

Forest Carbon Partnership Facility (FCPF)

Carbon Fund

Note on Decision-Making Modalities in the Carbon Fund

April 19, 2011

This note presents information on the proposed decision-making modalities in the FCPF Carbon Fund and its two Tranches, and the proposed apportionment of 'Common Costs' between the Tranches.

Background

1. The World Bank acting as Trustee of the FCPF Carbon Fund has signed Participation Agreements for approximately US\$100 million so far, well in excess of the US\$40 million necessary under the Charter to operationalize the Fund (Section 4.2 (b)¹), and it is anticipated that the Fund will be made operational in the near future with at least two private sector Participants.
2. In order to encourage the participation of private entities in the Carbon Fund, it has been decided to structure the Carbon Fund into two Tranches, with segmentation of the Participants, namely between those who wish their use of Emission Reductions (ERs) to be unfettered (unrestricted) and those who have restrictions on the use of their ERs.² It is expected that private sector Participants would belong to the unrestricted Tranche. Government Participants would likely make a choice between the restricted and unrestricted Tranche. The unrestricted Tranche will be named "Tranche A", and the restricted Tranche will be named "Tranche B".
3. It is the intention of the Carbon Fund Participants to make every effort to take decisions together in the Carbon Fund as a whole and to reach decisions by consensus, both in the Carbon Fund and in the individual Tranches.
4. However, in case all efforts at consensus have been exhausted, and no consensus has been reached, decision-making modalities need to be agreed.
5. The Charter currently states that, in the event of no consensus, decisions in the Carbon Fund shall be taken by a simple majority on the basis of one vote per US\$1 million contribution (Section 12.2). This part of the Charter (Article 12), which only refers to the Carbon Fund, can be amended with the unanimous consent of all Carbon Fund Participants (Section 21.1 (c) (ii)).

¹ All Section references in this note are references to the Charter of the FCPF available on the FCPF website at http://www.forestcarbonpartnership.org/fcp/sites/forestcarbonpartnership.org/files/Documents/PDF/Sep2010/FCPF_Charter-August_2010_clean.pdf

² These Carbon Fund Participants represent and warrant in the Participation Agreement that the Carbon Fund Participant's share of Emission Reductions will not be used for sale or for compliance purposes.

6. The Charter is silent on decision-making modalities within each Tranche. Therefore, these modalities need to be determined by the relevant Tranche Participants.
7. The Trustee is expected to define, *inter alia*, the purpose, establishment and terms of participation for each Tranche, in consultation with the Participants Committee (Section 4.2 (b)).
8. The Carbon Fund, including the establishment of the two Tranches, has been discussed in each Participants Committee meeting since October 2009 and in dedicated exchanges with civil society and Indigenous Peoples representatives since September 2010.³

Objectives of the Decision-Making Modalities

9. During recent discussions with existing and potential Carbon Fund Participants, it has become clear that the decision-making arrangements ought to pursue and balance the following objectives: (1) consensus building among the Participants; (2) learning-by-doing; (3) efficiency; (4) incentive generation; and (5) fairness.
10. Consensus should ideally be the way that most, if not all, decisions are made in the Carbon Fund. In spite of the variety of the Participants, it is important for the impact of the Carbon Fund's pioneering work that the Carbon Fund Participants' decisions are made jointly, whenever possible.
11. Learning-by-doing will be greater if different classes of Participants, in particular public and private, jointly take key decisions that come before the Fund. Given the pilot nature of the Carbon Fund and the importance of generating lessons for long-term financing of REDD+, enhancing understanding between the public and private sectors, and mutual recognition of their roles, would be desirable. This is best achieved if the Participants of the two Tranches of the Carbon Fund strive to arrive at joint decisions in the Carbon Fund Meetings.
12. The decision-making arrangements should be designed in such a manner as to allow the Carbon Fund to fulfill its mission at the lowest transaction cost possible.
13. The decision-making arrangements should create incentives for further contributions to the Carbon Fund.
14. Finally, the decision-making arrangements must protect the interests of Participants with a smaller share of the contributions while at the same time providing an incentive to increase contributions.

Proposed Decision-Making Modalities

15. It is the intention of the Carbon Fund Participants to make every effort to reach all decisions by consensus including on the selection of Emission Reductions (ER) Programs.

³ PC4, PC5, PC6, PC7 and PC8, and dedicated exchanges with civil society and Indigenous Peoples representatives in Washington, Accra, Vientiane and Lima.

16. However, in case all efforts at consensus have been exhausted, and no consensus has been reached, decision-making modalities need to be agreed.

17. Following recent discussions with the existing and potential Carbon Fund Participants, the FMT is proposing the decision-making modalities outlined in the following paragraphs.

All Decisions

18. As stated above, the Carbon Fund Participants will make every effort to reach consensus. If all efforts at consensus have been exhausted, and no consensus has been reached, the Participants will vote.

19. By default, all decisions, except for decisions that are specific to a Tranche as defined in paragraph 21, will be made in the Carbon Fund Meeting of all the Carbon Fund Participants.

