

Contractual arrangements for the implementation of forest carbon schemes with emphasis on REDD schemes in Peru: *Legal and institutional considerations.*

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The relationship between avoiding deforestation of forests and dealing with climate change in developing countries has become an interesting opportunity among the various stakeholders linked to the management and conservation of forests. This also implies an opportunity to link two significant objectives for the planet, the preservation of forests (as the main sink-source of ground carbon) and the mitigation of climate change.

In Peru, the opportunity to create incentives for the conservation of natural forests draws special interest, due to the significant extension of their natural forests (especially Amazon forests) in the country. Peru ranks second in terms of the area of Amazon forests, after Brazil, with approximately 70 million hectares of forests (approximately one third of the national territory). It is also worth noting the relationship between the conservation of forests and the AFOLU projects in general and the improvement of life quality of Peruvian citizens who are directly related with this ecosystem.

Talking about forest carbon, one the most significant opportunities in Peru is found in mechanisms such as reduce emissions from deforestation and degradation - REDD, where the natural forest coverage capacity to store carbon is valued and used as an offset and thus, we will focus specifically on this field in the document herein.

The possibility to provide incentives of this type has given rise to a large debate about the arrangements that should be included, both at regulation and institutional levels, which will influence contractual instruments. Thus, one of the objectives of this paper is to describe the main contractual issues required in order to implement this type of projects².

1. The need of a contract for a REDD scheme

As in any new and innovative arrangement between two or more parties the establishment of REDD schemes requires at least: (a) the objective of the contract, (b) identification of the rights of the parties, (c) reciprocal obligations, (d) activities (e) governance, (f) conflict resolution mechanisms and risk management provisions, among others, in order to grant legal security to this arrangements.

¹ Peruvian Society for Environmental Law. This paper was prepared with the support of Milagros Sandoval D., Lawyer of the Forestry Program at SPDA.

² It is worth mentioning that this document has as background a study performed for the CCBA, which had a preliminary analysis of the institutional and regulatory problems and, of the instruments for forest management in order to benefit from the incentives of REDD, specially about Peruvian perspective.

The need of a contract is also explained by the fact that conserving forests in Peru implies significant social, environmental and traditional issues which should be considered when elaborating the legal arrangements necessary to implement these projects.

These legal arrangements should also consider the causes that originate deforestation and degradation processes in Peru in order to regard them as potential threats to project implementation. The lack of enforcement of forestry and environmental regulations and the lack of capacities of the State to enforce these (due to financial and infrastructure problems, among others) is one of the biggest threats forest conservation faces nowadays.

The struggle between forestry conservation policies and diverse public policies that promote land use change is also considered an important threat that projects need to confront. Governance and legal security can be considered as solutions to these problems.

Contractual arrangements are required for the set of *to do and not do* activities/obligations that should be considered in the relationship established between the use of the soil and the reduction of emissions. There are core subjects to be considered in this contract that will be explained in a list, with the relevant recommendations. Therefore, we will discuss the main contractual aspects which we believe are indispensable in preparing a contract of this nature. We think these aspects, for the two more likely types of carbon contracts that could be implemented: spot contracts or forward contracts (similar to ERPAs within Kyoto Protocol).

2. The parties in this contract and the participation mechanisms

The State

Although the State is not necessarily one of the signing parts of the contract it is important to explain its relevance in the establishment of PES schemes.

The Constitution of 1993, states that forests (soil, trees, fauna, biodiversity, the whole ecosystem) are national heritage of the Nation and as such. Considering this mandate, private ownership over natural resources in their natural state is prohibited. However, the State can grant rights (different from property rights) in order to promote sustainable management and conservation of these resources by private entities.

Nowadays, rights granted over forests, have not included the granting of rights to benefit from the environmental services these provide.

Therefore, as a basis for the subscription of a contract with any individual that has been granted rights over forestry resources by the State, it is necessary that the State expressly stipulates that it has granted the negotiation rights. The granting of these rights should be given in coordination between the environmental national authority (ecosystem services value and climate change authority) and the forestry authority (forests and deforestation).

Provider

One of the first questions that arises at this point is who is considered provider of the ecosystem services. In other words, who holds rights over the conservation and sustainable management of natural forests? This information is necessary in order to clarify who will be considered provider of the ecosystem service.

