

LUDOVINO LOPES | ADVOGADOS

Negotiating REDD+ ERPAs from a position of strength

September/2014

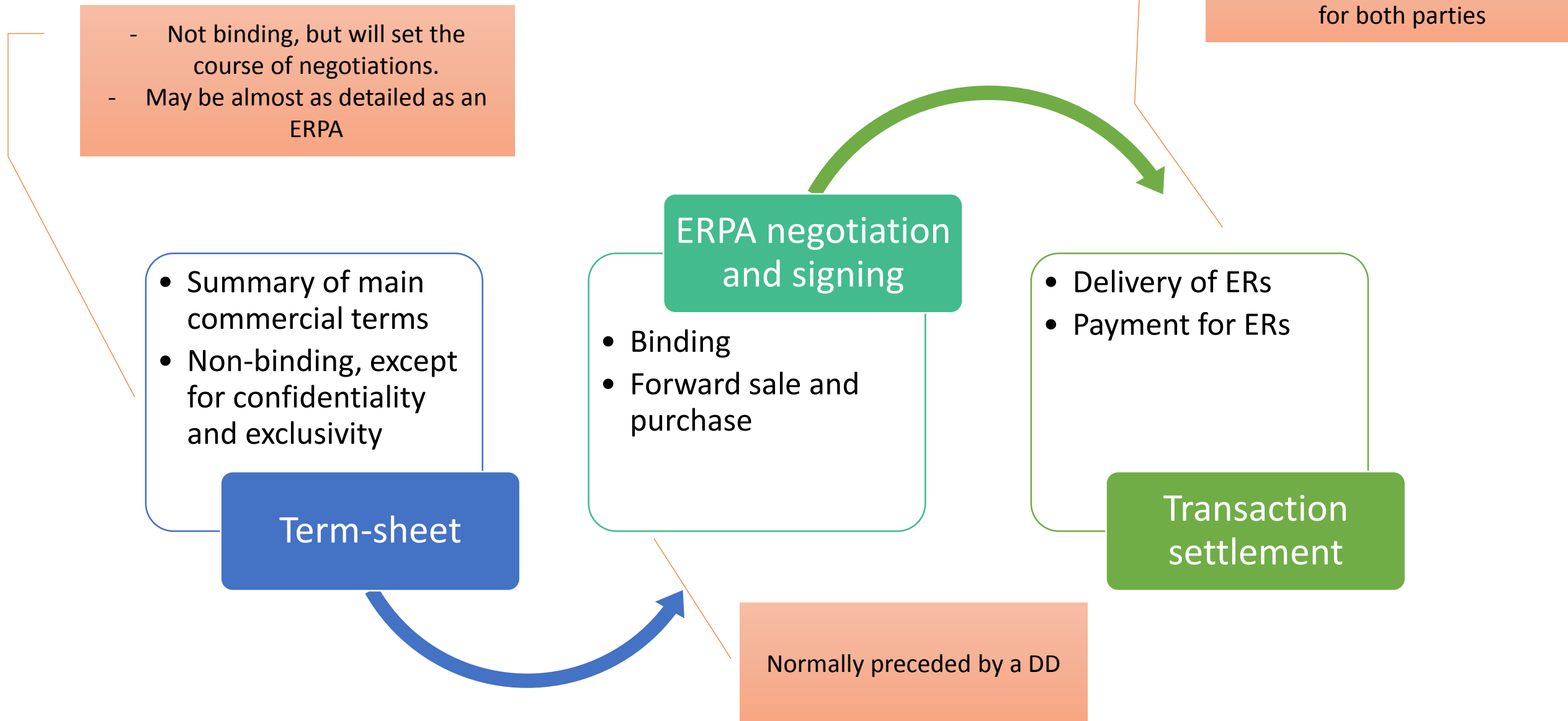
Context

- ERPAs are one way commonly used to transact environmental and REDD+ assets.

Examples:

- Peruvian Gov./ CI and Walt Disney Company;
 - Costa Rica and the World Bank (under the FCPF, term-sheet);
 - Suruí indigenous tribe in Brazil and Natura Cosméticos;
 - Project developer in Kenya and ENECO
-
- Why are REDD+ credits bought and sold?
 - Stimulate a market in REDD+ and PES;
 - Future potential compliance regimes;
 - Voluntary carbon neutral programs;
 - Market making and investment opportunities
-
- What they entail?
 - A forward agreement to deliver and pay for emission reductions;
 - Could involve a very long term contract or a short-term (almost a spot deal);
 - Could involve advance payments or only payments upon delivery

