CLIMATEFOCUS GAIA carbonfinance Triodos Facet

MidSEFF Neutral Primary ERPA Template – User's Guide

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Recitals

Recitals describe the context and background underlying the transaction. They generally do not form operable terms of the contract, but may be used to assist in the interpretation of the agreement between the contracting parties. Recitals can make reference to the project, to prior legal arrangements or a previous legal agreement between the parties, to relevant financing agreements, or to any fact that the parties consider relevant to be cited.

Recitals Alternative Language

Reference to financing or assignment agreements

"WHEREAS the Seller has entered into a financing agreement for the Project with [*insert name of lender*], dated [*insert date*] [*under which the Seller has assigned rights to [payments from] emission reductions generated by the Project to* [*insert name of lender*]].

Reference to previous legal agreements between the parties:

"WHEREAS the Seller and the Buyer have entered into [*an Exclusivity Agreement*][*other legal arrangement*], dated [*insert date*] in relation to negotiations to buy and sell GHG emissions reductions".

Article I – Definitions and Interpretation

Section 1.01 sets out the definitions used in the agreement. Several terms are also defined in the body of the agreement, and in this case reference is made in section 1.01. It is important to read each of the definitions carefully as they can significantly affect the rights and obligations contained the agreement.

Many of the definitions will be specific to the relevant carbon standard applicable to the agreement (e.g. the Gold Standard or the Verified Carbon Standard), and so care should be taken to ensure the right

options are selected. It is worth noting that, while the template is for voluntary projects, certain terms relating to compliance emission projects such as CDM or Kyoto Protocol are defined, as the Gold Standard rules in particular make reference to the CDM rules in certain cases.

Key definitions are discussed below in the context in which they are used.

Section 1.02 provides the rules that govern interpretation of the agreement. These are mostly standard provisions used in legal contracts. In addition, it is provided that terms shall be interpreted consistently with the carbon Standard of Verification, thereby reducing the risk that provisions of the agreement are construed out of the context of carbon projects and the specific rules that apply to them.

Article II - Conditions Precedent

Clause 2.01 (a) Commentary

Clause 2.01 (a) sets out 1) the clauses of the contract that will not come into effect until the conditions precedent have been met and 2) the specific conditions that must be met before the clauses under (a) will come into effect. If the conditions precedent are not met by a date the parties mutually have agreed upon, then clause 2.02 provides that either party will have the right to terminate the contract without incurring any liability.

Parties may agree on multiple conditions precedent and these conditions precedent may reflect the specific needs of the buyer and/or the seller. They may include requirements as diverse as the seller presenting a draft project design document; the project being validated or registered under a specific carbon standard; the buyer completing due diligence of the project; the seller completing due diligence of the buyer's creditworthiness; the seller securing financing for the project; or the project reaching certain project milestones.

It is important to note that if meeting a condition precedent is within the discretion or control of one party alone (such as completing due diligence to the satisfaction of the buyer/seller), then that party could retain a unilateral right to walk away from the project, without liability, at any time up until that condition precedent is met. Minimizing the number of conditions precedent and the timeframe within which conditions precedent must be met can help reduce the risk that a party will terminate the agreement because the conditions were not met.

The obligation in clause 2.01(b) to *"use all reasonable endeavours to procure satisfaction of the Conditions Precedent in good faith as soon as practicable following the execution of this Agreement"* also minimises the risk of termination by reducing the possibility of the buyer or the seller delaying or acting in bad faith to avoid the contract entering into force. This type of behaviour is not uncommon from contracting parties, in particular where market conditions vary considerably and carbon prices suffer serious fluctuations. In practice, deliberate delay or bad faith may be difficult to prove; however, this general language does provide a safety net in the event either party fails to act as agreed. An additional way to minimise the risk of termination by the party obliged to fulfil a condition precedent is to include a clause by which this condition precedent can only be deferred or waived by the other party. Provisions to this effect are included in section 2.03.

In the case of Verified Carbon Standard projects, the Buyer may also require the Seller to furnish documents that show a "right of use", as defined in section 3.11.1 of the VCS Standard and in the VCS Program Definitions (Version 3.3).[1] The buyer could also require the seller to provide evidence of no land title disputes existing. These documents are intended to show the project proponent's ability to claim that the project will or did generate or cause the reductions or removals from which credits are generated and are in line with Verified Carbon Standard requirements. Eligible rights of use include those granted by government regulation, contractual right or other law or agreement. For extra certainty, the buyer may also require such documents to be accompanied by an opinion of a lawyer experienced in VCS projects as to whether the documents are likely to be accepted by the VCS Registry as demonstrating a right of use. Note that seller liability may arise if a court finds the opinion to be based on knowingly false or unsubstantiated information.

On the other hand, it is important to note that there is not a wealth of legal experience with voluntary projects at present. Precedents for validating 'rights of use' may not be consistent from one validator to another. There is also little legal certainty over rights to greenhouse gas reductions and carbon credits under the domestic laws of most countries, including Turkey. Both contracting parties will have to bear this in mind when negotiating the provisions of the agreement and work together to minimize risks of future competing claims over the carbon credits.

[1] Note that in the case of Agriculture, Forestry and other Land Use (AFOLU) projects, eligible rights of use are currently those set out in section 3.4.2 of the VCS AFOLU Requirements Document, 4 October 2012, v3.3.

Section 2.01 Alternative Language

Clause 2.01 (a) Alternative Language

Some additional conditions precedent that a buyer or seller might seek to include:

Documentary evidence of right of use (VCS only):

"Provision of documentary evidence adequately demonstrating one or more of the rights of use that are accepted by the VCS Rules for the purposes of demonstrating a right of use in and over GHG Emission Reductions [*and an opinion of a legal counsel of the Seller that such evidence is likely to be adequate for demonstrating a right of use under the VCS Rules*]."