Considering the important activities implemented by forest concessionaries (established by the Forest and Wild Fauna Law, enacted by Legislative Decree 1090, amended by means of Law 29317) which include preventing illegal logging, establishing sustainable management practices through forestry management plans, among others, these forestry right holders can be considered providers of ecosystem services.

It is also important to consider the area extension where sustainable management and conservation practices are being implemented:

- In permanent production forests where some of these concessions are granted add up to approximately 20 million hectares. Of this important extension, 7 million hectares have been granted under the figure of timber concessions (thus the possibility of granting more forestry concessions is still open).
- In the case of non timber concessions we can identify several categories among which we find: other non timber product concessions, concessions for ecotourism and concessions for conservation, that together sum up more than one million hectares.
- In forests of native communities (indigenous people) we find approximately ten million hectares, which in the case of natural forests are granted to various native communities by means of contracts of assignment in use which do not imply granting property rights.
- In forests in private lands, where we find some cases of forest conservation initiatives on volunteer basis implemented in Peru, through tools such as private conservation areas and conservation easements

Finally, but not least important, it is important to mention the natural forests within the National System of Natural Protected Areas which sum many million hectares, with important parks and reserves involved. In these areas there are mechanisms for participation of the civil society for the administration (execution of the area master plans) within the framework that is currently exploring the implementation of forestry carbon schemes– REDD.

The above mentioned right holders have been identified as providers of ecosystem services considering they hold rights over the sustainable management and conservation of forestry resources.

However, many other ecosystem service providers probably exist. The problem that arises here is that many of these do not have rights granted over forestry resources, how could they be granted rights to benefit over the ecosystem services? This is an issue that should be considered by the Ministry of Environment, public institution that regulates the ecosystem services.

Buyer

Buyers should consider the legal and institutional framework of environmental services. Under this premises they should structure the negotiation with the ecosystem services right holders.

Because of the complexity of the relationship into a PES scheme like this, there may be several contracting levels; for example the ones that involves project design services and/or finance, project developers, business support services, brokers. And also is important to point out the above said necessity to an authorization by the Regulatory Agency (Environmental Ministry) that could be another kind of contractual document.

However we will focus on the contractual arrangements between buyer(s) and supplier(s), because we consider this relationship the most important level of transaction, and the one that will determinate the organization of the all scheme.

3. Rights over the forests and rights over environmental services

As we said above, at present, the rights over the forests do not expressly include the right of the holder to benefit from environmental services (carbon fixation) of the forest. In this theme, there are some uncertainties about what specifications need to be addressed within the authorization or permit to negotiate the carbon from the State. The retribution for the State is one of the most important. Due to the expectation created by the funding that could get by these contracts, the State wants to know what will be their participation in the sharing of benefits.

In addition of authorizations of the State, there are other preconditions to the establishment of the contract like: (a) the accomplishment of project goals (like number of years of successful implementation of a management plan in a concession), (b) legal opinions about rights, land tenure, others rights involved in the area, (c) proper registration and validation by the authority (if it is necessary) of the project or the rights and titles involved.

4. Building the Project contractual framework

We would like to explain the necessary contractual arrangements so that the holder of a right or competency over the forest can carry out a forestry carbon scheme.

4.1. Purpose of the contract

The main objective of the contract is to assure the continuity and permanence of the forest and the activities involved in the implementation of the carbon scheme. In other words, the idea is to link the AFOLU and conservation activities to the incentive mechanism, with appropriate rules, obligations and commitments.

In order to stipulate the type of contract, the core objective of the scheme should be stated, as we said above. Nevertheless, some significant questions will be: Will I only focus on carbon? Will it be possible to also include other environmental services such as biodiversity (within the framework of the CB), or to include other objectives, such as the fight against desertification? (Within the framework of the CCD).

In our opinion, it is difficult at present to include or to try to “pack” other objectives as the main purpose of the contract, due to well known reasons, such as the difficulty to quantify or measure these other possibilities (to complement an offsetting system) and the technical criteria, which would make the contract process much more complex.

In order to achieve these synergies between the environmental services, performing around the opportunity supplied by the carbon as offset, one possibility is to focus the project purpose on carbon resulting from the REDD scheme, considering biodiversity, water and other environmental services as potential sources to improve the proposal and/or bonus for a better project.

