured. For a discussion of some of the ongoing refinements of what is meant by the requirements that CERs be "real, measurable and long term" and "additional" see Section 5 of Legal Background. To make the best prediction concerning the requirements for credits three interrelated those carbon offset financial instruments developed by the private sector. In forestry projects the standards under which the amount of offsets are to be measured are particularly difficult because obtaining accuracy in such

long-range enterprises may require a revisable baseline. Any refinement in definition of what constitutes a carbon offset and how to measure such offsets will make such measurements more exact but also may make earlier credits suspect. The INVESTOR will want the inclusion of some guarantee that his already acquired credits are secure.

- ii. Certification, and perhaps the monitoring and verification, has been performed by a reliable independent entity. (Monitoring refers to the ongoing data collection; Verification to an examination of whether offsets have actually occurred.) The additional cost of hiring a third party must be weighed against the environmental expertise and the legitimacy such a party provides.
- iii. Monitoring and Verification Protocol shall be developed and attached to the Agreement and should include provisions specifying the frequency of offset monitoring activities, the GHG impacts record keeping requirements, and the demonstration, accounting and review procedures and shall include within its procedure for calculating offsets the following:
  - (a) The calculation of a Project reference case;
  - (b) Emissions in metric tons of C-eq avoided on the Project Site by preventing the forest's destruction over the Project Term as compared to the reference case; plus
  - (c) The incremental emissions in metric tons of C-eq. The Project sequesters, fixes, or otherwise mitigates over the Project Term as compared to the reference case; plus
  - (d) The net emissions in metric tons of C-eq avoided through the Project's Leakage prevention activities as compared to the reference case; plus
  - (e) Such other green house gas mitigation impacts of the Project as compared to the reference case as may be necessary or appropriate to consider in accordance with the offset measurement and calculation methodologies acceptable to or approved by the... and that are established in future broadly accepted international programs.

- APPORTIONMENT: In designing the means by which to apportion the offsets to the Parties the following should be considered:

- i. Assignment of offsets may be based on a formula such as the assignment of credits in proportion to the party's financial contribution.
- ii. Apportionment can be used as an incentive device. An initial amount may be guaranteed to INVESTOR with subsequent amounts divided equally among the parties. Such terms would provide a near term guarantee for the INVESTOR and would shift the risk of under performance to the party with control over the project operations.
- iii. Under the Article 12.8 of the Kyoto protocol the CDM would require some of the proceeds from the carbon project be allocated to cover administrative costs and assistance to Parties for adaptation to climate change. The Agreement should include a formula for how the partners should be responsible for such allocations.
- iv. Throughout the Agreement risk management should always be kept in mind. In the case of carbon offsets the parties may decide to allot only a proportion of the carbon output to the parties, withholding a contingency pool of carbon credits. The more uncertain the project the higher the percentage of offsets that should be withheld.
- v. Whether or not the Host Government is a Partner in the project giving the Host Government rights to a percentage of the offsets may give the HOST Country a real stake in the project's success. The Host Government could then either sell the offsets or, if it chooses, save them for use against any national emission limitations that might be imposed if it in the future becomes a Party to an international emissions limitation plan. In the Noel Kempff AIJ project the Bolivian government, recognizing that Bolivia had a national asset in the availability of cost effective carbon offset activities, asked for a fifty-percent share of any offsets and the Investors, deciding that such financial involvement would give the Government a significant stake in the success of the project, agreed.  
<http://www.tnc.org/frames/index.html/html/list.html>

- REGISTRATION: This section should set forth the understanding that the owner of the carbon offsets has the sole right to register such rights in whatever domestic or international registry exists. At the present time no international register exists. Future international carbon offset trading will most likely require that transfers be registered internationally and domestically to protect against offsets being used more than once.

Registration by itself does not mean the production of credits of value. In the United States under Section 1605(b) of the Clean Air Act corporations can register their offset activities with the Department of Energy but no credits are being granted. Exactly what is being registered should be clearly documented because of the possibility that a domestic government may decide to “grandfather” such activities into a future domestic carbon crediting scheme.

