Forest Carbon Partnership Facility

Update on ERPA General Conditions

FCPF Carbon Fund Meeting (CF9)
Brussels, April 9-11, 2014
I. Roadmap for ERPA General Conditions

II. Transfer of Title to ERs
   - Methodological Framework
   - FCPF ERPA General Conditions (update)

III. Reversal Management Mechanism
   - Methodological Framework
   - FCPF ERPA General Conditions (update)
<table>
<thead>
<tr>
<th>Time</th>
<th>Action</th>
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<tbody>
<tr>
<td>March 26, 2012</td>
<td>FCPF Carbon Fund (CF) established Carbon Fund Working Group (CFWG) to develop a Methodological Framework (MF) at CF3 (March 24-26, 2012 in Asuncion, Paraguay)</td>
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<tr>
<td>June 29, 2012</td>
<td>PC12 endorsed guiding principles on the MF for REDD per PC Resolution (Santa Marta, Colombia)</td>
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<td>October 2012 &amp; March, 2013</td>
<td>Meetings of the CFWG on the MF in Brazzaville and Washington DC</td>
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<td>March 21, 2013</td>
<td>PC14 endorsed ERPA Term Sheet per PC Resolution requesting first draft of the ERPA General Conditions (GCs) by PC15 (June 30-July 1, 2013 in Lombok, Indonesia) with the initial objective of endorsement of ERPA GCs at PC16</td>
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<td>June 21-23, 2013</td>
<td>Meeting of the CFWG on the MF in Paris</td>
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<td>June 24-25, 2013</td>
<td>CF7 meeting in Paris to discuss certain issues of ERPA GCs</td>
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<td>June 28, 2013</td>
<td>Pre-PC15 Workshop (Lombok, Indonesia) on ERPA GCs</td>
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<td>June 30-July 1, 2013</td>
<td>Presentation of first draft of the ERPA GCs at PC15 (Lombok, Indonesia)</td>
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<td>Time</td>
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<td>October 26-28, 2013</td>
<td>Meeting of the <strong>CFWG on the MF</strong> in Oslo</td>
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<td>December 5-6</td>
<td>Meeting of the <strong>CFWG on the MF</strong> in Paris</td>
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<td>December 8-9</td>
<td>CF8 meeting in Paris; <strong>approval of the MF</strong></td>
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<td>December 12, 2013</td>
<td><strong>Pre-PC16 Workshop</strong> <em>(Geneva, Switzerland)</em> on Implications of MF on ERPA GCs</td>
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<tr>
<td>December 13-15, 2013</td>
<td>PC16 <em>(Geneva, Switzerland)</em> on Implications of MF on ERPA GCs</td>
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<td>January-March 2014</td>
<td>Revision of the first draft of the ERPA GCs (in progress)</td>
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<td>April 9-11, 2014</td>
<td>CF9 meeting in Brussels</td>
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<td>April-June 2014</td>
<td>Videoconferences for PC members/Observers regarding crucial issues related to the draft of the ERPA GCs</td>
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<td>June 2014</td>
<td>CF10</td>
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<td>July 2014</td>
<td>PC17 (Lima, Peru); <strong>presentation of cornerstones of ERPA GCs</strong> (potentially with Pre-PC17 workshop)</td>
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<td>August-October 2014</td>
<td><em>(Potentially) additional explanatory sessions on ERPA GCs</em> (primarily for PC members with ER-PINs selected by the Carbon Fund)</td>
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<tr>
<td>November/December 2014</td>
<td>PC18 <em>(tbd)</em>; endorsement of ERPA GCs by PC</td>
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Transfer of ‘Title to ERs’
• **Indicator 36.2**: The ER Program Entity demonstrates

- its ability to transfer Title to ERs

- while respecting the land and resource tenure rights of the potential rights-holders, including Indigenous Peoples (i.e., those holding legal and customary rights, as identified by the land and resource tenure assessment conducted in the Accounting Area).

