

# CDM PROJECTS: LETTER OF INTENT AND ERPA

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## SCOPE OF PRESENTATION

- Letter of Intent (LoI)
- Emission Reduction Purchase Agreement (ERPA)
- Other Project Documentation

## LETTER OF INTENT

- To be concluded between seller and buyer of CERs
- Secures exclusivity and confidentiality
- Helps the project owner to obtain financing
- Gives comfort to buyer to start spending money on due diligence and contract drafting and negotiations
- Cost recovery by a party in case the other party unilaterally decides not to move forward with negotiations
- May include some basic or key terms regarding the transaction that will be dealt with in the ERPA

## ERPA: DEFINITION AND TYPES

- **ERPA = Emission Reductions Purchase Agreement**
  - Parties: seller (the project entity) and buyer
  - Object:
    - Certified Emissions Reductions (CERs), i.e. a metric ton of CO<sub>2</sub> equivalent reduced by a CDM project and approved and issued by the CDM EB after verification and certification
    - Verified Emission Reductions (VERs)
  
- **Different types of ERPA's:**
  - Forward contract
    - CERs are sold and bought at a pre-agreed price at a future point in time
    - Project specific
  - Spot contract
    - CERs are sold and bought at a price quoted for immediate payment and delivery
    - Standardized sale of CERs
    - Not project specific
  - Option contract
    - An option is granted to purchase agreed volumes of CERs at a later date
    - CERs should be callable by the buyer with obligation to purchase, otherwise value of ER stream diminishes for the lender
  - A combination of the above

## ERPA: OTHER SALE METHODS

- **Other possible sale methods:**
  - Sale and purchase CERs incorporated in debt finance contract relating to the CDM project: (part of) the loan will then be repaid in CERs
  - CERs are used as payment for (renewable energy) technology
  - CERs are bundled with other commodities produced by the CDM project and sold together with those commodities
  
- In the event of non-recourse Project Financing of a CDM Project: ERPA must be satisfactory to financiers

## ERPA: KEY LEGAL ISSUES

- **Important provisions:**
  - Conditions Precedent
  - Purchase price + payment default
  - Volume and Shortfall in delivery of CERs
  - Legal title to CERs
  - Transfer
  - Warranties and indemnities
  - Force Majeure
  - Termination
  - Applicable law and jurisdiction

## ERPA: CONDITIONS PRECEDENT

- Receipt Letter of Approval from Host Country
- The project having achieved Validation and Registration
- The project having achieved Commissioning
- Legal opinions
- Cross effectiveness of (e.g.) financial closure / power purchase contract / tolling agreement
  
- Useful for both parties:
  - buyer can drop non-performing project without being in default
  - seller will not be liable if conditions are not fulfilled

## ERPA: PURCHASE PRICE (1)

- **Several possibilities:**
  - **fixed price:**

“The buyer agrees to pay the seller EUR X for each CER delivered to the registry account of the Buyer before [date]”
  - **indexed price:**

“The buyer agrees to pay the seller X% of the market price of [an EU Allowance] / [CER spot market price] for each CER delivered to the registry account of the buyer before [date]”
  - **indexed price with floor and ceiling:**

“the price paid for each CER shall never exceed EUR X and shall never be less than EUR X”
  - **combination:**

e.g. price per CER is a fixed amount + a percentage of the market price

## ERPA: PURCHASE PRICE (2)

- **Taxes**
  - Does price include or exclude taxes?
  - If price excludes taxes: who will bear taxes?
- **Other costs/aspects:**
  - Who pays share of proceeds for CDM EB administrative costs (USD 0.20 per CER)?
  - Who bears risk of increased costs / increases in inflation?
  - Costs of licenses necessary if CERs are considered derivatives and financial arrangements
- **Modalities of payment**
  - Upfront payments generally only given if required for financing
  - Security for payment purchase price: e.g. Letter of Credit, parent company guarantee.

## ERPA: PURCHASE PRICE (3)

- **Factors that affect purchase price:**

- Supply and demand
- EU market
  - Price for EU allowances
  - EU policy developments
- Timing of payment and delivery
- Guarantee for under delivery
- Risks:
  - CDM related: baseline, additionality, registration, DOE fails to accurately verify the GHG emission reductions
  - Project related: e.g. financing, approval, construction, cost overruns, project underperformance, delays
  - Reputation / capitalization / experience parties
  - Host country: letter of approval, legislation, political uncertainties, legal title, change in laws, absence of efficient legal system for parties to enforce their rights, etc.

