

## **Financial Mechanisms**

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### **Introduction**

The Legal Response Initiative (LRI) received and answered 5 questions on financial mechanisms during the Barcelona meeting. These were not, as anticipated, about the terms on which finance would be provided, but instead about the consistency of the proposed mechanisms with the provisions concerning funding contained in the UNFCCC and the level of control that might be exercised over any fund.

### **Funding under the UNFCCC and relevance to proposed new mechanisms**

Article 11(1) of the UNFCCC provides:

*“a mechanism for the provision of financial resources on a grant or concessional basis, including for the transfer of technology, is hereby defined. It shall function under the guidance of and be accountable to the Conference of the Parties, which shall decide on its policies, programme priorities and eligibility criteria related to this Convention. Its operation shall be entrusted to one or more existing international entities.”*

Questions included whether proposals for new funding mechanisms might contravene, or require amendment to, Article 11(1). Clarification was also sought as to whether the operating entities for such mechanisms would qualify as “existing international entities” and what their relationship to the COP should be

The legal analysis explained that new funding mechanisms can be structured without reference to Article 11(1) for their legitimacy. For example, both the Kyoto Protocol Adaptation Fund and the Adaptation Fund Board (“AFB”) are created under the authority of Article 12(8) of the Kyoto Protocol and relevant decisions. This is discussed further below. A new funding mechanism that did rely on Article 11(1) for its authority would have to comply with its terms, which may need amendment in order to accommodate the circumstances.

### **Existing international entity**

Certain proposed funding mechanisms clearly involve new operating entities and these would need to derive authority from a source other than Article 11(1) unless it were amended. Questions were also asked about the status of the UNFCCC COP and Secretariat with a view to their capacity to take on the role of operating entity.

An “international entity” should possess certain characteristics, namely, (i) it should be a permanent association of states, (ii) there should be a distinction between its legal powers and those of member states, and (iii) its legal powers should be exercisable on the international plane rather than solely in national jurisdictions.

The weight of opinion suggests that the COP itself may be an international entity whereas the Secretariat is not. There is doubt, however, as to whether the COP could be said to have been ‘existing’ at the time the UNFCCC came into force. Using principles of international treaty interpretation, it was noted that the negotiations which preceded the adoption of the UNFCCC revealed an explicit preference for using existing mechanisms such as the Global Environmental

Facility (“GEF”) rather than new bodies. The COP came into being with the signing of the UNFCCC itself, ie. concurrently with Article 11(1) coming into force and is difficult to characterise as ‘existing’ within its terms.

### **Authority/Guidance by the COP**

The weight of opinion is that language such as “under the guidance of” is weaker than “under the authority of”. The GEF, for example, acts under the guidance of the UNFCCC COP and has a degree of independence concerning how goals will be achieved. By contrast the relevant fund under the Montreal Protocol operates “under the authority of the Parties which shall decide on its overall policies”. The Parties under the Montreal Protocol were thought to have more direct engagement with and influence over that fund than is the case with the GEF.

### **Fund created by COP decision**

A COP decision can be the basis for the creation of a funding mechanism as the operational entity, although this may be a weaker basis than a specific provision in a relevant treaty. The latter binds the parties to the treaty according to its terms, whereas the strength of a COP decision depends on the powers given to the COP by the parties and such decisions can expire or be superceded.

A COP decision can also be the basis for nominating a mechanism that already exists under a particular international agreement to serve as the funding mechanism under a new international agreement. This would, however, need the agreement of the prior agreement’s Parties and the relevant fund’s board, as well as requiring amendments to its constitution.

Certain other relevant issues are discussed below in the context of the position of the Kyoto Protocol Adaptation Fund and the AFB.

### **Kyoto Protocol Adaptation Fund and AFB**

Article 12(8) of the Kyoto Protocol provides:

*“The [CMP] shall ensure that a share of the proceeds from certified project activities is used to cover administrative expenses as well as to assist the developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation.”*

Note that, in contrast to Article 11(1) of the UNFCCC, which defines the relevant finance mechanism, Article 12(8) of the Kyoto Protocol merely states that funds will be distributed without saying how or by whom.

A number of decisions pursuant to Article 12(8) were used to create the Adaptation Fund and the AFB to administer it. The basis for the Adaptation Fund was changed, possibly to reflect concerns about the requirements of Article 11(1).

Originally, Decision 10/CP.7 decided that the Adaptation Fund should be operated by “an entity entrusted with the operation of the financial mechanism of the Convention, under the guidance of the COP/MOP.” This would require such an entity to fulfil the criteria set out in Article 11(1) regarding being an ‘existing international entity’. The present AFB was set up as a new entity at the Bali conference by Decision 1/CMP.3 and would not comply with such criteria. However, the basis for the Adaptation Fund was revised in Decision 5/CMP.2 which provides merely that the fund “*should operate under the authority and guidance of and be accountable to the COP/MOP.*”, with which criteria the AFB complies. The Parties to the Kyoto Protocol had more room for manoeuvre under Article 12(8) than they would have done if the more prescriptive Article 11(1) had applied.

The UNFCCC is the framework convention within which the Kyoto Protocol was agreed and also for any new agreement at Copenhagen. Care needs to be taken with dealing with inevitable overlapping of issues, but a new treaty or protocol can make provision for a new funding mechanism which could be set up according to the new agreement's terms rather than Article 11(1).

The question was also asked whether the AFB itself could function as the operating entity for any new funding mechanism that is created in any new Copenhagen treaty or protocol. An immediate issue is the lack of participation by the US and others in the Kyoto Protocol and the AFB. For example, Article 13(2) of the Kyoto Protocol prevents non-parties from participating in decisions. Assuming the required willingness to collaborate on the part of the relevant parties, it would be possible to amend the AFB's constitutional arrangements to provide for input by the US and others on non-Kyoto Protocol matters. This would, however, be complex and time-consuming<sup>1</sup>. In any event, the US may be unlikely to submit to such an arrangement for as long as it declines to ratify the Kyoto Protocol. The AFB model could be retained for Kyoto Protocol purposes and replicated for the purposes of any new LCA agreement, but this raises issues of duplication and waste.

If the parties at Copenhagen do identify a preferred funding model and there is sufficient political support for it, they are free to decide that it should become the funding model for all climate change related purposes. Following such a decision, the parties would have to take the various steps necessary to redirect funds to the new model and, where necessary, to wind up existing funds.

*This summary will be updated following the Copenhagen summit.*

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<sup>1</sup> Amendments to the Kyoto Protocol, for example, require 6 months prior notification.