Comment: See discussion above. The Seller should evaluate the legal risks before agreeing to provide such a legal opinion.

Verification Report:

"The first Verification Report finding that the Project generated at least [*insert amount*] VERs in the first 12 months of operation since Registration has occurred."

Comment: This condition may be appropriate if the contract contains strict delivery default clauses but the number of VERs the project will in fact generate each year remains uncertain. Alternatively, this concept could also be used as a trigger to revise the Indicative Annual Amounts.

Letter of Credit or Other Security:

"The Buyer's provision of a [*Letter of Credit/a Parent Guarantee/ Performance Guarantee/ other security*] pursuant to [*insert clause number*]."

Article III - Contract VERs

Article 3 sets out the terms of the purchase and sale of VERs. The precise number of Contract VERs is set out in Section 1.01, under 'Definitions' and in Schedule 2. There are essentially three methods to determine how many VERs are to be bought and sold – all VERs generated by the project independently from its number, a fixed amount, and a percentage of generated VERs. In each case the amounts relate to each individual Vintage Year, i.e. the years in which the VERs are generated. Fixed amount contracts are often used when the contracting parties desire to clearly establish the sale and purchase liability for the buyer and seller, and the amount of revenue that can be expected by the seller. When there is no clarity on the number of VERs the project will generate and the seller prefers to not bear liability in terms of concrete carbon reductions amounts, parties contract the acquisition of all carbon credits generated.

Clause 3.01 (b) can be applied in the case of contracts for "all" VERs generated or a percentage of VERs. In these cases the contract amount is uncertain, although the contracting parties can rely, to some extent, on the project estimates and GHG reduction projections as reported in the project design

document. In these cases it is important for the parties to clarify whether they wish to agree on a minimum amount or whether they intend only for VERs actually and in fact generated to be purchased and sold. Two options are therefore provided.

The first option provides for a minimum amount for each year, the 'Guaranteed Annual Amount'. The seller is required to ensure that this amount is generated and delivered to the buyer each year. This arrangement provides a minimum security for the buyer, despite the overall amount being uncertain, thus facilitating the buyer to undertake long term planning. It does, on the other, set a clear liability threshold for the seller, who makes a firm commitment to deliver each Vintage Year the Guaranteed Annual Amount.

In the second option, the parties agree on the amount they expect to be generated each year, the 'Indicative Annual Amount', but confirm that there will be no obligation to deliver if the project in fact fails to generate these amounts. This creates minimum obligations for the seller, and so may not be acceptable to some buyers. The Indicative Annual Amount is often used by parties as an exit strategy from the agreement. For instance, the buyer may want to include a provision that allows it to unilaterally terminate the agreement if the seller delivers less than the Indicative Annual Amount in any Vintage Year. The seller, in turn, may counter by requesting that any such right to unilateral termination be only available to the buyer in the event the seller has under-performed for two or three consecutive years..

Each of these two options is facilitated by the inclusion of relevant textual options in several other areas of the template, most notably in Section 1.01, Article XXII and Schedule 2.

Section 3.02 sets out the terms of delivery and notification. The seller is required to notify the buyer upon each issuance of VERs, providing details as to the number of Contract VERs issued and the date Contract VERs will be issued. This allows the buyer to make appropriate arrangements for accepting and utilising the VERs and making payments.

Where the contract includes provision for option VERs (that is, the buyer is given a call option right over VERs issued in excess of the contracted amount), the issuance notice should also include the number of Additional VERs that have been issued, in order to inform the buyer of the quantity of the option.

Clause 3.02 (b) provides for delivery to an account specified by the buyer and provides for the contingency where the buyer's account is not able to accept delivery. The buyer is required to provide notice to the seller in the event that the registry account is not established or otherwise incapable of receiving VERs. In the event that the buyer fails to provide such notice or the second delivery attempt by the seller fails, delivery will be deemed to have occurred and the buyer must pay the seller. This is for the benefit of the seller and mitigates the risk of delays in payment.

Article IV - Option VERs

The entirety of Article 4 relates to option VERs, and thus should only be included where the contract provides for an option. Other provisions providing for and facilitating the inclusion of options are included in brackets throughout the template, and all these provisions should be considered when including provision for options in the contract.

Article 4 provides two main alternatives: a purchase option for the buyer (also known as a "call option") and a sale option for the seller (also known as a "put option"). A call option over a VER is a right but not an obligation to buy the VER (i.e. the buyer has a choice whether or not to buy, and the seller must sell if the buyer wants to buy). A put option over a VER is a right but not an obligation to sell (i.e. the seller can choose whether or not to sell, and the buyer will have to buy if the seller chooses to sell). Under market conditions prevailing at the time of writing, call options are more common.

In the inclusion of an option over VERs, the parties should consider factors such as when in time the option is exercised; whether it can only be exercised at a particular moment in time or over a number of years; the price to be paid for the VERs bought and sold under the option; and any premium or fee paid for the option. The language in the template provides for an option with respect to all VERs additional to the Contract VERs in each year, and sets a separate price (the "Option VER Price") for their purchase.

Article V - Price and Payment

Article 5 sets out the payment terms for Contract VERs and Option VERs. The contract provides for a fixed price for all VERs' although other pricing options are also possible, including indexed prices and combinations of fixed and indexed prices. Indexed prices, however, are less common in the voluntary market, where there are few exchanges providing spot prices to which prices could be indexed, and where the value of credits is more closely connected with the specific characteristics of each individual project and the particular interest of the buyer in such a project (e.g. host country, project type, social benefits).

Some parties also negotiate the payment of an advance payment or of payment for certain project development costs to be made by the buyer. In each case such payments can facilitate the seller meeting the upfront costs of the project. Sometimes advance payments are provided in phases and subject to the fulfilment of certain milestones agreed by the parties. Given the uncertainty in current carbon markets, however, advance payments and payment of project development costs are no longer common in either the compliance or voluntary markets.