4.2. Baseline and scale of the projects: Dealing with the leakage

Currently, the REDD initiatives in Peru are stipulated per project, that is, under the so called nested approach that involves one singular project and is based on a specific area like a NPA (and his buffer zone), or a concession.

It is worth noting that the information about forests and their preservation is still incipient in Peru. The compilation of the forestry surface has not been completed, neither have all the areas been granted some type of legal instrument for forestry preservation and/or management.

Other important issue for Peru will be defining properly concepts like: deforestation and degradation.

There were some problems with those definitions as some governmental agencies interpreted that forest with little value because of the timber that houses should be categorized as a forest cleared, even when provided with other species (not so commercial) and provide several ecosystem services.

On the other hand, the real extension of the deforested areas in Peru is not known, thus the gathering of trustworthy data is complex, and as a job that bring together State competences and also private obligations, has been difficult to achieve (finance) and to enforce (compliance of the private sector).

4.3. A Analysis of the underlying causes of deforestation and identification of activities

A good project design should involve an appropriate knowledge about the main deforestation drivers in the area of the project. Not only cabinet information should be use, but sound ground identification of stakeholders, social and political systems, incentives, in order to establish an adequate cause effect relationship between activities and conservation of forest.

For example, in Peru, the implementation of one of the most important highways of the IIRSA project, so called the South Inter oceanic highway, that will connect Peru with Brazil and Bolivia (Ocean Pacific with Atlantic) bring a complex scenario of deforestation and degradation drivers to Amazon and de Amazon Andes, that should appoint for the implementation of projects.

4.4. Contract Arrangements and Policy Mechanisms

One of the reasons for trying to use incentives that link the provision of environmental services and the non-deforestation of the forests, is that several of the regulation mechanisms and control command used in the past decades, have not been necessarily effective. In other words, in many cases, the availability of a law has not been sufficient to avoid forest degradation or deforestation.

Nevertheless, given that the system to assign rights over the forest has control-command concepts and several specific regulations and limitations for private subjects to have rights over the forests, it is important to consider the characteristics of such rights in order to build the projects. For instance, in forestry concessions, some considerations to take into account in addition to the aforementioned right that should be granted, are: a) the need to have management plans, b) the need to make a compensation in favor of the State, c) the acceptance of oversight and monitoring from the State through a competent institution (Oversight Agency for Investment in Forestry Matters – OSINFOR).

5. Price and distribution of the benefits

One important question to the implementation of the projects is if the offset from the carbon scheme will be enough to avoid degradation or deforestation of forest areas. Therefore, is important to establish a correct baseline and also to have adequate governance over the area of the project, to know in a basis ground way if the project is working.

When project funding covers all the activities required within the project in order to put into practice the REDD scheme, the surplus should be used in the management of the whole basin where deforestation is taking place, and also by the authorities that deal on a daily basis with deforestation and degradation actions, such as the Regional Governments (fight against illicit felling of trees, fight against illicit mining).

The premise is that it will be very difficult to make every assumption required to cover the deforestation drivers, and in addition, such a possibility highly increases the costs for project building. Therefore, it is necessary to take the incentives towards flexible mechanisms for contracting/redistribution, in order to achieve the purpose of avoiding deforestation.

We think that that in this theme using standard and specialized certification authorities can reduce the problems of definition and reduce transaction costs on the development of schemes.

6. Dealing with internal and external risks to the project

Risks associated to the project itself, as it may be that due to issues out of the holder's control, some activities result inefficient for controlling deforestation drivers and consequently, areas matter of the contract would be lost.

The REDD initiatives in Peru have operated at project level (nested approach), thus, the solutions mentioned about the risks are proposed from that same scenario.

In the Peruvian legal framework, provided that the event is not attributed to the holder, and provided that the event is extraordinary, unforeseen and irresistible, this type of assumptions for non-execution of obligations, would become a case of *force majeure* or act of God (which may arise from human causes or nature events, such as the entrance of illegal tree cutters or a forest fire). As such, for the contractual obligation to overcome this risk possibility, the contracts should expressly state the liability to replace the lost carbon, and the way to proceed in such cases. In other words, to state who will assume the delivery risks.

