

Kyoto Protocol: Ukrainian Aspects of Implementation

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Both Ukrainian companies and government authorities are starting to realize that inefficient use of energy resources negatively influences the competitiveness of Ukrainian companies on international markets. Regardless of the credit crunch's challenges, a number of Ukrainian companies are following their earlier agreed plans on implementation of energy-efficiency programs. In the course of implementation of such programs the companies may obviously benefit from carbon trading schemes. In this article we provide a brief overview of the existing legal framework for carbon trading in Ukraine and reveal a few existing uncertainties and irregularities regarding applicable regulations in Ukraine.

General Information

Ukraine ratified the *United Nations Framework Convention on Climate Change* (the UNFCCC) on 29 October 1996, the *Kyoto Protocol to the UNFCCC* on 4 February 2004 (which became binding from 16 February 2005) and is presently considered to have one of the world's greatest potentials for the production of emission reduction units (ERU) through Joint Implementation projects (JI Projects). However, so far only a small fraction of this potential is being implemented. At present only tens of projects are in the process of qualification as JI projects in Ukraine since relatively few Ukrainian businesses seem to be aware of the potential value of Kyoto carbon credits.

Legal Framework

Ukrainian authorities had been rather active in developing and adopting legal regulations for implementation of the the Kyoto Protocol in Ukraine. The main normative act in the existing Ukrainian legal and regulatory framework for procedure of JI projects implementation is the Decree of the Cabinet of Ministers *On the Procedure for Appraising, Approving and Implementing Projects Aimed at Reducing the Volumes of Anthropogenic Emissions or Increasing the Absorption of Greenhouse Gases in Accordance with the Kyoto Protocol to the UN Framework Convention on Climate Change of 22 February 2006, No. 221* (Project Approval Decree).

Government Authority

The National Environmental Investments Agency of Ukraine (NEIA) was established as the central coordinating authority for the implementation of the Kyoto Protocol in Ukraine and was exclusively authorized to approve JI Projects, while the Ministry of Environmental Protection has certain general supervisory powers over the activity of NEIA.

Overview of Joint Implementation Projects Submission Procedure

The effective Ukrainian normative acts regulating the disposal of ERUs are incomplete, leaving unsolved a range of issues on the transfer of ERUs. According to the Projects Approval



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Decree, the transfer of ERUs from the Ukrainian National Registry for Anthropogenic Emissions and Greenhouse Gases Absorption (National Carbon Registry) to the registry of a partner country can be carried out only if a number of conditions are met, including the following: (1) an actual reduction (absorption) in greenhouse gas emissions is reached as a result of the JI Project's implementation, (2) the submission of the report on the results of the verification and monitoring of the scope of anthropogenic emissions reduction or absorption of greenhouse gases (Report) to the NEIA (such reduction and absorption shall be achieved due to the implementation of the JI Project by the owner of the source of emissions of greenhouse gases), and (3) the receipt of a Letter of Approval from the authorised body of the partner country certifying the consent of the partner country to the receipt by its registering authority of the ERUs to be transferred.

The Report should be submitted by the enterprise on the territory of which the source of emission of greenhouse gases is located (which is a Ukrainian project participant or the Seller) and is subject to registration by the NEIA. An accredited independent entity should carry out the monitoring for the Report. In addition, the Seller of the ERUs shall obtain a Letter of Approval from the appropriate Ukrainian authorities, where the total amount of ERUs being transferred pursuant to such approval and reference to the JI Project resulting in the creation of such ERUs shall be indicated.

The NEIA is the body authorised to register a Report, ERU purchase agreement and the Letter of Approval. The amount of ERUs to be transferred should be indicated in the agreement on their transfer or sale and purchase and should be equal to or less than the amount of the ERUs generated as a result of the implementation of the JI Project. The actual transfer of the ERUs is also subject to the prior payment of the fees for the registration of the agreement on the transfer of said ERUs with the rates of such fees to be established by the NEIA.

Practical Issues of Projects Implementations

Applicable Exchange Control Provisions

According to the *On the Procedure of Settlements in Foreign Currency Act of Ukraine of 23 September 1994, No.185/94-BP* and the latest amendments of 23 June 2009, Ukrainian residents shall receive payments for export of goods or works/services into their foreign currency accounts with Ukrainian servicing banks within 90 calendar days. Failure to comply with the mentioned requirement shall lead to imposition of a fine. However, at present it is unclear whether for the purpose of currency exchange control the ERUs should be treated as goods or works/services.

As a possible solution to the problem, one may include a clause into the ERU Purchase Agreement on obliging the Purchaser to reimburse any fines imposed on the Seller. Another option in this case is to apply to state authorities for an extension of the mentioned 90-day period.

Transfer and Acceptance of ERUs

The mechanics and procedure of ERU transfer is not currently regulated by effective Ukrainian legislation. The effective regulations only state that ERUs may be transferred between registries.

The effective legislation implementing the Kyoto Protocol in Ukraine provides that only the owner of the facility where the JI Project is implemented (as the Seller) can apply for and have the ERUs credited to its account in the National Carbon Registry by the NEIA. Only after issuance of such ERUs and their crediting to the account of the Ukrainian project participant can they be transferred to the corresponding account of the foreign project participant which is the Buyer.

At present the Seller is the only person eligible to apply to the NEIA for such a transfer. Although the Seller is not expressly prohibited from authorising any other entity to apply for such transfer on the basis of a power of attorney, under Ukrainian legislation such powers of attorney cannot be issued as irrevocable ones.

Therefore, there is a potential risk that the Seller may subsequently breach its contractual obligations and refuse to apply for the transfer of the ERUs to the Buyer or transfer such ERUs to any third party. Unfortunately, no effective non-judicial security for the protection of rights of the Buyer in such cases is currently available in Ukraine, although certain types of pledge can be used to significantly strengthen the position of foreign participants.

Pledge of ERUs

To secure the proper performance of the Seller's obligations under an ERU Purchase Agreement, a pledge over ERUs may be provided to the Buyer. Effective Ukrainian legislation does not expressly refer ERUs to any specific types of property or provide for the possibility of their pledge.

However, we believe that Ukrainian legislation implicitly appears to provide for such a possibility and a pledge over ERUs, disposed of or generated in the future, as movable prop-

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erty, may be registered with the Registry of Encumbrances of Movable Property if it is expressly provided for by the ERU purchase agreement. However, we are not aware of any precedent for a pledge of ERUs.

Recent Developments in JI Projects Implementations

Since the Kyoto Protocol is set to expire at the end of 2012, the Cabinet of Ministers of Ukraine recently adopted the *Regulation of 25 November 2009, No.1313*, governing the procedure of application for and transfer of ERUs generated after 2012 through JI Projects and state assistance in implementation of JI Projects, which is expected to provide more security for investors in the JI project in Ukraine.

To sum up, development and implementation of carbon trading should become a trend in Ukraine, although a number of legislative uncertainties still undermine this process. Due to the complexity of contractual arrangements and structuring of JI Projects, their implementation depends greatly on proper legal assistance. Except for being engaged in general issues of the JI Project, the legal advisor shall be involved in drafting the term sheets for initial negotiations of the Projects, drafting the ERU purchase agreement with all relevant security agreements and conducting a Due Diligence investigation of the perspective Seller of the ERUs.