Where advance payments or payment of project development costs are made it is common for them to be deducted from payment for VERs upon delivery. Deduction of advance payments can be made from the contract price till the total amount of advance payment has been discounted. The parties can also agree to deduct payments progressively through a number of years so that the seller can retain some part of the payments during the first year/s of the project implementation. The unit price received per VER is often discounted when advance payments or project development costs are paid. The seller should make sure that such discount does not make the advance payments less attractive than other sources of financing. The buyer, in turn, will ask for some form of security for the money advanced - such as a letter of credit, company parent guarantee or performance guarantee- so that if the project does not go forward, such payments will be repaid to the buyer. It is important that the repayment schedule for advance payments be set up with the needs of the project in mind. The box below provides some possible text where advance payments are to be included.

Additional Clause – Advance Payment

Section 5.0# Advance Payment

(a) The Buyer agrees to pay the Seller an Advance Payment in the amount of [insert amount] towards the future Delivery of the Contract VERs.

(b) The Advance Payment is conditional upon the following:

(i) Seller providing the Buyer with a guarantee in the form of a [*Letter of Credit/ Parent Guarantee/ Performance Guarantee*] or other security acceptable to the Buyer for an amount equal to the amount of the Advance Payment; [and]

(ii) [*list other conditions the Parties may agree upon such as Registration.*]

(c) Within 30 days of the conditions in clause 5.0# (b) being met, the Buyer shall make the Advance Payment.

(d) The Buyer shall have the right to deduct the Advance Payment it has disbursed to the Seller in accordance with clause 5.0# (c) in equal instalments of up to [*insert amount*] from each payment under clause 5.01 (c) until the total amount of Advance Payment disbursed under clause 5.0# (c) has been deducted from such payments.

(e) After each payment, the Buyer may reduce the [*Letter of Credit/Parent Guarantee/ Performance Guarantee/ other security*] by the amount in (d) above which has been deducted from the Annual Payment.

(f) Once the full Advance Payment has been repaid, the Buyer shall notify [*the Bank/Parent Company/ or other provider of security*] of the reimbursement to it by the Seller of the full amount of the Advance Payment and such notification shall constitute the Buyer's consent to the cancellation of the [Letter of Credit/Parent Guarantee/Performance Guarantee/other security].

(g) The Buyer may only exercise its rights under the [*Letter of Credit/Parent Guarantee/Performance Guarantee/ other security*]:

(i) in the event and to the extent that all or part of the Advance Payment has not been reimbursed to the Buyer as provided in clause 5.0#(d) by [add date]; or

(ii) in the case of an Event of Default as set forth in clause 10.01 which has not been cured in accordance with clause 12.02(c).]

Article VI - Taxes and Costs

Section 6.01 sets out the tax obligations of each party with respect to the transaction. The transaction of VERs may attract taxes or duties in both the buyer and the sellers' principal place of business. Particular attention should be paid to the potential VAT liability as well as any import or export taxes/duties levied on international transfers. It is always advisable to confirm the applicability of a certain tax arrangement by consulting with a local tax expert (and to review double taxation treaties).

Responsibility for payment of VAT is often a point of negotiation in ERPAs. Therefore, the template proposes various formulations that allocate VAT liability either to the buyer or to the seller, according to the outcome of negotiations. It is common for each party to pay other taxes and charges levied by its own jurisdiction, and so this arrangement is reflected in clauses 6.02 (c) and (d).

Section 6.02 sets out responsibility for costs. Particular attention should be paid to responsibility for the payment of any costs or charges levied by the Gold Standard or VCS. This is often a point of negotiation between parties, and so several options are provided.

In the case of Gold Standard projects, the costs include any share of proceeds. Under the current version 2.2 of the Gold Standard, project owners may choose to deduct a 2% share of VERs generated and transfer the deducted credits to the Gold Standard Foundation´s registry account ("share of proceeds deduction") or pay a USD 0.10 fee on each VER ("fee per credit" or "issuance fee"). In current market conditions, most project owners find it more economical to pay a share of proceeds, unless they have reason to expect to retrieve above-average prices for their VERs. Under the present template "Share of Proceeds" has been defined to include both a share of proceeds deduction and an issuance fee. The VCS does not levy a share of proceeds, and so this provision will not be included in contracts concerning VERs from VCS projects.

Under the VCS no share of proceeds is levied, and so all charges levied by the VCS are in monetary form and would be covered by clause 6.02 (a).

Under clause 6.02 (d) the Seller is responsible for all Project Development Costs, which are defined in section 1.01 to exclude the charges levied by the Gold Standard or VCS. See comments on Article 5 for further discussion of alternative arrangements for payment of these costs.

Article VII - Implementation, Milestones and Project Cycle

Section 7.01 sets out the obligations of the seller with respect to project implementation. The obligations are designed to ensure the seller takes all reasonable care to ensure the issuance of the Contract VERs, and thus serves to minimise the risk of non-delivery for the buyer. Clause 7.01 (d) also provides for progress reports to be provided to the buyer, to allow the latter to monitor project implementation and take steps accordingly. Note that where the buyer is listed as Project Participant/Project Proponent, it will be privy to all relevant communications with the Gold Standard/VCS with respect to the project (see further the following paragraphs).

Section 7.02 further defines the obligations of the seller, in this case with respect to ensuring validation and verification. The obligation in clause 7.02 (a) is an obligation of best efforts, reflecting that it is not

reasonable to asks the seller to guarantee that a project will secure a positive validation or verification. The obligation to contract a validator in clause 7.02 (c), by contrast, is an absolute obligation.

Clause 7.02 (b)(ii) sets out the rights to choose the entities who will participate in the project. Under both the Gold Standard and the VCS there are two categories of such participants. Under the Gold Standard there may be several Project Participants who are involved in and have responsibilities for carrying out the Project. Project Participants are collectively represented by the Project Representative, who serves as focal point for communication with the Gold Standard, and may add or remove Project Participants.

