Law and Development: **In Focus**

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The Green Climate Fund: open for investment?

Peter Zaman and
Pryderi Diebschlag

In the drought-ravaged Gedo region of Somalia, obtaining water can involve treks of 20km or more © Mohamed Gaaran/ IRIN

At the UNFCCC climate change conference in Copenhagen in 2009, developed countries committed to setting up the Green Climate Fund (GCF) with a view to providing developing countries access to finance of up to US $100 billion per year by 2020 to help them adapt to a low carbon economy and reduce their emissions.

Conceptually, the GCF was to be funded primarily by public sources. The reality is, three years later, very little public funding has yet been committed. The debt crisis currently facing developed countries is unlikely to abate in the near future, therefore, logically requiring the GCF to increasingly rely on the private sector to achieve the desired levels of funding. Despite the formalisation of the involvement of the private sector at the last international climate change conference in Durban, there is still a lack of recognition amongst the developing community as to the significance of this sector to the success of the GCF.

A risky investment?

Private sector investors are traditionally willing to invest where a favourable balance exists between risk and return. In the context of climate change the investor will not always require a high level of return, but will want assurances that its investment is relatively safe.

Risks broadly fall into two categories: (a) those which attach to all projects in developing countries, such as currency fluctuations, or an unpredictable political or regulatory environment, and (b) those which are specific to carbon sector or climate adaptation projects, such as long term investment in unproven technologies or inexperienced operators and developers.

While risks flowing from unproven technologies or inexperienced operators are often resolved in the early stages of a project, frequently private investors are still reluctant to commit at this stage. Public sector finance can be used here to entice private sector investment.

Managing risk

Pledges of funds to projects in their early stages may not need to be substantial in order to establish a project as a viable commercial investment. Any such pledge can be made as a grant or a subordinated equity, allowing the private investor to achieve recovery in priority to the public sector investment. This would allow the public sector to take the initial risk, so that the private sector investment could become viable. The focus should now therefore be on maximising the resources of the public sector in order to reduce or mitigate risk, giving the private sector the necessary safeguards it needs to encourage investment in this area.

The role of the GCF

The decisions made by the newly formed GCF board will be crucial in attracting private sector investment. There is debate to be had on whether the GCF should focus on the efficient distribution of funds from the public sector or on encouraging gross investment from the private sector.

Although half of the GCF funding is committed to adaptation, a disproportionate amount of research has been dedicated to mitigation. If carried out, this research may well conclude that allocating public funding for adaptation is more justifiable than for mitigation activities, as the former may see lower financial returns and hence attracts less private sector investment. More research is therefore required to ensure the GCF meets its mandate and uses its available financial resources most effectively.

With current levels of available public funding diminishing, it is imperative that clear and forward looking decisions are made at the climate change conference in Qatar this year to ensure private financiers can begin to do what they do best: invest. •

Peter Zaman is a partner at Reed Smith LLP where he specializes in carbon finance, derivatives and structured products and energy trading. Peter's carbon specialization extends to all aspects of carbon finance, emissions trading, carbon funds and the voluntary markets.

Pryderi Diebschlag is a trainee at Reed Smith LLP.

The Overseas Development Institute notes that the risks associated with investments in developing countries can be mitigated by public financial institutions through the deployment of a number of tools, e.g.:

1. credit or risk guarantees that provide security to private sector lenders, ensuring that loans will be repaid despite political upheaval or other difficulties which result in borrowers being unable to service their debts;

2. policy insurance that allows recovery in the event of loss caused by policy or regulatory change, helping to ensure the long term sustainability of a project; and

3. foreign exchange or liquidity facilities that allow investors to draw down funds in case of adverse currency fluctuations, with repayment obligations that only take effect when the interest rate improves, or when the project becomes sufficiently profitable.