- TRANSFER OF OFFSETS BY PARTIES: The owner of such certified offsets may trade them to a third party or may use them to assist its country of origin as part of its compliance with its current or potential future GHG mitigation obligation for which in turn the Investor would receive domestic credit. One difficult issue concerning transfers is whether liability for invalid offsets is transferred with the ownership of the offsets. Under the CDM scheme post facto certification of the offsets would seem to resolve the issue because certification would “gold plate” the offsets.

11.1 FCCC JI Pilot Phase. The Parties to this Agreement understand and agree that:

- (a) this Project is being developed during the Pilot Phase for Activities Implemented Jointly established by Decision 5 of the first Conference of the Parties to the FCCC in furtherance of Article 4.2 of the FCCC;
- (b) that the AIJ plan specifically states that no credits are to be earned during the Pilot Phase
- (c) that the date on which the Pilot Phase will conclude is uncertain and
- (d) that the Parties intend that this Project shall continue beyond any date on which the AIJ is concluded.

11.2 The Clean Development Mechanism. The Parties to this Agreement further understand and agree that the Pilot Phase for Activities Implemented Jointly has

not yet, but is expected to, lead to a permanent program for JI activities among the parties to the FCCC. A potential program or mechanism as referred to above is the Clean Development Mechanism (CDM).

11.3 Certification of Project. The Project including the Monitoring and Verification Protocol (MV Protocol, as attached), developed by [Independent Entity] was approved by the... Bureau of the HOST government on ... 19... and by the ...Agency of the Investor Country on, 19....;

11.4 Monitoring and Verification. All emission measurements shall be done in accordance with this Agreement and with the methods set forth in the Monitoring and Verification Protocol (MV Protocol), attached to this Agreement as Attachment ....;

11.4.1 Refinements of Methodologies. The Project's offsets monitoring, measurement and reference case calculation methodologies and techniques will be developed and refined over the Project Term. The Project Board must approve any such refinement.

11.4.2 Certification of Carbon Offsets. The creation of offsets by the Project shall be calculated, demonstrated, submitted for certification, at least annually, to an Agency within the Host Government and/or to an independent third party with expertise in environmental measurements as determined by the Project Board.

11.5 Possible Future Certification Bodies. If at any time there comes into being an entity recognized by the FCCC any other such international organization as the official body for certifying such offsets the Parties agree to work with that body either in place of or in coordination with the Host Government Agency and Independent Entity.



11.6 Certification of Project Design under the CDM or any other international GHG mitigation plan established in the future. If the CDM or any other similar plan comes into effect, the Parties agree:

- (a) to prepare and submit an application to the appropriate operating entity of the CDM or other similar organization for certification of this Project as meeting the criteria to be accepted as a CDM Project able to produce CERs in the future.
- (b) to prepare and submit an application to the appropriate operating entity of the CDM or other body for certification of emission reductions already achieved by the Project.

11.7 Apportionment of Certified Offsets. As long as a Party is not in default of its duties under this Agreement, Certified Offsets will be apportioned to it as follows:

- (a) Partners shall receive (on a pro rata basis in proportion to their respective financial contributions to the Project) the equivalent of [X%] of the offsets accumulated each year during the Project Term.
- (b) HNGO shall receive the equivalent of [X%] of the offsets accumulated each year during the Project Term.
- (c) Host Government shall receive the equivalent of [X%] of the offsets accumulated each year during the Project Term.

11.7.1 Contingency Pool of Certified Offsets. [X%] of the Certified Offsets shall be placed in a contingency Pool, managed and accounted for by the Funds Manager, to be distributed to the parties only upon agreement of two thirds of the Project Board. .

11.7.2 Certification Costs. The Parties receiving Certified Offsets under this Agreement shall, in proportion to the allocation of such Certified

offsets, share any and all charges, fees, as well as “share of the proceeds” as indicated in Article 12.8 of the Kyoto Protocol and shall also share any other costs associated with any preparation and application for any Certification required under international or domestic law.