Under the VCS there may be one or more Project Proponents who have overall responsibility for the Project. However, where there is more than one Project Proponent, they should nominate an Authorised Representative, who will be responsible for communicating with the VCS and designating the account into which VERs will be issued.

In most cases the seller or an entity chosen by the seller, such as the project consultant, is the person responsible for the carbon project, and so will undertake the role of Project Representative/Authorised Representative. However, many buyers will seek to be included as Project Participant/Project Proponent, as this ensures that they are included in all relevant communications and can undertake more direct supervision of project progress.

Article VIII - Transition of Turkey to Compliance Markets

Article VIII sets out the contingencies that will come into play if and where Turkey becomes eligible to participate in compliance emission markets or begins a national compliance emission trading scheme.

Turkey is currently ineligible to participate in compliance markets under the Kyoto Protocol due to its special legal status, but it is conceivable that this may change in the future. It is also possible that a domestic emissions trading will emerge in Turkey and the country may seek in the future to link with other emissions trading schemes, such as the EU-ETS.

Section 8.01 therefore provides for the parties to enter into negotiations to convert the project into one under an alternative mechanism where it becomes eligible to do so. In this situation parties should pay particular attention to the terms of payment for the costs of transition, and of the price to be paid for resulting emission reductions. Under a new market mechanism in particular, project development/operation procedures will not have been tested, and so costs may be difficult to predict. At the same time, prices may be volatile at first, and so the parties may wish to consider sharing the risk by linking the price to an international spot price.

Section 8.02 requires the seller to take measures to avoid double counting in the event of Turkey undertaking an international GHG reduction or limitation commitment or introducing an emission reduction scheme, such as an emission trading system. This is crucial, as double counting can not only be detrimental to the ability to market VERs, but may also result in the project becoming ineligible under the Gold Standard or VCS. In each case the provision only applies where such target or scheme applies to the emission reductions covered by the project.

Both the Gold Standard and the VCS set out specific rules to avoid double counting in the case where the emission reductions covered by the project are also covered under an emission trading or similar trading scheme (e.g. a white certificate trading scheme). Under the Gold Standard, projects that include facilities under the EU ETS are eligible only where equivalent EU Allowances are retired to back-up any VERs issues. Where project activities claim white certificates or equivalent certificates, the Project Representative must make a "clear and convincing demonstration that no double counting" will arise. Under the VCS, where projects include emissions that are covered under an emission trading or similar schemes, the Project Proponent must provide evidence that allowances representing the relevant VERs have been cancelled under the trading scheme. In the case of countries that take on a commitment under the Kyoto Protocol or other international agreement that involves the creation of tradable emission rights, participation is allowed only where emission rights corresponding to issued VERs are cancelled.

Article IX - Representations and Warranties

Article IX sets out a number of representations and warranties for each party. In each case a number of representations and warranties that reflect common commercial practice are included, such as representations of legal authority to enter into the agreement and the absence of known legal challenges that may affect the ability to perform obligations thereunder. In addition, several representations and warranties specific to the purchase and sale of emission reductions are included.

Under **clause 9.02 (b)**, the seller represents and warrants the validity of its rights to the Contract VERs (and any Option VERs). It is advisable for the Seller to seek adequate legal advice concerning its right to the VERs, including in the case of the VCS whether it possesses an adequate right of use (see the discussion under **clause 2.01 (a)**). However, in many jurisdictions rights to emission reductions has not been regulated, and may therefore in some cases be difficult to assess accurately. For this reason, the language "to the best of its knowledge after due investigation" is used in clause. As an alternative option the seller may choose to represent that it has the authority to sell the VERs rather than that owns them.

Section 9.03 Commentary

If the buyer is a government, government agency, or international organization it may be appropriate to consider a representation and warranty that it will not attempt to exercise any immunity with respect to its obligations under the agreement. If a broad representation regarding all obligations is not possible, a representation that it will not attempt to exercise any immunity with respect to its payment obligations under the agreement could be considered. It is likely that immunity clauses will not be common in voluntary carbon agreements. Generally buyers of voluntary projects are private entities with neutral carbon objectives rather than governmental entities. It is however possible that some of the private companies engaged in voluntary market transactions are state companies in which case they might enjoy prerogatives and immunities typical of state entities.

Section 9.03 Alternative Language

(h) The Buyer represents and warrants that none of its [*payment*] obligations under this Agreement is subject to any immunity from enforcement and it shall not exercise any

immunity with respect to the enforcement of any of the terms of this Agreement [*relating to making any payments*].

Article X - Notice of Deviation in Quantity of VERs

Article X requires the seller to provide notice to the buyer if he learns that the quantity of VERs generated from the project is likely to deviate significantly from what has been expected. This provision of notice serves to allow the buyer to adjust its expectations and may apply either in the case of a contract for a guaranteed annual amount or a contract where there are not guaranteed amounts but the contract includes the number of expected VERs to be generated per year – in other words, the Indicative Annual Amount.. Note that this provision only speaks to notice, and does not affect the other respective rights and obligations of the parties with respect to the project failing to generate the Guaranteed Annual amount or the Indicative Annual Amount of VERs, such as the right for the buyer to terminate the contract or to initiate proceedings based on an event of default.

Article XI - Force Majeure

Article XI excuses a party from performing its obligations where a force majeure event prevents it from doing so, while also setting out the limitations on such excusal and providing remedies where a force majeure event continues for more than a certain number of days.

The definition of force majeure event under the template is set out in section 1.01 and covers, in the first place, standard events considered as force majeure that could have a material effect on project implementation and, in the second place, force majeure events specific to voluntary offset projects. Standard events include a range of extreme weather and unforeseen political events, including a material change in the law.