## ERPA: PAYMENT DEFAULT

- **Possible remedies for failure to pay purchase price in time**
  - Obligation for buyer to pay default interest to the seller at a fixed rate of X% per annum
  - Recovery by seller of CERs already delivered to buyer but not paid for
  - Termination by seller + recovery of outstanding payments
  - Additional damages, if any, to be paid by buyer (e.g. difference between agreed price and market price of CERs)

## ERPA: VOLUME AND DELIVERY DATE

- **Several possibilities:**
  - **Fixed annual volume:**

“Before the 1<sup>st</sup> [*month*] of each year seller shall deliver the first X CERs generated by the project in the previous year into the registry account of buyer”
  - **Fixed annual volume with acceleration:**

“Before the 1<sup>st</sup> [*month*] of each year seller shall deliver [100]% of the CERs generated by the project in the previous year into the registry account of buyer until a total of X CERs have been delivered”
  - **Percentage of annual volume:**

“Before the 1<sup>st</sup> [*month*] of each year seller shall deliver [100]% of the CERs generated by the project in the previous year into the registry account of the buyer”

## ERPA: Delivery default

- **Possible remedies for shortfall or failure to deliver CERs**
  - Negotiate amended delivery schedule
  - Delivery of replacement CERs from other projects / third parties
  - Delivery of additional CERs in future years
  - Pay to the buyer the costs of replacement CERs / market value of CERs
  - Termination by buyer (+ recovery of advance payment)
  - Penalty

## ERPA: LEGAL TITLE TO CERs (1)

- Creation of valuable commodity (CERs) from reducing GHGs relatively new concept
- Kyoto Protocol and Marrakech Accords silent on legal status of CERs and question who has legal title to CERs.
  - Same goes for ETS Directive + underlying documents for EU allowances.
- General approach: project owner is legal owner CERs
  - i.e approach of project developers, buyers, Dutch Government and World Bank
- Other approach:
  - GHG emission reductions are a “national resource” and thus property of Host Country
    - In that case, Host Country could enter into concession contract with project developers for management resources and creation CERs
    - Concession contract must allow project to take ownership of all ER rights

## ERPA: LEGAL TITLE TO CERs (2)

- Title to GHG reductions may also be in dispute between different entities involved in project:
  - E.g. landowner, lessee of land, project developer, construction contractor, project manager and project owner.
  - Sometimes different parties own ER process, plant and land, and other parties (e.g. banks) may have underlying interests in these also.
- Thus:
  - Buyer will ensure that seller can prove legal title to CERs.
    - Will insist on title warranties and appropriate remedies if seller can not provide legal title
  - PPs should review all legal project arrangements to ensure that rights to CERs have not already been assigned to another party and confirm that none of the entities involved will lay claim to the CERs.
    - E.g., in an afforestation project:
      - Have rights and benefits to ERs been reserved by land owner in leasehold arrangement?
      - Are there any contracts that sell “carbon rights”, “carbon offsets”, etc to another party?

## ERPA: TRANSFER OF CERs

- Specify at which moment title to CERs passes to buyer
- Moment of transfer depends on applicable law
  - E.g. if Dutch law applies, transfer requires that CERs are debited from seller's account in emission trade register and credited to purchaser's account in relevant register
    - In that case, stipulation that legal title would pass to buyer at – for example - signing of ERPA or payment would be null and void (instead thereof: stipulation that the CERs will be for the risk and the account of buyer as from signing/payment)
    - CERs can be used by Dutch (and other European) operators to cover their GHG emissions to a certain extent
  - This brings us to question which law is applicable to transfer
    - Answer is unclear since there are no conflict rules for CERs and Kyoto Protocol and Marrakech Accords are silent on this
      - Most suitable solution in my opinion: transfer of CERs has to be ruled by law of country in which they are registered