- 11.8 Reduction of Offsets Not Allowed. The Parties agree that, once the offsets for any one year have been demonstrated, certified and Apportioned in accordance with Law and this Agreement, the quantity of such offsets shall not thereafter be reduced by virtue of any subsequent changes or refinements in offset monitoring, measurement or reference case calculation methodologies and techniques.
- 11.9 Use of Carbon Offsets: The Parties agree that each offset apportioned to a Party under this Agreement shall constitute an unconditional marketable private right to thereafter hold or transfer such offsets as each such Party may independently decide including but not limited to, registering the offset with any governmental or non-governmental GHG mitigation registries and tracking systems that may be hereafter established.

## ARTICLE XII – WARRANTIES

The Host Country Party may insist on a Provision under which no Party warrants that the CDM or any similar mechanism will be adopted. More generally it may insist that it in no way warrants that any given amount of offsets will be produced or that the worth of the offsets will be a certain amount. Since the INVESTOR is the party that has invested most of the money in the Project such a provision basically puts on the INVESTOR the risk that the absence of any crediting system will result in worthless offsets. If such a risk is imposed the Investor may gain some protections by insisting on high performance standards.

- 12.1 Warranties. Each Party independently and separately hereby warrants as follows:

- 12.1.1 It will not make, offer or authorize a payment of anything of value nor use any form of influence to obtain or elicit favors, especially such influence as is prohibited under Host Government law to any government official, political party or official thereof, in connection with any business transactions under this Agreement.
- 12.1.2 It is an organization duly authorized under the laws of ... to own and operate its properties and to carry on its business;
- 12.1.3 It is authorized to grant its appointees the authority to act on behalf of, and to fully bind such Party in entering into this Agreement;
- 12.1.4 It has duly obtained all material consents, licenses, approvals and authorizations and has effected all declarations, filings and registrations necessary for the due implementation, delivery and performance of this Agreement and that it shall use all its best efforts to acquire such permissions as necessary in the future;
- 12.1.5 Its implementation, delivery and performance of this Agreement: (i) will not violate any applicable regulation or ruling of any governmental authority; and (ii) will cause such Agreement to constitute a legal, valid and binding obligation of such Party;
- 12.1.6 It will ensure observance of confidentiality with regard to any Restricted Information or confidential information or data disclosed to it.
- 12.1.7 That it has the capacity and the will to perform all of its obligations under this Agreement.
- 12.1.8 That it does not warrants that any mechanism for achieving national obligations under the FCCC will be adopted, established or authorized by the Parties to the FCCC;

12.1.9 That, notwithstanding any good faith estimates of the net greenhouse gas benefit of the Project, they make no representations, warranties or guarantees as to the amount, quality, or quantity of the offsets that will be produced, demonstrated or certified under the Project; provided that, each Party hereto does hereby covenant and agree that it will faithfully comply with the responsibilities and obligations under this Agreement on its part to be performed;

12.2 Debts & Encumbrances. Each party further warrants that:

12.2.1 It does not have outstanding any kind of security interest in any of its properties or revenues that would materially interfere with performance hereunder and all tax returns required by Law have been duly filed, and all taxes, and other governmental charges due upon it, have been duly paid;

12.2.2 It is not in breach of any provision of any Agreement to which it is a party which would have a materially adverse effect upon its ability to perform its obligations under this Agreement and no proceeding is pending against it by any governmental authority, nor, to the best of its knowledge and belief after due inquiry, is any action threatened against it that, if likely to materially adversely affect its ability to perform its obligations under this Agreement.

12.2.3 All documents, reports or other written information pertaining to the Project which have been furnished by it to another Party are true and correct;

12.2.4 The Financial Statement dated....and approved by the INGO has been furnished to the other Parties, is complete, correct and fairly represents ....'s financial condition;

## ARTICLE XIII – EVENTS OF DEFAULT

Liability for failure to perform should be imposed on both Parties to assure the success of the Project. As a general rule the INVESTOR will be liable for defaults in financing and the party that implements liable for failure to carry out implementation tasks. The remedies for such defaults should be examined with the understanding that a Host Country partner may have limited assets and that enforcement under the Host Country legal systems may be difficult.