There are two offset project-specific events: failure of the registry and decisions or changes in rules under the standard that affect the ability to perform obligations. Technical failures in the registry can prevent issuance or delivery, and are beyond the control of either party. Decisions of the voluntary standards' governance boards can change the rules governing project eligibility unpredictably and therefore make implementation the project impossible. In all cases the event must be the proximate (i.e. direct) cause of the delay or failure to be considered a force majeure event.

Parties need to pay particular attention to the definition of force majeure provided by the law of the contract and its jurisprudential interpretations. The concept of force majeure has different meanings depending on the legal system in question. In certain legal systems–particularly civil law systems-the concept of force majeure cannot be the object of definition by the parties and it will be applied automatically according to civil law provisions and jurisprudence. In all cases parties should fully understand the regime of force majeure according to the specific governing law and its implications for the contract.

The definition of force majeure in the template covers the case of failure of malfunctioning of the voluntary standard registries. The Parties may, however, wish to differentiate between general force majeure events and events affecting the registry functioning by providing for with different

consequences in each case. Alternative definitions and an alternative formulation for Article XI regulating the respective events are proposed below. Definitions of "Force Majeure" and "Suspension Event" are provided as an alternative to a single definition of force majeure.

Article XI Alternative Language

11.01 Force Majeure and Suspension Events

(a) Subject to clause 11.01(c), a Party's failure to perform any of its obligations under this Agreement due to Force Majeure shall, provided that the Affected Party notifies the other Party in writing within 5 (five) Business Days of becoming aware of such Force Majeure and the manner and extent to which its obligations are likely to be prevented or delayed by it (including a non-binding estimate of the expected duration of its inability to perform its obligations due to the Force Majeure), have the following consequences:

(i) subject to clause 11.01(a)(iv), if any delay occurs, the date for performance of the obligation affected shall be postponed for so long as is made necessary by the Force Majeure.

(ii) subject to clause 11.01(a)(iv), the affected Party shall not be liable for any loss or damage suffered or incurred by the other Party arising from the Force Majeure.

(iii) each Party must use its reasonable endeavours to minimise the effects of any Force Majeure. Upon the Force Majeure being overcome or it ceasing to subsist, both Parties will, as soon as reasonably practicable thereafter, resume full performance of their obligations under this Agreement (including, for the avoidance of doubt, any suspended obligations).

(iv) if any of a Party's obligations under this Agreement is postponed by reason of Force Majeure (A) for more than 180 consecutive days; or (B) up until the date that is three (3) Business Days prior to [*insert date*] the other Party may terminate this Agreement.

(b) Subject to clause 11.01(c), a Party's failure to perform any of its obligations under this Agreement due to the occurrence of a Suspension Event shall, provided that the affected Party notifies the other Party in writing within 5 (five) Business Days of becoming aware of such Suspension Event and the manner and extent to which its obligations are likely to be prevented or delayed by it (including a non-binding estimate of the expected duration of its inability to perform its obligations due to the Suspension Event), have the following consequences:

(i) the obligations of both Parties which would otherwise be required to be performed under this Agreement will be suspended for the duration of the Suspension Event and will not be required to be performed until the day that is 10 (ten) Business Days after the Suspension Event ceases to exist (such date being the **"Delayed Delivery Date"**);

(ii) subject to clause 11.01(b)(iv) below, the affected Party shall not be liable for any loss or damage suffered or incurred by the other Party arising from the Suspension Event;

(iii) each Party must use its reasonable endeavours to minimise the effects of any Suspension Event. Upon the Suspension Event being overcome or it ceasing to subsist, both Parties will, as soon as reasonably practicable thereafter, resume full performance of their obligations under this Agreement (including, for the avoidance of doubt, any suspended obligations);

(iv) Where a Suspension Event continues to exist on the [*insert date*], then either Party may terminate this Agreement.

(c) Where an event or circumstance that would otherwise constitute or give rise to a default also constitutes a Force Majeure or Suspension Event, it is to be treated as Force Majeure or Suspension Event and not as a default. Where an event or circumstance that would otherwise constitute Force Majeure also constitutes Suspension Event, it is to be treated as Suspension Event and not as Force Majeure.

Alternative Definitions

Force Majeure means in respect of either Party, a relevant occurrence of one or more of the following event(s) or circumstance(s) which are beyond the reasonable control of the affected Party acting (and having acted) in accordance with prudent operating practice and which is the proximate cause of a delay in performing or the failure of the affected Party to perform any of its obligations under this Agreement:

(a) act of a public enemy, war declared or undeclared, threat of war, extreme weather conditions or events, terrorist act, blockade, revolution, riot, insurrection, civil commotion or public demonstration, the expropriation, confiscation, compulsory purchase, nationalization of any part or the whole of the affected Party's assets by any competent governmental authority;

(b) any decision of the [Gold Standard Foundation][VCSA] or change in the International Rules that substantially prevents either Party from fulfilling and obligation under this Agreement.

(c) a Material Change in Law.

Suspension Event means a failure of [Gold Standard] or [VCS Registry] operation that renders the Delivery and/or receipt of VERs under and in accordance with this Agreement impossible.

Section 11.02 Commentary

If an Option is included in the Agreement (see the discussion on **Options** above), the Parties may consider increasing options as additional or alternative remedies to termination for a force majeure event.

Clause 11.02 Alternative Language

[If the Seller fails to Deliver Contract VERs for more than 180 consecutive days due to Force Majeure, then:

(d) the Parties agree to reduce the Contract VERs and increase the amount of Option VERs by an amount equal to the number of Contract VERs the Seller has failed to Deliver as a result of the Force Majeure; and

(e) the price payable by the Buyer to purchase the VERs referred to in subsection (a) shall be [the [*Contract VER Price*][*Option VER Price*] or the Market Price, whichever is less].