Steps of the transaction



Conditions Precedent

- Evidence of title (seller)
 - Financial health and ability to pay (buyer)
 - Letter of approval, validation or registration under one or more standards (seller)
 - Approval by (or consultation) with a certain local authority (seller)
 - Submission of a benefit sharing plan / safeguards plan
 - Others ...
- **Specific conditions applicable to advance payment?**
- **Due diligence must have been completed at this stage.**

May include a legal opinion (will add to costs)

“to best of its knowledge and based on current interpretation of prevailing legal system”

- Cannot be generic or entirely under the control of a party (obligation to undertake best efforts to fulfil the conditions within a specific timeframe)
- Will not lead to an event of default unless there is bad faith

Primary obligation (sale and purchase)

- Deliver and pay
 - Other options:
 - pay and deliver (advance payment – through milestones/collateral?)
 - retire and pay (or pay and retire);
 - deliver, pay and retire
 - Note: Payment (net) without any withholdings or deductions
- Object needs clear definition
 - Verified Emission Reductions
 - Electronic issued VERs (example, VCUs)
 - Units tagged with social standard label
 - Some buyers will demand a widely known and used standard, others will only require electronic tracking and independent validation/verification
- Methods of delivery (varies with the object)
 - Delivery of a verification report;
 - Delivery of an electronic unit created in and transferred through a registry system.
 - Registry system (costs)
 - Legal title transfer
 - “Deemed delivery”

All these have costs. May be able to share or receive as an advance payment

Have costs. May also be taxed as an “importation of services”

Passes upon transfer or receipt of payment?

Pricing

The seller should have a good understanding of the costs of developing the program or project;



The more env. and social attributes an ER possess, the greater will be its unit value;



Granting a call option for future ERs is an important right usually given away to the buyer for free. Should be reflected on the price.



The more the buyer takes a risk in the project/program (buyer as a partner), the lower will be the ER value;



For near-to-spot deals (buyer as a off-taker only), delivery risks are very low. This should be also reflected on price



- price may be fixed
- indexed to some other asset, with a cap and a floor
- mixed = fixed but with option to negotiate a band after a certain number of years
- Experience shows that, for long-term contracts, flexibility is very important.

Other duties and obligations

- Implementation of the Program/Project

- [Takes reasonable steps to:]

- implement the project/program in accordance with program description and agreed methodology;
- obtain a social standard validation and verification;
- implement a benefit sharing scheme;
- comply with a safeguards plan;
- ensure validation and registration
- achieve certification and issuance

- Inform on any deviation of volumes

New methodologies and standards tend to increase the costs considerably

It has costs but should also add value to the ER or credit

Reasonable as these are an essential part of REDD+. But the if the contractual wording is too restrictive, may easily lead to a default by the seller.

Note: what is reasonable to demand from seller (and what is not) also depends on the level of involvement from the buyer. Is the buyer a partner or a simple off-taker of credits??

Other duties and obligations

- Communications with the chosen standard

- Right to be a focal point of communications
- If this role is assigned to a buyer:
 - may create difficulties for the seller in case of conflict or dispute;
 - it will increase the perceived risks by other buyers (less options to sell)

Is the obligation to assist = cooperation (reasonable efforts? Best efforts?) or to effectively achieve conversion?

- Make use of a predetermined standard

- Assist in converting the program/project to a different standard
- Costs of conversion/adjustments?

Who pays for document preparation, validation, verification and registry fees?

- Communication to the general public

- Parties need to agree what can and what cannot be communicated;
- May review each other's communication prior to announcement, provided this is done within a reasonable timeframe. Silence means tacit approval?

Other duties and obligations

- Call options
 - Should be sold for a premium;
 - Must be precisely defined:
 - Does it refer to VERs generated over and above the contracted volume?
 - Does it refer to VERs generated in subsequent crediting period?
 - Or both?
 - Are they set as a percentage or a fixed volume?
 - When and how many times can the option be exercised?
 - What is the exercise price?
- Call option vs. right of first refusal
- Put option?

Other important features

- Termination

- Non-default termination

- Supervening condition beyond the control of the parties (ex. material change in law);
 - Force majeure event (may include registry failure);
 - Mutual agreement of the parties;
 - Settlement of the transaction.

- Default termination

- Involves a material breach of obligations;
 - Non-delivery / Payment default
 - Allows the non-defaulting party to terminate (and request the return of the advance payment, if any);
 - Penalty payments (liquidated damages)?

Some ERPAs will have too many obligations on the seller. Seek reasonable or best efforts obligations.

- Governing law and dispute resolution

- Some state entities require domestic law and courts;
 - English law and arbitration more commonly used;
 - Be careful with costs;
 - May include some sort of expert determination or mediation

Remember to cap liability and exclude indirect/consequential damages (loss of profit, business opportunities, etc.)

LUDOVINO LOPES | ADVOGADOS

Thanks

Thiago Chagas
tc@llalaw.com.br