Some considerations are:

- During the initial stage of a project the INVESTOR may obtain some protection via security interests in timber, land or equipment through title transfers, liens or bonds. (A country may not permit foreign entities to own land)
- If the Implementing party fails to perform he may be required to:
  - (a) to provide alternative opportunity for equivalent expected GHGs benefits
  - (b) to repay the money invested plus interest for failure to perform, or to pay an amount equal to the monetary value of the planned emission credits (one problem with the latter remedy may be difficulty in ascertaining the value of such credits)
- The production of fewer offsets than the initial “good faith” estimate will not be a default, but including a penalty for the production of fewer offsets might act as a spur to more effort.
- Installment payments may encourage the implementing party to produce under the contract but in many sequestration projects most of the money required for implementation is needed at the beginning of the project.
- The parties may agree upon a schedule under which if a certain amount of offsets have not achieved at given times or are not worth a given amount an Investor may be permitted to conclude the Agreement without penalty.

13.1 Events Constituting Default. The occurrence and continuation of any of the following events or circumstances constitutes as “Event of Default” under this Agreement:

13.1.1 Failure to Pay. A Party fails to pay when due any amount payable pursuant to this Agreement which failure continues for a period in excess of thirty (30) days; or

- 13.1.2 Failure to Issue Disbursement. The FUNDS MANAGER fails to issue when due a Project Disbursement; or
- 13.1.3 Indebtedness. Any Party fails to tender any payment on any outstanding indebtedness when due, and have a material adverse affect on (i) the Project financing or schedule, (ii) the defaulting Party's ability to perform or fulfill its obligations under this Agreement, or (iii) on the rights and interests of any other Party; or
- 13.1.4 Failure to Perform Material Obligation. Any Party fails to comply with or perform any other material obligation contained herein; or
- 13.1.5 Representations. Any representation or warranty made by or on behalf of any Party shall prove to have been incorrect or false in any material respect when made;
- 13.1.6 Authorizations. Any authorization, consent or approval of any governmental agency or public authority required to be obtained by a Party and necessary for the implementation of a material provision of this Agreement, in the degree permissible by Host Countrylaw, is not given or is withdrawn due to the malfeasance or nonfeasance of such Party; or
- 13.1.7 Cessation of Grants of Rights. a Party ceases to give another Party the rights, titles, remedies, powers or privileges provided by this Agreement; or
- 13.1.8 Condemnation. Any governmental authority condemns, nationalizes, seizes or otherwise expropriates any substantial portion of the assets of INVESTOR] or HNGO, or the Offset Registration Interests of a Party, or takes any other action that would prevent such Party from performing any material obligation under this Agreement, due to the malfeasance or nonfeasance of such Party; or

- 13.1.9 Contesting of Obligations. Any Party takes any judicial or other action to void, repudiate or otherwise contest the validity of its obligations under this Agreement
- 13.1.10 Bankruptcy. Without its consent, a proceeding that could void a Party's obligations hereunder is instituted in a court of competent jurisdiction, or before a governmental agency, seeking an adjudication in bankruptcy or other arrangement with creditors, a readjustment of debt, the appointment of a trustee, receiver, liquidation or the like, of any substantial part of its assets or other like relief and, if such proceeding is being contested by it in good faith, the same shall continue undismissed for a period of sixty (60) days; or
- 13.1.11 Discharge of Judgments. Any final judgment(s) for the payment of money is rendered against INGO or HNGO, and such judgment or judgments shall affect INGO's ability to perform its obligations as PROJECT MANAGER or HNGO's ability to perform its obligations as FUNDS MANAGER and that shall not be satisfied or discharged within sixty (60) days of entry; or
- 13.2 Notice Upon an Event of Default. In the event that any Party shall become in default and such Event of Default is determined by a simple majority of the non-defaulting Parties to be of a material nature, then notice of such default shall be given to such Party by the non-defaulting Parties, which notice shall be directed to the defaulting Party by registered mail at the Party's legal address.
- 13.3 Remedies Upon an Event of Default.
- 13.3.1 Opportunity to Cure. The defaulting Party shall cure the Event of Default within thirty (30) days from the date on which notice is given to the defaulting Party;