The ability to transfer Title to ERs may be demonstrated through various means, including e.g.:

- reference to existing legal and regulatory frameworks,
- sub-arrangements with potential land and resource tenure rights-holders (including those holding legal and customary rights), and
- benefit-sharing arrangements under the Benefit-Sharing Plan.
Transfer of ‘Title to ERs’
- Methodological Framework -

- **Indicator 36.3**: The ER Program Entity has to demonstrate its ability to transfer Title to ERs either
  - prior to ERPA signature, or at the latest,
  - at the time of ER Transfer.
  - **Prior to ER Transfer**, if this ability to transfer Title to ERs is still unclear or contested, an amount of ERs proportional to the Accounting Area where title is unclear or contested shall not be sold or transferred to the Carbon Fund.
  - **After ER Transfer**, if Title to ERs becomes contested, the ERPA should provide for appropriate remedies, including the potential use of a buffer reserve.
Process of Transfer of ‘Title to ERs’

Prior to ERPA Signature

- Seller demonstrates ability to transfer title to ERs; if not/not in full:
  - Postponement of ERPA signature
  - Reduction of Contract ER volume & increase of Call Option (w/ Action Plan)

Prior to ER Transfer

- Seller demonstrates ability to transfer title to ERs; if not/not in full:
  - No transfer of/payment for affected ERs

After ER Transfer

- Third party challenges regarding validity of transfer of title to ERs (Contesting Party):
  - Assessment of claim; if it has merit and cannot be resolved...
  - ER Program Buffer; otherwise...
  - Event of Default / Action Plan / Remedies
Transfer of ‘Title to ERs’
- Prior to ERPA Signature -

• Seller has to provide Carbon Fund with evidence demonstrating its ability to transfer Title to ERs.
  ➢ Question: What is the required level of scrutiny?
  ➢ Carbon Fund may contract external adviser to help assessing such evidence

• If Carbon Fund determines that Seller did not, fully or partially, demonstrate its ability to transfer Title to ERs:
  ➢ Buyer may postpone ERPA signature until further progress can be demonstrated (if the affected amount of ERs is significant)
  ➢ Otherwise:
    • (Initially anticipated ) ERPA Contract ER volume may be reduced accordingly
    • Reduction amount may be included in a Call Option

• In addition, Seller and Buyer may agree on additional steps (Action Plan) to maximize Seller’s ability to transfer Title to such ERs at the time of ER Transfer:
  ➢ Agreement on the Action Plan could become a Condition Precedent for Sale and Payment under the ERPA, and
  ➢ Certain progress made regarding the implementation of such Action Plan could become a milestone for any advance payments to be made prior to ER Transfer
Transfer of ‘Title to ERs’
- Prior to ER Transfer -

• Seller has to provide Carbon Fund with (updated) evidence demonstrating its ability to transfer Title to ERs.
  ➢ Carbon Fund may contract external adviser to help assessing such evidence

• If Carbon Fund determines that Seller’s ability to transfer Title to ERs is still partially unclear:
  ➢ No transfer/purchase of such affected ERs

• If Carbon Fund determines that Seller’s ability to transfer Title to ERs has been partially contested:
  ➢ Buyer may allow Seller to resolve the Title issue with the contesting party within specified time period (e.g. through grievance redress mechanism).
  ➢ If Seller can resolve the Title issue within specified time period, ER Transfer of the affected ERs can proceed.
  ➢ If Seller cannot resolve the Title issue within that specified time period, such affected ERs shall not be transferred/purchased. Seller may continue to try to resolve the Title issue prior to the next ER Transfer.
If any **third party or group contests** Seller’s ability to transfer Title to any previously transferred ERs, the following procedures could apply:

- Seller shall be allowed to resolve Title issue with contesting party **within specified time period** (potentially by using an available grievance redress mechanism under the ER Program).

- If the Title issue cannot be resolved within specified time period, Buyer (potentially with help of external adviser) assesses whether or not allegations by the contesting party appear ‘on its face’ (**prima facie**) to have merit under domestic law.

- If such assessment concludes that contesting party’s **allegations seem to have no merit**, no further action would be deemed necessary.

