

Legal Alert



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First JI Projects Approved Implementation of the Kyoto Protocol in Russia

Introduction

The mechanism known as "joint implementation" (*JI*) is established by Article 6 of the Kyoto Protocol. JI enables an Annex B country with an emission reduction commitment under the Kyoto Protocol to transfer or acquire emission reduction units (*ERUs*) to or from any other Annex B Party. ERUs are each equivalent to one tonne of carbon dioxide, and they may be earned from a project that removes or reduces carbon dioxide from the atmosphere.

JI is considered mutually beneficial to both the party acquiring and transferring ERUs. That is, JI is a flexible and cost effective means which assists Annex B Parties to adhere to their emission reduction commitments under the Kyoto Protocol; and is also an effective means of supporting host Parties by providing foreign investment and technology transfer.

Russia has always been seen as a key potential jurisdiction for JI projects with many international companies exploring opportunities to develop projects there. However, with no projects having been approved until now and uncertainty around the ability to get such projects approved significant uncertainty as to when and if JI would be formerly implemented existed.

First JI projects approved

On July 23, 2010, the Russian Ministry of Economic Development approved 15 projects as joint implementation projects under Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change (as per its Order No. 326). This is the final stage in the approval process; the first emission reduction units (ERUs) are expected to be issued in November 2010.

The approvals were granted on the basis of recommendations prepared by Sberbank - the Russian Government-appointed carbon units operator. In total 37 project applications were considered before making the final decision. Projects that were not approved, and also new projects may be submitted for selection and approval as joint implementation projects through a second tender to be conducted by Sberbank.

Sberbank's role in further implementation of ERPAs

Sberbank's ERPA approval methods and its "binding recommendations" provoke discussion

Since completion of the first tender selection of Joint Implementation Projects ("JI Projects"), the right of Sberbank of Russia OJSC ("Sberbank") to sign off on contracts ("ERPAs") governing the transfer of Emission Reduction Units (ERUs) under JI Projects has become a major focus of discussion.

As can be inferred from the "recommendations" it has been giving to JI Project participants with regard to various aspects of such contracts, Sberbank appears to contemplate linking its approval of such ERPAs:

- (i) to the sale price of ERUs;
- (ii) to the terms and conditions of payments for delivered ERUs as provided in such ERPAs; and
- (iii) to some other criteria mentioned in Sberbank's recommendations.

Whether such recommendations given by Sberbank are binding or not is a cause for much discussion. Also, the effect of these recommendations on the respective ERPAs is not clear. What is clear, is that this effect will heavily depend on the provisions of the respective ERPAs on the rights and obligations of the parties in case of changes in the legislation. Negotiations between participants of JI Projects on amendments to their ERPA can reduce risks stemming from the ERPA's non-compliance with Sberbank's recommendations.

Should negotiations prove difficult and not easily lead to an agreement, each participant in a JI Project should develop its own strategy for interaction with its counterparty in order to minimize the legal and commercial risks connected with Sberbank's possible refusal to sign off on the respective ERPA.

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