13.3.2 Failure to Cure. If the Event of Default is not cured within the applicable deadline set forth above, or the default arises under Subarticle 13.1.9 or 13.1.10, and except when the noticed Party disputes the alleged default diligently and in good faith, then and in that event the following remedies shall be available to the non-defaulting Parties (without limiting the availability of any other remedies available under this Agreement, or in law or equity,

(a) Continuing Defaults. In the event of any Party that has caused an event of default, the Project Board may:

- i. suspend or defer performance of the non-defaulting Parties' obligations under the Agreement, in whole or in part, until the event of default is cured by the defaulting Party, or
- ii. continue performance if it deems it reasonable to do so, or
- iii. in the event of an incurred payment of Project Funds default by a Party, withhold the defaulting Party's Registration Interest in, and/or delivery of, offsets.

13.3.3 A majority of the Project Board may proceed under this SUBARTICLE without the concurrence of such defaulting Party.

(a) PROJECT MANAGER Default. In the event of a PROJECT MANAGER default, the non-defaulting Parties may seek such relief in proceedings initiated under Article XIV, as is permitted by Law or in equity to continue full implementation of the Project. To the extent that the equitable relief necessary to prevent irreparable harm to the Project or any Party cannot be



awarded in arbitration, the non-defaulting Parties shall have the right to seek such relief directly in any court of competent jurisdiction.

- (b) The non-defaulting Parties may, by unanimous agreement:
  - i. declare, by written demand to the defaulting Party, to be made whole without any other notice of any kind;
  - ii. without notice of default proceed to protect and enforce its rights and remedies by appropriate proceedings; and
  - iii. suspend or terminate this Agreement as to such Party, in which case all the rights of the defaulting Party hereunder shall wholly cease without any right of compensation for money paid or to be paid.
  
- (c) Costs. In any such event of continuing default, the reasonable costs incurred by the Project Board as a result of a Party's default shall be due and payable by such defaulting Party. In the event that the defaulting Party shall institute any suit or action to enforce any right hereunder and not prevail, the defaulting Party shall pay to the other Parties reasonable attorney's fees and court costs.

## ARTICLE XIV – DISPUTE RESOLUTION

Clarity in defining how disputes are to be dealt with is particularly important in international agreements involving individuals and organizations representing sharply different interests and cultural backgrounds. If parties are unable to work out differences among themselves a request for mediation may be the next step and if that fails, binding arbitration.

The following check off should be used in designing a dispute resolution section:

- The sponsoring organization
- The procedural rules
- Choice of arbitration site
- Choice of arbitrators (number and method of selection)
- Language of arbitration
- Finality of arbitration
- Governing law
- Time limits
- Costs
- Locale of hearings
- Method for enforcing awards and entering judgement

Some recognized institutions engaged in Dispute Resolution are:

- The UN Committee on International Trade Law (UNTICRAL)
- The American Arbitration Association
- The International Chamber of Commerce Arbitration Court
- The Commercial Arbitration and Mediation Center for the Americas
- The Inter-American Commercial Arbitration Commission
- International Centre for Settlement of Investment Disputes
- London Court of International Arbitration (LCIA)

14.1 The Parties hereby delegate to their respective Principal Contacts all responsibility and authority with regard to disputes and the settlement of disputes between the Parties under this Agreement.

14.2 Except as otherwise provided in this Agreement, the Parties hereby agree that, in the event of any claim, counterclaim, dispute or other matter in question between any two or more Parties arising out of, or relating to, this Agreement or a breach

of this Agreement, the Parties shall first seek to resolve the matter in question through informal discussions.

14.3 In the event any matter in question cannot be resolved between any two or more Parties informally within sixty (60) days, the Parties agree that such matter shall be negotiated between the parties in dispute through mediation in accordance with the rules set forth in ...The cost of mediation shall be shared equally by the Parties to the mediation.

