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New Rules for the Joint Implementation Mechanism under Article 6 of the Kyoto Protocol in Russia

On October 28, 2009, the Russian Government adopted two new enactments relating to the development of joint implementation (“JI”) projects under the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the “**Kyoto Protocol**”) in the Russian Federation, namely:

- 1) Russian Government Resolution No. 843 “On Measures to Implement Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change” (the “**Resolution**”); and
- 2) Regulations “On Implementation of Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change” (the “**New JI Rules**”).

These two enactments have replaced two previous documents adopted by the Russian Government on May 28, 2007 (namely: Russian Government Resolution No. 332 “On the Procedure for Adopting, and Checking the Development of Projects Implemented Under Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change” and the Regulations “On Adopting, and Checking the Development of Projects Implemented Under Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change”, jointly – “**Resolution No. 332**”).

It is the general view that the New JI Rules finally completes the basis for JI projects in Russia. The below is a summary of the New JI Rules.

I. Summary of the New JI Rules

1. General Aspects

The New JI Rules differ from Resolution No. 332 in major aspects (such as the procedure for adoption of JI projects, the parties involved, responsibilities of the parties, etc.). This will have ramifications for project documentation prepared on the basis of the Resolution No. 332.

2. Parties Involved in the Implementation of JI Projects

The New JI Rules foresee the interaction of state bodies and private entities in the various activities required under the New JI Rules (such as approval of a JI project, issuance and transfer of ERUs, etc.):

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- 1) the Russian Ministry of Economic Development (the “**MED**”) performing the functions of a focal point (the “*Focal Point*”) pursuant to the Resolution;
- 2) OAO “Sberbank of Russia” (“*Sberbank*”) performing the functions of an “operator of carbon units”;
- 3) *Expert Council* formed by Sberbank with the consent of the Focal Point; and
- 4) Investor in a project.

Sberbank

The New JI Rules grant Sberbank important powers relating to the implementation of JI projects in Russia. Sberbank not only participates in approval of the projects or transfer of ERUs as described in section 3 below, but is also authorized to give its consent to the agreements between the project participants governing the transfer of ERUs between them. However, the procedure for giving such consent and the consequences of not obtaining such consent have not yet been defined.

Additionally, according to clause 28 of the New JI Rules, the procedure for determining the maximum fees under agreements governing the operations with carbon units is to be established by the MED. This clause, however, does not clearly state whether MED is authorized (i) to establish a limit for Sberbank fees for the services it will be providing to the project participants in connection with operations with carbon units (such as storage of ERUs, transfer of ERUs, etc.), or (ii) to establish a maximum price for ERUs. We believe that option (i) should apply, but only practice can show the real impact of this rule.

Investor in a project

According to the New JI Rules, only a Russian legal entity may be a project applicant which is defined as being the investor in the JI project (“**Project Investor**”) from the date of approving the project as JI project.

To be eligible for a JI project, as of the date of submitting the project application the project applicant must meet the following criteria:

- 1) no bankruptcy or liquidation procedure has been initiated against the applicant;
- 2) the applicant’s activity must not be suspended pursuant to the Russian Code on Administrative Offences;
- 3) the applicant must not have outstanding debts on taxes, duties and other obligatory payments to budgets of any level or state non-budget funds for the previous calendar year; and
- 4) the applicant must have the right of ownership over, or other proprietary rights in, the facilities at which the project is to be implemented.

Criteria 1 and 3 above do not apply to entities included in the list that might be adopted by the Governmental Commission on Increasing the Stability of the Russian Economy.

3. Implementation of a JI Project

According to the New JI Rules, implementation of a JI project consists of the following major stages:

- 1) selection of the project applications and approval of a project;
- 2) implementation of a JI project; and
- 3) issuance and transfer of carbon units.

