

Developing host country legal frameworks for the CDM

A case study from Zambia

Background

CDM has developed global project pipeline of **4200** out of which **2344** are registered

CDM growth concentrated in China, India, Brazil & South Korea, hosting **77.12%** of global projects

Other developing countries (Sub-Saharan Africa lagging behind hosting **1.96%** (46 projects) ¹

Background

Reasons for the disproportionate CDM project growth

Developing countries:

Lack of financing (a major reason) 2

World Bank and other global financing institutions:

Lack of strong and conducive legal frameworks

Predictable and strong legal regimes are foundation for economic growth and investment

Developing a CDM legal framework

International and domestic CDM legal requirements

Rules for developing CDM projects and trading in CER's set out in the Kyoto Protocol and Marrakesh Accords

CDM projects also subject to host country legal systems

Both are important considerations for establishing a CDM legal framework

Developing a CDM legal framework

International legal requirements

- Ratification of UNFCCC and Kyoto Protocol
- Establishment of DNA
 - Legal basis of DNA and decisions
(Sound legal foundation & institutional mandate)

Domestic legal systems comprises

- Legislation relevant to and impacts on CDM project development
 - Effectively support and promote CDM project development

Developing a CDM legal framework

International legal requirements

(Legal basis of DNA and decisions)

Paragraph 39 of Decision 17/CP.1

Governments of CDM host countries party to the Kyoto Protocol have authority to approve CDM projects and transfer CER's

DNA's act on behalf of host governments when Issuing letters of approval/endorsements

Developing a CDM legal framework

International legal requirements

(Legal basis of DNA and decisions)

To act as an effective agent of host government and grant rights to transfer CER's DNA must have sound legal authority

Without legal recognition:

Future inter-ministerial or political changes could lead to reversal of prior project approvals or DNA's decisions

Developing a CDM legal framework

Legal basis of the **Zambian DNA**

- UNFCCC and Kyoto Protocol ratified in 1993 and 2006 respectively
- DNA established under MTENR in 2007

However:

- DNA has no specific and explicit legal authority 3
- Approval procedures and decisions not backed by legal instrument
- DNA operates on Adhoc basis

Despite official recognition, DNA lacks unequivocal sound legal foundation and institutional mandate

Developing a CDM legal framework₄

Domestic legal system (Identifying CDM-related laws)

First step: Determination of legal issues in CDM project Implementation 5

Most cited legal issues relate to:

- Foreign direct investment
- Property rights (title to CER's and land)
- Taxation of CER's and CER revenues
- Classification of CERs
- Environmental management

Foreign Direct Investment

Foreign Direct Investment (FDI laws) may:

- Require government approval for foreign investment
- Impose restrictions on foreign ownership of assets e.g. land
- Impose higher taxation rates on the investment
- Restrict repatriation of profits through foreign exchange controls

FDI regulations should be managed in a way that does not unduly hinder investment

Zambian Foreign Direct Investment Law

The Zambia Development (ZDA) Act

- Foreign or local investors may invest in any part of Zambia or any sector and industry 6
- No compulsory acquisition of property **except** for public purposes under an Act of Parliament providing for payment of compensation
- No restrictions on land ownership by foreign investors
- No restrictions on repatriation of funds
- Certain sectors & products offered priority treatment -tax incentives)

Zambian Foreign Direct Investment Law

The ZDA provisions:

- Useful mechanisms for attracting investment
- Key considerations for investors

However: Investment promotion provisions in the Act do not embrace the CDM

E.g. Priority sectors in the Act possible hosts for CDM Projects 7 but CDM not specified as such a sector

Property ownership

In particular:

- Legal ownership of CERs
- Ownership of land where project is to be located

1. Legal ownership of CER's

- Allocation of title to CER's and revenues from CER sales
- Transferability of such title

Property Laws

Lands Act -Principal law dealing with property in Zambia

Land is:

“any interest in land whether the land is virgin, bare or has improvements, but does not include any mining right” 8

CER's are not covered by the definition of land

Treatment of the rights to CERs (allocation of title and transferability) uncertain

Property ownership

International law presumption 9: The host country
Having agreed to be bound by the Kyoto Protocol:

- has sovereign rights to GHG reductions and CER's achieved by CDM projects hosted within its jurisdiction
- may transfer these rights to authorized project participants through Letters of Approval

Despite the presumption, uncertainty may still persist about security of title to CER's and prevent CDM project development 10

Property ownership

Added dimension:

Argument that reduction of GHGs is the management of a natural resource; responsibility and property of host government

Host government may treat CER's as sovereign rights that can only be owned and traded for profit by itself

Hence need for absolute clarity

Property ownership

Impact of other property right holders on CERs

(where project developer does not own land on which project is built)

- Q: Whether property law confers on the landowner any rights in respect to the project or the CERs
- OR allows the landowner to secure such rights

If property law confers or has potential to confer competing rights to CERs; project developer can not secure full proprietary rights to CERs

Project developer may find it difficult to sell the CERs 11

Property ownership

Sale of CERs are key source of revenue and financing for CDM project and means of obtaining additional debt equity finance

Obstacles to the sale of CERs may be obstacles to the broader financing and viability of project

Property ownership

Security of title to land in Zambia 12

The Lands and Deeds Registry Act:

Certificate of title is issued following successful registration of documents of transfer of land

Certificate of title:

- Is conclusive evidence of ownership of respective land
- Protects the registered proprietor against ejection and adverse possession 13

Land rights adequately protected & title demonstrable

Property ownership

Proprietary rights to GHG reductions

Q: Whether property law provides for the taking of proprietary rights to GHG reductions achieved on a piece of land **separately** and **distinctly** from other rights attached to such land 14

Argument: Since trees located on a piece of land can be classified as a resource forming part of the land...