14.4 In the event any matter in question cannot be resolved between any two or more Parties through mediation and such mediation is terminated, the Parties in dispute agree that such matter shall be settled between the Parties by binding arbitration, pursuant to the rules of arbitration to which the Parties mutually agree in writing. In order to maximize the efficient and convenient administration of the arbitration the Parties further agree, as follows:

- (a) The number of arbitrators shall be one,
- (b) The Parties will exhaust conciliation to then make use of Arbitration subjected to [name of country] law, in agreement with the (name of Arbiters).
- (c) Any party to the arbitration may bring a cross-claim or counter-claim against any other Party involved in the arbitration, or a third-party claim against any Party not previously involved in the arbitration, and
- (d) The arbitrator shall have discretion to consolidate multiple claims, cross-claims or counter-claims arising under the Agreement.

14.5 The Parties agree that arbitration proceedings will take place in [name of country], or at such other location as may be agreeable to the Parties; provided that, a Partner's travel expenses will be covered by the Project Funds if a location other than partner's country is chosen by the Parties.

- 14.6 Each Party agrees that a final arbitration decision against it in any action or proceeding arising out of or relating to this Agreement shall be conclusive.
- 14.7 Jurisdiction and Consent to Suit. Without prejudice to the rights of the Parties to bring suit in the courts of any other jurisdiction:
- (a). Each Party hereby agrees that any proceeding to enforce an arbitration decision reached under this Agreement may be commenced and maintained either in the courts of the Host Country or the INVESTOR country, by suit on the arbitration decision, a certified or exemplified copy of which shall be conclusive evidence of such decision and that a final court judgment against such action or proceeding shall be conclusive and may be enforced in any jurisdiction within or outside of Host Country or the Investor Country.
  - (b) Each Party hereby irrevocably waives any present or future objection to such venue, and irrevocably consents and submits unconditionally to the jurisdiction of such court over itself and in respect of any of its property.
  - (c) Each Party hereby agrees that any service of process, writ, judgment or other notice of legal process shall be held to be effectively served upon it in connection with proceedings under this Agreement, if delivered by certified mail, return receipt requested to an Authorized Officer of the Party;
- 14.8 Party Indemnification. Each Party shall defend, indemnify and hold harmless the other Parties and, representatives from any and all losses, damages, penalties, deficiencies, claims, and liabilities (including reasonable attorneys fees and costs actually incurred), and any and all costs, expenses, fees, or loss of offsets suffered or incurred (collectively, "Losses"), in any way connected with such Party's negligence or willful misconduct with respect to its duties under this Agreement. Except as otherwise provided herein, this indemnity shall apply

without regard to whether such Losses are based on violation of a Law, breach of Agreement, breach of warranty, negligence, strict liability, or other tort, and shall survive termination or expiration of this Agreement.

14.9 Notwithstanding any other provision in this Agreement:

- (a) No Party shall be liable to any other Party for incidental, indirect, special, exemplary or consequential damages of any kind connected with or resulting from performance or nonperformance of this Agreement, and
- (b) the INVESTOR's total liability to the other Parties for breaches of its obligations under this Agreement (other than its obligation to defend and indemnify other Parties against its own negligence or willful misconduct) shall not exceed the total financial obligation of the INVESTOR pursuant to this Agreement, plus any interest on default due and any forfeit of its offset Interests hereby created; and
- (c) INGO's total liability to the other Parties for breaches of its obligations under this Agreement (other than its obligation to defend and indemnify other Parties against its own negligence or willful misconduct), shall be limited as follows: INGO's total liability to the other Parties for any breaches of its obligations under this Agreement shall not exceed its total financial obligation and the total aggregate amount of Project Funds held by INGO in the Project Funds Account (including all interest accrued on undisbursed Project Funds),
- (d) HNGO's total liability to the other Parties for breaches of its obligations under this Agreement (other than its obligation to defend and indemnify other Parties against its own negligence or willful misconduct) shall not exceed the total aggregate amount of the Disbursements actually received by HNGO under this Agreement and its obligation to perform under any equitable remedies concerning this Agreement.