[If the Buyer fails to make any payment due to Force Majeure, then:

(a) the Parties agree to reduce the Contract VERs [*and increase the Option VERs*] by an amount equal to the number of Contract VERs which the Buyer failed to make payment for as a result of the Force Majeure; and

(b) the price payable by the Buyer to purchase the Option VERs referred to in subsection (a), shall be [[*Contract VER Price*][*Option VER Price*] or the Market Price, whichever is greater.

Article XII - Events of Default and Remedies

Article XII Commentary

Article XII sets out the events that constitute an "event of default" under the contract. These are generally the more serious breaches of the contract and can be distinguished from other breaches by the specific procedures and remedies that are set out to apply where an event of default occurs. Note that Article XIII also provides for termination where certain events of default occur. It is important therefore to read Articles XII and XIII closely in conjunction with one another.

The events of default and remedies are a key element of the agreement and have a substantial effect on the respective right and liabilities of the parties. For either party they can at once be a means of providing financial security in the event of the other party's non-performance and creating potentially major risks where it does not perform itself. When negotiating events of default and remedies, therefore, parties need to consider matters such as the likelihood of non-performance, their capacity to assume risks and their need for security of the other side's performance. Often striking the right balance will require making trade-offs between the risks each party assumes.

The template provides for a relatively standard arrangement in which parties can terminate for most serious events of default and recover damages that are likely to closely reflect their actual loss. However, in many cases it is possible to limit exposure to risk through the inclusion of the qualification that a remedy will only be available where the event of default occurs as a result of "gross negligence" or "wilful misconduct" on the part of the defaulting party. Definitions of these terms are provided in section 1.01.

Section 12.01 Commentary

Section 12.01 sets out the individual events of default. In the first place, **clause 12.01 (a)** specifies a material failure to comply with a "material term" as an event of default. A material term is defined in section 1.01 as a condition or innominate term. These are standard terms under English law, and refer to important terms that go to the "heart" or main subject-matter of the agreement. This is a general classification and exists in addition to the more specific events of default listed in the following sub-paragraphs. It is worth noting that the occurrence of any of these specific events of default would likely also constitute a material breach, and so the non-defaulting party would be able to base a claim on either (or both) of these grounds.

Clause 12.01 (b) provides that an "under delivery" constitutes an event of default. In the case of a contract for a guaranteed amount, an under delivery refers to any failure to deliver that guaranteed amount. In the case of a contract with an indicative amount the seller is not required to deliver a given amount every year, and so failure to reach the indicative amount should not constitute an under delivery. However, in order to provide some security for the buyer under such contracts, the template also provides the option to define an under delivery as a substantial failure (defined as failure to reach a given percentage of that amount) to achieve the indicative annual amounts that is repeated over several years. Defining the failure to reach a given percentage of indicative annual amounts as an event of default that allows for termination provides the buyer with the possibility to end the agreement in case the project is not achieving his expectations.

Clauses 12.01 (c) and 12.01 (d) can be distinguished from clause 12.01 (b), in that in they involve a situation where VERs have been created, but have not been delivered. Similarly, **clause 12.01 (e)** involves non-payment by the buyer after delivery has been effected. In both Clauses 12.01(c) and 12.01(d) there is no event of default where failure is due to issues with the receiving account, and is thus not within the control of the transferring party. **Clauses 12.01 (f), 12.01 (g) and 12.01 (h)** refer to events that involve intentional wrongdoing or fundamentally change the circumstances of the agreement.

When the seller is entering into a VERs agreement and there is some type of credit support mechanism, it is also in the buyer's interest to include as an event of default the failure by the seller or any credit support provider to comply with or perform any agreement or obligation to be complied with or performed by it in accordance with the credit support document.

Additional provision – Section 12.01 *bis*

The following events shall constitute an Event of Default in respect of the Seller:

(a) failure by the Seller or any Credit Support Provider to comply with or perform any agreement or obligation to be complied with or performed by it in accordance with any Credit Support Document if such failure is continuing after any applicable grace period has elapsed;

(b) the expiration or termination of such Credit Support Document or the failing or ceasing of such Credit Support Document to be in full force and effect for the purpose of this Agreement (in either case other than in accordance with its terms) prior to the satisfaction of all obligations of the Seller under this Agreement, without the written consent of the Buyer;

(c) the Seller or any Credit Support Provider disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenges the validity of such Credit Support Document

Section 12.02 Commentary

Under Section 12.02, the defaulting party must be allowed the opportunity to cure an event of default before the remedies specified in sections 12.03, 13.01 and 13.02 can come into effect. This intends to preserve the transaction by allowing the defaulting party to make good any non-performance within a defined period. Once this is done, the regular relationship will resume and no remedies will be triggered. The requirement of a cure period does not apply in cases of wilful misconduct or to events of default specified in Clauses 12.01 (f), 12.01 (g) and 12.01 (h), which are not generally capable of being cured by the defaulting party. It is worth noticing that the cure period starts from the moment that the non-defaulting party requires the defaulting party to remedy the event of default and not from the very moment in which the event of default occurs. This is why the contract requires that in the event that either party becomes aware or has reason to believe that an event has occurred that is likely to become an event of default they shall notify the other party in writing immediately.

Clause 12.02 (b) determines whether the seller will be allowed to cure an under delivery by providing replacement credits. While under the CDM credits of the same validity (e.g. EU ETS validity) tend to have broadly similar value, under the voluntary market there is a wide disparity in the value of credits, with factors such as project size, type, project developer and location playing an important role in determining their value. Moreover, in some cases the buyer may have already publically associated itself with the project, and so will only value credits from that project. It is important therefore for the buyer to consider whether to accept provision of replacement VERs as an acceptable cure. Where this is provided, section 1.01 defines Replacement VERs as VERs that "in the reasonable opinion of the Buyer, are of the same quality and utility as the Contract VERs." This provides the Buyer with the opportunity to assess the value of the replacement VERs offered before accepting them.

