



Legal Issues around Carbon Credit Transactions and Introduction to Emission Reduction Purchase Agreement (ERPA)

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Definition and transaction type

- n Parties
 - seller and buyer
- n Object
 - CER, VER or other formal of emission reduction
- n Type
 - ∅ Forward contract
 - ∅ Spot contract
 - ∅ Option contract
 - ∅ A combination of the above

Purpose of ERPA

- n Record of agreement
- n Identify responsibilities
- n Establish rights
- n Manage risk

Issues to be negotiated in ERPA

- n Spot or forward CER
- n Guaranteed or non-guaranteed CER volumes
- n Fixed or floating prices
- n Responsibility for CDM development costs
- n Default and remedies
- n Governing law and dispute resolution
- n Cooperation period

Involvement of buyer in CDM development

- n Buyer could involve in CDM development of project in different degree:
 - ü Only purchase of spot CER
 - ü Purchase of forward CER but not involve in CDM development
 - ü Purchase of forward CER and support CDM development (CDM cost prepayment)
 - ü Not only purchase CER, but also provide investment or equipment to the project

Due Diligence

- n Objective: risks are identified and reflected in the commercial terms
- n Focus: Legal, regulatory, technical, financial and commercial aspects of the project
- n Sources
 - ∅ Seller: responses to due diligence questions, site visits
 - ∅ Legal: Host Country laws and regulations, corporate documents, licenses, permits and consents
 - ∅ Buyer: own knowledge of market and previous transactions
- n Findings
 - ∅ Project Owner operates the CDM project lawfully
 - ∅ Project Owner owns project assets and CERs

Project Participant

- n In bilateral cooperation, one seller and one buyer has to be the Project Participants
- n Advantage: instruct delivery of CERs from CDM pending account – mitigates delivery risk
- n Buyers and secondary buyers may wish to become Project Participant to take direct delivery
- n DNA Letter of Approval (LoA) has to be obtained to become a Project Participant
- n Addition or removal of Project Participants requires approval of existing Project Participants
- n Buyer may seek right under ERPA to add additional Project Participants

Focal Point

- n Each CDM Project requires one or more Focal Points
- n Focal Point is a party authorised by Project Participants to communicate with Executive Board and UNFCCC Secretariat in respect of a CDM project
- n Focal Point authority includes:
 - ü instructions for forwarding CERs
 - ü addition and removal of Project Participants
- n Focal Point appointed using standard form Modalities of Communication (MoC)
- n Focal Point assignment among Project Participants could be as follows:
 - ü Sole Focal Point
 - ü Joint Focal Point

Pre-conditions of the ERPA

- n General pre-conditions of ERPA includes:
 - ü Effective of the signature
 - ü Obtain LoA from DNA
 - ü Registration of the project
 - ü Buyer as a Project Participant
 - ü Project commission
 - ü Completion of Due Diligence or consent by lawyer
- n It is important to make sure that project could meet deadline of each condition
- n Due Diligence schedule and deadline shall be clearly set

Guaranteed Delivery

- n Guaranteed delivery obliges seller to deliver a fixed volume of CERs to buyer
- n Breach of Delivery Guarantees:
 - ü replacement CERs from the project in the next delivery
 - ü replacement CERs from other CDM project
 - ü pay to the Buyer a cash amount equal to the Buyer's Replacement Costs with respect to the Delivery Shortfall

Non- Guaranteed Delivery

- n CER volumes sold under primary forward ERPAs often determined by project performance
- n Two form of Non-Guaranteed Delivery:
 - ü purchases all CERs from the project
 - ü purchases a percentage of CERs from the project, and the rest percentage of CERs could be sold to other buyer or subject to call option

CER Price

n Fix Price

- ü CER price = X Euro/CER
- ü Set at the time of ERPA

n Floating price

- ü CER price = % of market price
- ü The percentage normally set at the time of ERPA

n Other profit sharing structure

- ü CER price = A fixed price (bottom price) + % of (market price – bottom price)

CDM cost during development period

- n CDM development costs
 - ü PDD development (charged by consultancy company)
 - ü Validation fee (charged by DOE)
 - ü Registration fee (charged by EB)
 - ü Methodology development or revision costs (Only when necessary, charged by consultancy company, DOE)
- n Other commercial costs
 - ü Costs related with ERPA negotiation and hire of lawyer
 - ü Due Diligence cost

CDM cost and tax during monitoring and CER transaction

- n Monitoring and verification period (annually):
 - ü Monitoring report development and verification support (charged by consultancy company)
 - ü Verification fee (charged by DOE)
 - ü Change of monitoring plan or revalidation (only when necessary, charged by DOE)
 - ü Share of proceed (Administrative SoP and Adaptation SoP (tax), charged by EB)
 - ü Specific domestic CDM tax (if required, charged by DNA)
 - ü General company taxes (VAT, corporate income tax, etc)

Allocation of CDM cost

- n CDM costs shall allocated between seller and buyer
- n CDM costs include in the price or deduct when CER revenue to be paid
- n In case of project falls at one of these hurdles, will prepayment be lost, or refunded to buyer
- n Incidental cost arrangement: methodology development or revision, request review charges by DOE, Monitoring Plan revision, etc

Events of Default and Remedies

- n Events of defaults most commonly included in ERPAs are:
 - ü breach of material obligations (e.g. delivery failure by seller, payment failure by buyer)
 - ü breaches of representations and warranties
 - ü insolvency
- n Parties may allow a "cure period" under an ERPA
- n Remedies typically include:
 - ü right of seller to make up any shortfall within following year or delivery replacement CERs
 - ü right for non-defaulting party to terminate the ERPA
 - ü right to receive damages from the defaulting party

Governing Law and Arbitration

- n Normally ERPAs to be governed by the law of the buyer. English law is more prevailing.
- n Seller has intention that ERPA shall be governed by the law of the seller
- n A third country's law is a solution
- n Language: English
- n ERPA arbitration needs to specify:
 - rules governing arbitration, location of arbitration, language of the arbitration, number and appointment of arbitrators.

Thank you !

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