Selection of the Project Applications and Approval of a Project

The project applications are to be selected on the basis of tenders arranged by Sberbank pursuant to the rules to be adopted by the Focal Point. Such rules should, inter alia, provide for (i) the limit of emission reduction (absorption) units which may be issued based on the results of the implementation of projects approved (the “**Tender Limit**”); and (ii) criteria for selection of the project applications (including the criteria of energy and ecological efficiency of the anticipated results of the investment activities under the project, as well as criteria of applicant’s technical and financial potential for achieving the declared project results and the anticipated economical and social effect from the project’s implementation).

The project applications submitted to Sberbank should include, inter alia: (i) the project documentation developed in accordance with the legislation on investments, and international rules; (ii) a positive determination report prepared by an independent entity (determinator) chosen by the applicant; and (iii) materials confirming the applicant’s compliance with the requirements of the New JI Rules (including those relating to the applicant’s technical and financial potential to achieve the declared project results and the anticipated economical and social effect from the project’s implementation). Within five business days from the date of receipt of a project application, Sberbank decides on its compliance with the tender rules and notifies the applicant on acceptance of the project application or a motivated rejection.

Tenders in fact constitute an expert evaluation of the project applications by Sberbank and the Expert Council. The results of evaluation as well as recommendations of the Expert Council are recorded in a protocol which is to be submitted to the Focal Point for approval within three business days from the date of the meeting of the Expert Council.

Within 10 business days from the date of receiving the protocol, the Focal Point makes a decision on approval of the projects, or sends a motivated refusal to Sberbank. The basis for refusal may only be violation by Sberbank of either the tender rules (affecting the tender results) or the New JI Rules.

Approved projects are to be registered in the register of projects maintained by the Focal Point. The register of projects includes, inter alia, information on the planned volume of greenhouse gases emission reductions (absorption).

Implementation of a JI Project

The project is to be implemented in accordance with the project documentation approved.

Any deviations from the project terms or stages set forth in the project documentation are to be reported by the Project Investor to Sberbank. Subject to agreement with the Focal Point, the Project Investor may introduce changes in the project that do not impair the project's energy and ecological efficiency.

Before September 30 each year, the Project Investor submits a report on the project's implementation to both the Focal Point and Sberbank, which report should, inter alia, contain an expert opinion on the project's implementation including a verification report prepared by an independent entity chosen by the Project Investor (the "**Expert Opinion**").

During the year, the Project Investor may also submit interim reports on the project's implementation.

Issuance and Transfer of Carbon Units

Upon the projects' approval, the Focal Point decides on transfer of AAUs in the amount corresponding to the Tender Limit to the account of Sberbank in the Russian register of carbon units.

Subject to a positive Expert Opinion and a request from the Project Investor, within five business days from the date of the request the Focal Point decides on issuance of ERUs (by transforming corresponding AAUs reserved on the account of Sberbank) in the amount corresponding to the projected volume of emission reductions but no more than the volume indicated in the project documentation. Such ERUs are to be credited to the Sberbank account in the Russian register of carbon units.

Sberbank transfers ERUs relating to a JI project to the account of a third party based on (i) a request from the Project Investor; (ii) a report on the project implementation; and (iii) an agreement between the Project Investor and the third party, to which agreement Sberbank's consent has been obtained.

4. Withdrawal of a JI Project's Approval

The Focal Point may exclude a project from the register of projects in the following cases:

- 1) repeated (i.e., more than twice) missing of deadlines for submitting reports on project implementation;
- 2) a negative Expert Opinion on the report on project implementation; and
- 3) liquidation of the legal entity being the Project Investor.

For more information, please contact: II. Taxation

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The New JI Rules like Resolution No. 332 do not contain any specific provisions on taxation of operations performed under agreements covering a JI project. Therefore, the general rules of Russian law should apply, depending on the particular agreements governing the relationship of the parties to a JI project.

For questions, please call the lawyers of the Climate Change and Energy Efficiency Practice Group at the Moscow Representative Office of Baker & McKenzie, through either Max Gutbrod, Partner, or Sergei Sitnikov, Associate, at +7 (495) 787 27 00

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