The second risk, external to the contract, which we deem relevant, derives from the possibility that the State has to grant other rights (for other natural resources) in the project area. These are the rights to exploit non-renewable resources (mining, hydrocarbons) and also the possibility to execute major infrastructure (roads). In both cases, provided that the projects require the deforestation of some areas within the territory, the environmental impact assessment should show the necessary considerations to remediate any damage caused in the areas.

At present, a problem that worsens this situation is the lack of approved compatibility mechanisms to relate the management plan of a granted forest (for instance in concession) with the implementation of an EIA for hydrocarbons operations. The approval of a mechanism of this type would provide a significant improvement in the feasibility to execute projects.

To improve this situation, Peru is beginning to have some attempts on public-private partnerships that seek to increase the level of law enforcement and the possibility to obtain information and systems that facilitate such schemes. We think, that this alliance will also be important to point out with participatory process and interchange of information a national position that involves all stakeholders.

7. Dealing with different market-based mechanisms and funds

Nowadays, even if is not yet decided whether REDD arrangements will be implemented through Market Mechanisms or Funds, we believe useful to explore the experiences of current market tools operating within the Peruvian legal and institutional framework. As the matter of fact, there are current market-based instruments happening in Peru that are relevant to point out because the way they relate conservation of forest with economic incentives, market enhancement or market creation.

In the case of economic incentives, we can find an indigenous community that has a joint venture with an ecotourism operator working in their land, and receives 50% of the business profits, compromise with the conservation of the forest as part of the sustainability of the business.

On market enhancement, the recollection of the so call Brazil nuts (*bertholetia excelsa*) or shade-grown coffee are view like environmentally and social friendly activities, and also related to facing and fight against degradation or deforestation of forest, because the relationship between the production and the conservation of the forest.

Finally, but no less important, in Peru there are some initiatives for the creation of specific markets for the conservation of watersheds services, identifying downstream stakeholders and upstream land or forest rights holders that can change their uses of the land and secure the provision of water, conservation of the basin and other ecosystem services.

Also, is relevant to sort out that in Peru coexist many funds related to natural forests, like the Fund create to the conservation of the protected areas (PROFONANPE), the National Environmental Fund (FONDAM) and the fund to promote forestry development (FONDEBOSQUE).

8. Conclusions

- a) A complex relationship like the one we are talking about linking forest conservation and climate change needs a contractual framework that addresses the obligations, rights and definitions needed to implement schemes.
- b) Clarity is required about the rights on fixed carbon; the entitlement over it is a main element. In this regard, the Peruvian regulations at present require the consideration of some adjustments, especially with regard to spaces regulated by means of the Forestry and Wild Fauna Law, where there is already express reference with regard to granting forestry rights (concessions or permits), but which still needs to be developed by defining accurately how and under which conditions, the concession holder may benefit from the carbon. Two significant issues are to identify: the role of the State and the retribution it receives, and its utilization.
- c) Contractual arrangements in preparing the project (scale, baseline, activities) and their link-up with public institutions (Environment and Agriculture Ministry – Forest Authority). This arrangements need to be address considering the different kind of areas where the project will be implement:
 - Concessions. Taking account the management plan of the concession and the relation between their accomplishment and the permanence of the carbon scheme. The retribution for the State is another important issue.
 - Indigenous forests. Only with the voluntary ratification of the community, and their involvement both in the preparation and execution of the project, and in the benefits that it will bring.

- Natural Protected Areas. There will be a different role of the State, in this case from the SERNANP (NPA Service) and also carbon schemes could be implemented with participatory tolls, such as, administration contracts.
- d) There are some considerations and limitations about rights over the forests and rights over environmental that need to be taken into account in order to correctly implement the schemes. The governance of the projects is an important issue to take account, not only within the specific activities, but also in the surrounding political and social framework.
 - e) In the construction of the contract, themes like, purpose of the contract, baseline and scale of projects, leakage, underlying causes of deforestation and policy mechanisms should be taken into account.
 - f) The price of the offsets and the distribution of the benefits is a theme when more discussion and information should be done. The raising of expectations for critical stakeholders will be a problem in the pursuit of adequate governance for the schemes.
 - g) It is very important to deal with internal and external risks for the project in an appropriate way. This makes a public-private union of forces urgent, which involves all stakeholders and levels of government. Peru is getting important steps in that way.