- If such assessment concludes that contesting party’s **allegations do have merit**, contesting party’s alleged failure to transfer Title to the contested ERs would constitute a **Title Transfer Failure**, which, **unless** cured through the ER Program Buffer, would be an **Event of Default**.
Transfer of ‘Title to ERs’  
- After ER Transfer (continued) -

• In the event ER Program Buffer does not exist or does not suffice to cover such contested ERs in full, the Buyer may issue a **Default Notice** and either
  - Allow the Seller to **cure the (remaining) Title Transfer Failure** during a 90-day cure period, or
  - Agree with Seller on an **Action Plan** process to **cure the (remaining) Title Transfer Failure** during a specified time period (e.g. by way of having Seller and contesting party agree on including the contesting party in the Benefit Sharing Plan in return for an express assignment of Title to the contested ERs from the contesting party to the Seller).

• If Seller is able to cure Title Transfer Failure within prescribed time period no further action would be deemed necessary.

• If Seller fails to cure Title Transfer Failure within prescribed time period, Buyer may decide to enter into a (new) **Action Plan** with Seller or to exercise the following remedies:
  - **Exclude the relevant area of land** from the Accounting Area.
  - If the amount of such contested ERs equals or exceeds \([x]\)% of the ERPA Contract ER volume, **terminate the FCPF ERPA**.
How ER Program Buffer May Work (1)

1st Reporting Period

Contract ERs/Additional ERs

Other ERs

Buffer ERs* (Reversal risk)

Buffer ERs* (Title risk)

Buffer ERs* (Other risk)

2nd Reporting Period

Contract ERs/Additional ERs

Other ERs

Buffer ERs* (Reversal risk)

Buffer ERs* (Title risk)

Buffer ERs* (Other risk)

1st ER Transfer

ER Program Buffer

Reversal Risk Account

Title Risk Account

Other Risk Account

Trustee

2nd ER Transfer

$ ERs

$ ERs

* To be determined in accordance with Risk Assessment Tool prior to each ER Transfer
How ER Program Buffer May Work (2)

ER Program Buffer

- Reversal Risk Account
  - Buffer ERs cancelled
- Title Risk Account
  - Buffer ERs set aside pending instructions by Contesting Party
- Other Risk Account (e.g. for uncertainties)
  - Buffer ERs cancelled

Program Entity

- Transfer of Contract ERs

World Bank (as Trustee)

- ERPA

* Percentage relates to transferred Contract ERs/Additional ERs and is determined in accordance with Risk Assessment Tool
Reversal Management Mechanism
• **Indicator 19.1:** During the Term of the ERPA, the ER Program accounts for Reversals from ERs using one of the following options:

  ➢ **Option 1:** a Reversal Management Mechanism (e.g., buffer reserve or insurance) that is substantially equivalent to the Reversal risk mitigation assurance provided by Option 2.

  ➢ **Option 2 (default option):** an ER Program Buffer into which ERs from the ER Program are deposited to cover any potential future Reversals in the Accounting Area and which is managed by or on behalf of the Carbon Fund. In the event of a Reversal during the Term of the ERPA, ERs deposited in the ER Program Buffer (Buffer ERs) will be cancelled equivalent to amount of transferred ERs affected by the Reversal, provided that Seller is in full compliance with its ERPA obligations.
When does a ‘Reversal’ occur?

- Potential of 1 million ERs to be generated
- ERPA signature
- Reversal event (e.g. fire, logging)
- 1st Verification
- Reversal event (e.g. fire, logging)
- 2nd Verification

- Verification & transfer of 750,000 ERs
  - No Reversal, only reduced verified/transferred ER amounts
- Verification of 500,000 ERs
  - Reversal has occurred in amount of 250,000 ERs
How ER Program Buffer May Work (1)

1st Reporting Period

Contract ERs/Additional ERs

Other ERs

Buffer ERs* (Reversal risk)

Buffer ERs* (Title risk)

Buffer ERs* (Other risk)

ER Program Buffer

1st ER Transfer

Reversal Risk Account

Title Risk Account

2nd Reporting Period

Contract ERs/Additional ERs

Other ERs

Buffer ERs* (Reversal risk)

Buffer ERs* (Title risk)

Buffer ERs* (Other risk)

ERs

Trustee

2nd ER Transfer

ERs

* To be determined in accordance with Risk Assessment Tool prior to each ER Transfer
How ER Program Buffer May Work (2)