- 14.10 Indemnification of Individual Appointees. The Parties shall indemnify and hold harmless the individuals appointed to positions on the Project, jointly and severally from any Losses in any way connected with the activities of such appointee or other person on the Project that are not directly attributable to the gross negligence or willful misconduct of such appointee or other person separately retained to assist such appointee.
- 14.11 Priority of Claims. The Parties hereby agree that any and all claims made against a Party by one or more other Parties shall be expressly subordinated to any and all claims made by any person appointed under this Agreement, or by any other person retained to assist such appointee, brought against the same Party.
- 14.12 Survival of Indemnification. The indemnification provided herein shall survive performance of this Agreement.
- 14.13 Waiver of Claims of Immunity. Each Party hereby waives any and all claims to immunity.

## ARTICLE XV – LIMITATIONS ON LIABILITY AND FORCE MAJEURE

ARTICLE FIFTEEN sets forth the understanding between the Parties regarding their potential liabilities. There are so many types of risks in carbon offset projects that these issues should be first approached with risk management experts. Contracts must include ways to handle that liability for risks that the parties may find too difficult or too expensive to cover by insurance. Especially with forestry projects, the force majeure language needs to be quite specific. One might want to include specifics about natural disasters such as pest infestation, fires, and hurricanes.

### 15.1 Limitations on Liability.

15.1.1 Responsibility for Acts, Omissions or Malfeasance. Each Party shall be solely responsible for the acts, omissions or malfeasance of such Party or its employees, representatives or agents.

15.1.2 Liability for Non-Agents on Project Site. In no event shall any Party be made liable by virtue of this Agreement for any loss or injury sustained by any person that is not such Party's employee, representative or agent while on the Project SITE.

### 15.2 Force Majeure.

15.2.1 Force Majeure,"means any event, including acts of God, arising from causes beyond the control of a Party or of any person employed by or associated with a Party, that delays the timely performance of any material obligation under this Agreement notwithstanding that Party's use of best efforts to avoid the delay. The requirement that the Party exercise "best efforts to avoid the delay" includes using best efforts to anticipate any potential *force majeure* event and best efforts to address the effects of any actual *force majeure* event (a) as it is occurring, and (b) following the *force majeure* event, such that the delay and the

adverse effects of the delay are minimized to the greatest extent practicable.

- 15.2.2 If any event occurs or has occurred that may delay the performance by a Party of any material obligation under this Agreement, whether or not caused by a *force majeure* event, that Party shall notify the other Parties by telephone, within 48 hours of when the Party knows or should have known that the event might cause or contribute to a delay or non-performance of such obligation. Each Party shall exercise best efforts to avoid or minimize any delay and any adverse effects of a delay. Failure to comply with the above requirements shall preclude such Party from asserting any claim of *force majeure*.
  
- 15.2.3 If all the other Parties agree unanimously that the delay or anticipated delay by one Party is attributable to a *force majeure* event, the time for performance of the mutual obligations of the Parties under this Agreement that are directly affected by the *force majeure* event shall be extended by agreement of the Parties. In any such proceeding, to qualify for a *force majeure* defense, the Party claiming *force majeure* shall have the burden of demonstrating that the delay or anticipated delay has been, or will be, caused by a *force majeure* event, that the duration of the delay was or will be warranted under the circumstances, that the delaying Party did exercise or is exercising due diligence by using its best efforts to avoid and mitigate the effects of the delay, and that the delaying Party complied with the notification requirements of this ARTICLE.
  
- 15.2.4 Should the delaying Party carry the burden set forth in Subarticle
  
- 15.2.3 the delay shall be deemed not to be a violation of the affected obligation or a default of this Agreement.



- 15.2.5 No Party shall be liable for the obligations of any Party or person other than itself and those affiliated with it. No default by a Party shall constitute a default by any Party not affiliated with it.

## ARTICLE XVI – MISCELLANEOUS

The Miscellaneous Section must be drafted in a manner consistent with the other Sections of the Contract.