## ERPA: FORCE MAJEURE

- Failure to perform due to events beyond the control of a party
- Releases party from liability for non performance
  - E.g.
    - Acts of god, riots, war, flood, earthquake, epidemic, strike, change in law (important if HC is politically unstable), etc., etc.
    - CDM EB decisions after date ERPA
    - Failure of the registry functions of the CDM Registry to be operative
- Adequate time to remedy
- Termination as last resort

## ERPA: TERMINATION

- Termination in the event of (for example):
  - Material breach (payment default / delivery default)
    - Only non defaulting party may terminate
  - (Prolonged) force majeure
  - Mutual written consent
  - Bankruptcy (etc.) of a party
    - Other party may terminate
  - Withdrawal Host Country from UNFCCC or Kyoto Protocol

## ERPA: APPLICABLE LAW AND JURISDICTION

- Arbitration best option: parties can appoint expert arbitrators
  - Optional Rules for Arbitration of Disputes Relating to Natural Resources and/or the Environment (Permanent Court of Arbitration)
- Make sure arbitration clause is enforceable in Host Country

## ERPA: MODELS/TEMPLATES

- **UNEP:**
  - Draft Contract for Direct Sale of CERs
  - Draft CER Project Investment Agreement (where Buyer has underlying interest in the CDM Project)
    - Published in the UNEP Legal Issues Guidebook to the Clean Development Mechanism (appendices C and D)
    - <http://cd4cdm.org/Publications/CDM%20Legal%20Issues%20Guidebook.pdf>
- **CERSPA:**
  - CER Sale and Purchase Agreement template and explanatory document
    - Various languages
    - <http://www.cerspa.org/>

## CDM PROJECT DOCUMENTS (IN DIFFERENT STAGES) (1)

- **VALIDATION**
  - independent evaluation of project activity by a DOE
  - documents:
    - **PDD**
      - basis for independent evaluation of project activity against CDM requirements to be carried out by DOE
    - **Contract between PPs and DOE**
    - **Validation report**
      - request for registration submitted by DOE to CDM EB (if DOE deems proposed project activity valid)
    - **Formal approval of the DNA of host country**
- **REGISTRATION**
  - formal acceptance of validated project by CDM EB
  - documents:
    - **Validation report** = request for registration submitted by DOE to CDM EB (if DOE deems proposed project activity valid)

## CDM PROJECT DOCUMENTS (IN DIFFERENT STAGES) (2)

- **MONITORING**
  - collection generally by seller of data to calculate GHG reductions
  - documents:
    - **Monitoring plan**
      - monitoring plan is part of PDD
- **VERIFICATION AND CERTIFICATION**
  - periodic review and determination by DOE of monitored GHG emission reductions
  - documents:
    - **Monitoring reports**
      - Monitoring reports of PPs form basis for verification by DOE
    - **Verification Report**
      - written assurance by a DOE that the project activity has achieved the reductions in GHG as verified
    - **Certification Report**
      - Certification by DOE that during the specified time period, the project activity achieved the expected reductions of Greenhouse Gas emissions as verified
  - **Contract between PPs and DOE**
    - DOE wants to make sure monitoring is accurate / PPs want to hold DOE liable for any inaccurate verification or certification

## CDM PROJECT DOCUMENTS (IN DIFFERENT STAGES) (3)

- **ISSUANCE OF CERs**
  - In principle CDM EB will issue CERs equal to certified amount of GHG reductions within 15 days after receipt of Certification Report
  - documents:
    - ***Allocation Statement***
      - statement (generally provided together with Certification Report) clarifying how CERs resulting from a Certification Report should be issued

## OTHER POSSIBLE PROJECT DOCUMENTS

- Land purchase/Lease
- EPC Contract
- Grid Connection Agreements
- Grid Connection Construction Agreements
- Wayleave agreements
- Regulatory report describing relevant local laws and regulations
- Permitting
- Gas Purchase/Electricity supply or Tolling Agreement
- Electricity and gas transportation agreements
- Capacity booking agreements
- Commissioning Agreement
- O&M Agreement
- Master Services Agreement/Shared Services Agreement
- (Project) finance documents:
- Security Documentation
- legal opinions

A person is standing on the edge of a dark, rocky cliff on the right side of the image. The background is a vast, hazy landscape with rolling hills and a bright, overcast sky. The overall tone is muted and atmospheric.

**THANK YOU**