ER Program Buffer

- Reversal Risk Account
- Title Risk Account
- Other Risk Account (e.g. for uncertainties)

Buffer ERs

10-40% *

[x]% *

Buffer ERs cancelled
Buffer ERs set aside pending instructions by Contesting Party
Buffer ERs cancelled

Program Entity

ERPA

World Bank (as Trustee)

Transfer of Contract ERs

* Percentage relates to transferred Contract ERs/Additional ERs and is determined in accordance with Risk Assessment Tool
• **Criterion 20:** Provides incentives for the Seller to establish a Reversal Management Mechanism beyond ERPA term (**Post-ERPA Mechanism**):

  - **At the latest 1 year before Term of ERPA ends,** Seller should have in place a robust Post-ERPA Mechanism to addresses risks of Reversals beyond ERPA term.

  - If Post-ERPA Mechanism allows for use of Buffer ERs, **all or a portion of the remaining Buffer ERs** in the ER Program Buffer at the end of the ERPA term will be **transferred to that Post-ERPA Mechanism.**

• **If no Post-ERPA Mechanism** is in place 1 year before ERPA term ends, **all remaining Buffer ERs** in the ER Program Buffer will be **cancelled.**
A. CONDITION PRECEDENT FOR SALE AND PURCHASE

• Unless a Reversal Management Mechanism is in place at ERPA signature, the establishment of a Reversal Management Mechanism could become a Condition Precedent for Sale and Payment under the ERPA.

B. COVENANTS (GENERAL)

• The Seller would have to:
  - Implement and operate the Reversal Management Mechanism in accordance with best practices
  - Inform the Trustee if events occur that have the potential to (1) result in a Reversal and/or (2) negatively affect the risk mitigation assurance level provided by such mechanism
  - Report on the status of the Reversal Management Mechanism periodically
C. COVENANTS (‘ER PROGRAM BUFFER’-SPECIFIC)

- If ‘ER Program Buffer’ is the Reversal Management Mechanism, at each time of ER Transfer, Seller would deposit additional amount of ERs (equivalent to 10-40% of the amount of ERs transferred to the Carbon Fund) into the ER Program Buffer as Buffer ERs.

- Buffer ERs would be different from and additional to Contract ERs and Additional ERs.

- No extra payment would be required for Buffer ERs.

- Buffer ERs are non-transferable.

- ER Program Buffer covers intentional and un-intentional Reversal events, provided that Seller is in full compliance with its ERPA obligations.
D. REMEDIES

• In the event of a Reversal during the ERPA term, any Reversal Management Mechanism put in place will be used to ensure that validity of any previously transferred ERs remains unaffected.

• In case of an ER Program Buffer, an amount of Buffer ERs equivalent to the amount of previously transferred ERs that is affected by the Reversal would be released and cancelled.

• If the Reversal Management Mechanism does not suffice to ensure the continued validity of all previously transferred ERs during the ERPA term, the Buyer may issue a Default Notice and either
  - Allow the Seller to cure the Reversal during a 90-day cure period, or
  - Agree with Seller on an Action Plan process to cure the Reversal during a specified time period (e.g. by way of having Seller cancel other ERs generated under the ER Program that are neither Contract ERs nor Buffer ERs under the ERPA).
D. REMEDIES (continued)

• If Seller is able to cure Reversal within prescribed time period no further action would be deemed necessary.

• If Seller fails to cure Reversal within prescribed time period, Buyer may decide to enter into a (new) Action Plan with Seller or to exercise the following remedies:

  ➢ Terminate the FCPF ERPA
  ➢ Request payment of incurred Costs/unrecovered advance payments
  ➢ [Request liquidated damages: e.g. ER unit price \( \times \) amount of transferred ERs that remain affected by the Reversal event]
Next Steps

• The FMT will present the ERPA General Conditions in a more simplified manner at the next PC17 (July 2014, Lima (Peru))

• The FMT would appreciate it if the target date for PC endorsement of the ERPA General Conditions is moved from PC17 to PC18 (November/December 2014)

• The FMT will organize a pre-PC17 workshop

• Prior to PC17, the FMT will organize targeted information sessions for countries by video-conference, especially for countries under consideration of the FCPF Carbon Fund
THANK YOU