Section 12.03 Commentary

Section 12.03 sets out the remedies other than termination that apply in the case of certain events of default (termination for default is dealt with in section 13.02). Where termination is also available, these

remedies will apply in addition to termination. Reflecting general principles of contract law, damages are provided that are intended to accurately reflect each party's likely losses in the event of the other party's non-performance. Where no loss is incurred, no damages will be awarded. Note that Article XIV (Liability and Limitation of Liability) defines the extent of applicable damages other than those under this section.

Reflecting the foregoing, the buyer is entitled to damages for under delivery or delivery failure only where the market price is higher than the contract price, since where the market price is lower the buyer can simply buy replacement credits at a lower price. Conversely, the seller is entitled to damages for payment failure only where the market price is lower than the contract price, as where the price is higher it can recover the VERs under clause 5.01 (d) and sell them at a higher rate. Regardless of the market price, however, the non-defaulting party is entitled to recover transaction costs incurred.

The risks and potential benefits of including the remedies listed above need to be considered as they increase the risks for each party, and can turn the agreement from an asset into a potential liability. Given that the seller is generally at a greater risk of default, the increased risk to the seller for including remedies may be reflected in a higher unit price. Lower delivery default amounts and cumulative delivery defaults can also be considered. The buyer will need to assess the potential benefits gained by having stricter remedies for Delivery Failure in light of time and costs of enforcement.

It is worth noting that, given the variety in VER prices it is not possible to simply refer to the spot price on a given exchange to calculate the market price, as can be done in the case of CERs. As such, **clause 12.03 (c)** provides for a mechanisms to independently determine the market price using nominated brokers.

Article XIII - Termination

Article XI sets out the situations in which the agreement terminates or may be suspended or terminated.

Section 13.01 Commentary

Section 13.01 allows either party to suspend the implementation of its obligations under the agreement where an event of default occurs with respect to the other party. Such suspension should be communicated, providing the other party notice of such suspension and the opportunity to remedy. Where the event of default is remedied, the suspension ends and the regular contractual relationship resumes.

Section 13.02 Commentary

Section 13.02 sets out where the agreement can be terminated for an event of default. The conditions that apply depend on the event of default in question and relate to the seriousness of each.

A simple under delivery in a single year is considered the least serious event of default. A range of factors can result in this occurring, many of them beyond the direct control of the seller. It is therefore generally not considered reasonable to allow termination in this case, particularly where there are other remedies available to the buyer. As such, clause 13.02 (a) allows for providing for termination only where an under delivery occurs in a number of successive years. Note however that in the case of a

contract for an indicative amount, clause 12.01 (b) already defines an under delivery as a failure to deliver a given amount in successive years. In this case it is reasonable to provide for termination at the end of the cure period.

The parties could agree though to consider any type of under-delivery as an event of default allowing for termination. In this case the seller will be ready to assume the risks of project of performance and delivery and the buyer will likely pay a higher price. When the buyer is exposed to a back to back transaction in which it first acquires VERs that will later sell in a parallel transaction, the buyer will likely seek tougher under delivery clauses in order to guarantee sufficient number of VERs to fulfil its obligations under the secondary transaction.

In contrast with Under Delivery, Delivery Failure or Option Delivery Failure involve the non-delivery of VERs that have been created. These latter situations are generally considered more serious breaches, as delivery of existing credits is typically within the control of the seller to a greater extent than is the generation of the credits itself. Non-payment under clause 12.01 (e) is of a similar nature. For this reason, these events of default entitle the non-defaulting party to terminate after the cure period, while in the case of an under delivery under a contract for a guaranteed amount, this is only provided where under delivery occurs in two consecutive years.

The events of default stipulated in **clauses 12.01 (f), 12.01 (g) and 12.01 (h)** are generally considered to be fundamental, and as such entitle the non-defaulting party to terminate immediately, without the defaulting party being provided the opportunity to cure.

Section 13.03 Commentary

Section 13.03 provides for termination upon the occurrence of events that are both outside of either party's reasonable control and have a substantial effect on the ability to carry out the contract according to its terms.

Section 13.04 Commentary

Section 13.04 provides for automatic termination where all relevant obligations under the agreement have been satisfied.

In the event that the agreement includes an advance payment (see commentary and additional section under Article V above), the additional section below can be included to ensure that the buyer is repaid any outstanding amounts upon termination.

Additional section – Repayment of Advance Payment

Section 13.0#   Repayment of Advance Payment on Termination

If this Agreement is terminated before the full amount of the Advance Payment has been applied to pay for Contract VERs [*and Option VERs*], the Seller shall reimburse the Buyer for any amount of the outstanding Advance Payment which has not been applied against the Contract VERs [*and Option VERs*] in accordance with clause ##.

The buyer might consider the possibility to introduce a termination clause to cover the event that a serious reputational risk arises out of the project. Acquisition of VERs is very much linked to the intrinsic characteristics of the project. Buyers often enter into voluntary carbon transactions for reasons of satisfying neutral cabon objectives and corporate responsibility. Buyers tend to provide good measures of publicity to the voluntary projects they engage in. Any type of issue seriously affecting the project could therefore damage the buyer's reputation. Including a clause allowing termination in case of buyer's reputational risk might be an option. This is, however, a termination justification not easily be accepted by the seller and difficult to be drafted operationally.

Article XIV - Liability and Limitation of Liability

Article XIV Commentary

Article XIV stipulates the extent of the liability of each party under the agreement. By including specific provisions on liability, the parties agree to displace the default rules under the applicable law in favour of those agreed to here. As such, section 14.01 clarifies that no liabilities or warranties exist other than as set forth in the agreement and section 14.02 clarifies that no damages will apply other than those expressly provided for in the agreement.

Clause 14.03 (a) provides that there will be no liability for any consequential damages. Consequential damages are those that arise as an indirect result of the breach of contract in question.