- Choice of Law: To cover the possibility that litigation may occur the Agreement should delineate what substantive and procedural law should control and in what forum a dispute should be decided. One factor to be considered is how different legal systems would define carbon offsets and other major terms of the contract. Though the laws of the Investor Country might offer more advantages to the INVESTOR the Host Country may be a good forum because of the availability of witnesses and the greater ease of enforceability.
- Change in law: Because the law concerning carbon offsets is only beginning to be developed in both Developed and Developing Countries. the contract must include a way to handle unforeseen legal changes in law that might affect the performance of the Agreement.
- Adhesions Clause: The miscellaneous section may be the place to put an adhesion clause. When the parties have unequal bargaining power an Agreement drafted totally by the more powerful party may be considered an Adhesion Contract and therefore unenforceable. If all parties have been included from the beginning in the Project Design and if the Agreement grants equitable benefits to all parties no Adhesion problem should arise. Such a concern could also be addressed by adding to the Warranty Section a warranty that the Parties had fully explored the issues and signed the Contract with a full understanding of the project and their rights and responsibilities under the Comprehensive Agreement.

- 16.1 Subcontracting: No part of this Agreement may be subcontracted to any third party without the written approval of the Project Board.
- 16.2 Time is of the Essence. Time is declared to be of the essence under this Agreement.
- 16.3 Incorporation by Reference. Any Appendices and Attachments hereto are incorporated herein by reference as if their terms were set forth fully herein.

- 16.4 Successors and Assigns. This Agreement shall be binding on and inure to the benefit of the Parties and to their respective successors in interest and assigns, including any successor in interest or assign to any Registration Interest or share granted to the Parties under this Agreement.
- 16.5 Amendments and Termination. The provisions of this Agreement may be modified or terminated only by a written instrument signed by all the Parties.
- 16.5.1 References. Reference to, and the definition of, any Document (including this Agreement) shall be deemed a reference to such document as it may hereafter be modified from time-to-time in writing by the Parties.
- 16.6 Revisions Due to Changes of Law. It is the intent of the Parties that the rights, authorities, duties, responsibilities and obligations of the Parties provided for in this Agreement shall be consistent and implemented in conformance with Law. If any provision of this Agreement is found to be illegal, invalid, or unenforceable, the remaining provisions shall remain fully enforceable and unimpaired.
- 16.6.1 “Change in the Law” shall mean any change in the text, or interpretation by a governmental authority with jurisdiction, of a Law of the INVESTOR or Host Country that materially affect This Agreement.
- 16.6.2 The Parties agree to re-negotiate in good faith any revisions to this Agreement Necessitated by any Change in the Law, and to limit the scope of such re-negotiation to provisions materially affected by such Change in the Law.
- 16.6.3 If the Parties agree in good faith that this Agreement cannot be waived amended or modified to remove the substantial burden or to cure the prohibition or illegality resulting from such Change in the Law:

- (a) this Agreement or the affected provisions shall be terminated by agreement between the Parties as to all the Parties or as to any one Party as necessary; and
- (b) the Party or Parties obligated under the provisions so terminated shall, no longer be obligated to perform under such provision.

16.6.4 The Parties agree to use best efforts to prevent any harm to any Party resulting from a Change in the Law or from any amendment or termination of this Agreement due to such Change in the Law, including giving expeditious notice to the Parties of any change in the Law giving rise to a prohibition or additional burden, and pursuing all reasonable opportunities available under Law to challenge such Change in the Law.

16.7 Limitation of Liability Due to Amendment or Termination. The provision of this Agreement regarding, modifications or terminations shall be subject to the limitations on liability set forth in this Agreement.

16.8 Descriptive Headings. The headings used in this Agreement are for reference purposes only and shall not in any way affect the meaning or construction of any provision of this Agreement.

16.9 Complete Agreement. This Agreement, including all Appendices, and Attachments hereto, embodies the entire and complete understanding and agreement between the Parties, and supersedes all agreements between them, whether written or oral, with respect to the subject matter hereof.

16.10 Form of the Comprehensive Agreement. The Parties specifically declare that it is not their intent by entering into this Agreement to create, and this Comprehensive

Agreement shall not be construed to have created, a partnership, joint venture or other such business arrangement.

### **Addresses for Official Notices**

Any notice under this Agreement shall have legal effect when delivered to the following addresses:

INVESTOR:

INGO:

HNGO:

**IN WITNESS WHEREOF**, the Parties have executed and delivered this Agreement as of the date and year first above written.

***[Provide spaces for signatures and dates]***

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