20. If consensus cannot be reached in the Carbon Fund Meeting, the decisions to be taken by the Carbon Fund Meeting will be adopted by a simple majority of the votes cast by the Carbon Fund Participants, with this vote being tallied on the same two dimensions as described in paragraph 22, namely, one vote per Participant and one vote per US\$1 million contribution, with a decision requiring approval of a simple majority on both dimensions (i.e., a “double simple majority”).

Tranche-specific Decisions

21. As noted above, a decision regarding the inclusion of an ER program into the portfolio will initially be proposed to be made by consensus of the Carbon Fund Participants at a Carbon Fund Meeting. If consensus cannot be reached in the Carbon Fund Meeting with regard to the inclusion of an ER program into the portfolio, the decision will be made at the Tranche level. In any case, the following tranche-specific decisions will be taken by the Carbon Fund Participants in the respective Tranche:

- a. decisions on entering into ERPAs for these Tranche-specific ER Programs, and decisions to revise, extend or cancel these ERPAs;
- b. budget approval for these Tranche-specific ER Program design and supervision costs;
- c. decisions regarding the establishment of ad hoc Technical Advisory Panels (TAPs) for the Tranche-specific ER Programs.

22. Decisions listed in paragraph 21 will be adopted *by consensus in the respective Tranche* or, if consensus cannot be reached, by a two-thirds majority of the votes cast by the Carbon Fund Participants in the respective Tranche, with this vote being tallied on two dimensions, and a decision requiring approval of a two-thirds majority on both dimensions, as follows (“double two-thirds majority”):

- a. Based on allocation of one vote per Participant (thus protecting the interests of Participants with smaller contributions and putting them on an equal footing with Participants with larger shares); and
- b. Based on allocation of one vote per US\$1 million contribution (thus protecting the interests of larger Participants and also provide some incentive to increase the size of contributions to the Carbon Fund over time).

Decision Tree

23. To aid understanding of these different voting arrangements, a Decision Tree is attached in Annex I.

The Annual Budget Process and Apportionment of ‘Common Costs’

24. Shared Costs are the costs and expenses incurred in the administration of the FCPF, specifically Secretariat costs and REDD Methodology Support costs. Shared Costs reflect a specific subset of activities which do not include the direct country capacity building work of the Readiness Fund (e.g., grants and/or country advisory services or country implementation support). The Shared Costs comprise the support of the Secretariat (the Facility Management Team or FMT), e.g., organization of the Annual Meetings and other events, and a portion of the REDD Methodology Support work of the FCPF, reflecting for example the work to be done on pricing and valuation, General Terms and Conditions of ERPAs for REDD+, and ad hoc Technical Advisory Panels set up to review country proposals, mostly Readiness Preparation Proposals.

25. The Charter states that the Carbon Fund Participants will pay 35% of the Shared Costs, with the remaining 65% to be paid by the Readiness Fund, unless otherwise decided by the Participants Committee (Section 19.1(b)). The Participants Committee has subsequently agreed to cover all Shared Costs until the Carbon Fund is operational. The Participants Committee at PC8 further agreed that these costs be capped at US\$12 million over the full term of the FCPF (see Resolution PC/8/2011/8 ‘Capping Shared Costs for the Carbon Fund’⁴).

26. The portion of the Shared Costs as defined above in paragraph 25 is a charge to the Carbon Fund as a whole and therefore should be apportioned between the two Tranches of the Carbon Fund on an agreed basis (see paragraph 29 below).

27. Similarly, Carbon Fund Administration costs (i.e., costs relating to the Trustee/fiduciary role of the World Bank in relation to the Carbon Fund), are incurred on behalf of both Tranches and therefore should be apportioned between the two Tranches on the same agreed basis.

28. With regard to ER Program costs, if an ER Program is selected into the portfolio of both Tranches, it is proposed that costs are charged to the Carbon Fund as a whole and then apportioned between the two Tranches, again on the same agreed basis.

29. These costs described in the preceding paragraphs which are borne jointly by all the Carbon Fund Participants are to be defined in the Charter as ‘Common Costs’. The FMT’s proposal is that these ‘Common Costs’ are apportioned between the Tranches on the basis of relative capitalization levels of the two Tranches as of March 31 each year, unless the Carbon Fund Participants decide otherwise.

30. If one of the Tranches of the Carbon Fund buys a proportion of the emission reductions to arise from an ER Program that differs from its pro rata share of the total capitalization of the Carbon Fund as

⁴ Available at <http://www.forestcarbonpartnership.org/fcp/node/297>.

of March 31 in the preceding year by 5% or more, the ER Program costs shall be apportioned between the Tranches based on their respective shares in that ER Program.

31. If an ER Program is selected by one Tranche and not the other, all ER Program costs for that Program will be fully charged to the relevant Tranche.

Proposed Next Steps

- April 19: The FMT submits the revised FMT Note and the proposed Charter amendment to the Carbon Fund Participants for unanimous approval within 14 days (by May 3);
- May 4: Provided that approvals for the Charter amendment have been received from all existing Carbon Fund Participants, the FMT informs the Participants Committee that the Charter has been amended and distributes the Charter amendment to the PC for information.

Annex I: Decision Tree

FCPF CARBON FUND DECISION TREE