GHG reductions & related CERs achieved through sequestration of CO₂ in trees in a forestry CDM project can be construed as property of the landowner

Property ownership

Proprietary rights to GHG reductions Contd.

Definition of 'land' in the Zambian property law does not include GHG reductions

Possible interpretations:

- Land rights are separate from those relating to GHG reductions
- Interpret 'Improvements' broadly and argue that they include GHG reductions

Hence need to clarify whether title to GHG reductions is separate from title to land on which the project is located

Property ownership

Foreign ownership of land in Zambia

The Lands Act allows foreign ownership if the foreigner is:

- a permanent resident
- an investor in terms of the ZDA Act
- a company registered under the Companies Act
- a statutory corporation or a cooperative society
- a registered Bank or
- the President gives his consent etc

ZDA Act also allows foreign land ownership

Property ownership

2. Legal ownership of land

Key issues:

Security of title to land (CDM project location)

- Are land rights adequately protected
- Is security of title demonstrable

Proprietary rights to GHG reductions

Foreign ownership of land

Customary land rights

Property ownership

Customary land rights in Zambia

The Lands Act

- Explicitly acknowledges informal land uses regulated by customary law ¹⁵
- Recognizes the right of persons to hold land under customary law

Customary law challenges:

- Customary tenure not formally recorded
- Customary title unregistered difficult to characterize
- No clear boundaries between customary land holdings-overlaps between holdings

Property ownership

Customary law challenges contd.

- Needs direct engagement with local land owners to determine applicable customary land law & secure title
- Possibility of traditional leader claiming title to CER's in return for land use
- Difficulties in enforcing rights where dispute or competing interest arise

These challenges can hinder CDM project devl. and implementation

Classification of CERs

Status of CERs has impact on CDM project devl.

Classification of CER's is not specified by CDM Rules (determined by Host Countries)

Importance of classification (different Legal implications and requirements)

Two options for classifying CERs (Securities or Commodities)

Classification of CERs

Securities subjected to rigorous regulatory and legal requirements (licensing and registration)

- Long procedures involved

(may delay and increase transaction costs)

If CER's are treated as securities it may be difficult to transact their sale

Commodities are easier to trade and regulation is less rigorous

CER Classification in Zambia

Commodities are governed by the **Control of Goods Act**

“any manufactured or unmanufactured commodity or class of such commodities.”

Securities Act regulates securities (shares, debentures, stocks or bonds)

CERs not classified under any of the two Acts

Taxation

Trading in CER's is likely to attract some form of taxation

Potential ways of taxing CER's:

- Through direct taxes by retaining proportion of issued CER's
- Taxing the CER revenues
- Taxing indirectly through VAT imposed on goods and services

Zambian tax laws

Income Tax Act: Tax paid by individuals and companies on income from a Zambian source

Value Added Tax Act: Taxation of supply of goods and services & on imported goods

Property Transfer Tax Act: Tax charged on the Value realized from the transfer of certain property

Other taxes but these are the mainstream taxes specifically relevant to CDM

Zambian tax laws

Definition of 'income' in the Income Tax Act does not include CER revenues

No reference to CERs in the VAT or the Property transfer Act

Therefore treatment of CERs for taxation purposes is unclear

Expropriation

Expropriation important in CDM context because of the International Law presumption on host country's sovereign rights over GHG reductions and CERs

The international law presumption:

- allows CDM host governments' broad discretion in regulating trade and possession of CER's
- may create uncertainty about the circumstances in which project developers' rights to CER's would be expropriated
- may significantly hinder investment in CDM project development

Expropriation in Zambia

Constitution of Zambia

Article 11 provides the right of every person in Zambia to “protection for the privacy of his home and other property and from deprivation of property without compensation”.

Article 16 “property of any description shall not be compulsorily taken possession of, and interest in or right over property of any description shall not be compulsorily acquired, unless by or under an Act of Parliament Which provides for payment of adequate compensation for the property or interest or right to be taken possession of or acquired”

The protection is complemented by property and investment laws that provide protection for property rights

Environmental management

Environmental laws and regulations are relevant to CDM projects because of EIA & Licensing Reqs.

Process of complying with these requirements can either enable or hinder CDM investment

Environmental management in Zambia

Environmental Protection & Pollution Control Act (EPPCA) Principal legislation incorporating EIA Regulations

Environmental management in Zambia

- A project developer must engage consultants
- ECZ must approve consultants prior to commencing
- Project developer pay consultants & ECZ application fees
- Processing of applications longer than prescribed period
- CDM projects treated the same way as conventional projects 16
- EIA must be done prior to submitting PDD to DNA

Environmental management

Additionally:

- Environmental permits, planning approvals and other licenses may be required to construct or operate a CDM project
- Certain projects may require different permits (with different costs, conditions and authorities)
- Environmental Permits and other licenses need annual renewal (penalties for failure to renew in time)
- An authorizing agency may require additional procedures to be undertaken

Complying with EIA & licensing regulations in Zambia is **costly** and **lengthy**; Can discourage CDM investment

Conclusion

- Zambian government keen to participate in the CDM: (ratification of UNFCCC & KP)
- DNA lacks well founded legal authority
- Conspicuous lack of recognition of GHG reductions and CER's by all the relevant laws
- CDM a relatively new concept; not envisaged when enacting Zambian laws
- Issues of ownership dominate discussion on the legal framework (Investor interests)
- Need to address gaps in legal framework

Way Forward for Zambia

Action taken so far...

- Review of Zambian legal framework undertaken 16
- Presentation of report to DNA and other relevant stakeholders for comments and approval
- Report and recommendations accepted
- Submission of report to MTENR for further action
- MTENR to liaise with Ministry of Justice

Recommendations (separate presentation)