Clause 14.03 (b) limits the total liability of each party. Parties often seek to limit their liability under the agreement to a known amount to avoid the possibility of a default under the agreement bankrupting either party. Any limitation should, however, ensure the potential liability is still meaningful and sufficiently large to be an effective remedy and act as a deterrent. Limiting liability may be less important where liquidated damages are only triggered if there is an intentional breach or negligence. Under the template liability is limited to a pre-determined amount.

It is important to note that these issues are treated differently, depending on the governing law of the contract. In some jurisdictions liability limitation clauses might not be applicable if they are not in line with the applicable law, which in some cases does not permit deviation from set rules or places limits on such deviation. Local counsel should be directed to pay close attention to this article.

Section 14.04 requires each party to seek to mitigate any losses it incurs, and thus limit the liability of the other party. This serves to protect the parties from avoidable liability arising.

Section 14.05 prohibits recourse against persons other than the parties for damages under the agreement.

Article XV - Miscellaneous

Article XV contains a number of common legal terms often included in sale and purchase and other agreements. Certain of these terms are in standard forms that tend to be included without significant variance in many agreements. These terms are sometimes referred to as "boilerplate" terms.

Section 15.02 sets out the agreements rules on confidentiality. "Confidential Information" is defined broadly under section 1.01 to include the agreement itself and all information provided under or in connection with it or in connection with the project. However, the parties are free to identify information as non-confidential at the time of communication. As well as applying to the parties themselves, the obligation of confidentiality requires parties to impose similar obligations on any employees or other business associates as a condition for sharing the information. As in most agreements of this sort, the confidentiality obligations will not apply to information that is required to be disclosed by a legal authority or by the Gold Standard or VCS.

Confidentiality provisions tend to be seen as less relevant contractual clauses although the experience with carbon contracts shows that violation of confidentiality can result in serious problems. If confidentiality is a relevant question for the parties they should include clear legal provisions that set out the consequences of confidentiality violation.

Section 15.04 determines the means for provision of notices and the dates on which notices are deemed to be received. If either of the Parties lives in a jurisdiction where the post system is unreliable, the Parties may wish to stipulate that all notices and communication takes place via fax, e-mail or, in the case of documents that must be send in original form, courier.

Section 15.05 prohibits the assignment of rights and obligations under the Agreement without prior written consent of the other party. The exception to this is the right of the seller to receive monetary payments from the buyer. This allows the seller to assign payment rights to a financing institution in exchange for upfront capital to finance the project. This is known as carbon monetization.

The Buyer might, however, consider it important to retain the capacity to assign its rights, especially if it intends to enter into a secondary transaction to sell the acquired VERs. In that case parties can agree to allow the buyer the assignment of rights at any moment.

Clause 15.05 Alternative Language

[(a) The Seller may not assign or transfer its rights or obligations under this Agreement to any third party without the prior written consent of the Buyer, such consent not to be unreasonably withheld, except that the Seller may assign its right to receive payments under this Agreement without the consent of the Buyer. Any other such purported assignment or transfer without such consent shall be deemed ineffective and void.

(b) The Buyer may not at any time assign or transfer its rights or obligations under this Agreement to any third party any third party without the prior written consent of the Buyer, such consent not to be unreasonably withheld.

Another form of carbon monetization is for the seller to assign control over the VERs to a lender or other financial institution that enables the VERs to be used as a type of security. It is important to note that assigning such rights will affect the security of the buyer that will receive delivery of issued VERs, and so doing so may make buyers less willing to enter into an agreement. Concerns of the buyer in this regard may be abated by the provision of financial accounts showing that the seller is in good financial health and unlikely to default on the loan.

In practical terms, the assignment of rights to control over VERs to the lender can be done by giving the lender control over the issuance of VERs. Under the Gold Standard this is done by instructing the Gold Standard to issue VERs to the lender through the cover letter that is submitted prior to registration. Note that in the case the lender will be obliged to pay for all issuance fees. Under the VCS, assignment is done by designating the lender's account for the issuance of credits in a communications agreement.

It is important to note that certain countries do not allow the assignment of rights to currently non-existent assets (e.g. yet to be issued carbon credits) or revenues therefrom. Advice of local counsel should therefore be specifically sought before seeking to assign such rights.

Section 15.08 Commentary

Section 15.07 establishes the law governing the ERPA and the rules concerning arbitration. As in many international sale and purchase agreements, the law of England and Wales is often used in contracts for the sale and purchase of emission reduction credits, and is the favoured choice of law for many buyers due to its tendency to favour freedom of contract over prescription of the form of relations. The law of New York State is also sometimes used. The template is drafted to reflect the law of England and Wales, and where the law of another country is chosen the template should be revised with this in mind.

In the case of contracts in which the buyer and seller are both based in the host country, this will be the natural choice of law. In addition, since the project is being implemented in the legal and regulatory context of the host country and it is likely that most of the other project related contracts are governed by the laws of the host country, the VER agreement should be read in conjunction with the other contracts governing the project. Host country law may also become relevant if an arbitration award needs to be enforced. In the process of enforcing arbitration awards, judges in a number of jurisdictions, correctly and legally or not, often re-open substantive aspects of the award and evaluate them in the context of local law. If the country has not ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, it may be worth including a provision clarifying that the decisions of arbitral tribunals are final, and cannot be re-opened by national courts in the host country.

The template provides for arbitration under the UNCITRAL Arbitration Rules. In general, most published, formal arbitration rules are suitable. The Permanent Court of Arbitration's (PCA) Optional Rules for Arbitration of Disputes Relating to Natural Resources and/or the Environment are suggested as the PCA's specialized panels include emissions trading experts and the Secretary General maintains a list of emissions trading experts. The rules can be downloaded from http://www.pca-cpa.org. The International Chamber of Commerce Arbitration Rules and UNCITRAL rules are also appropriate to govern contracts for emission reductions.

The language of the arbitration is stated as English, as the language should be the same as the language of the contract. When deciding on the number of arbitrators, the parties should also consider the implications for the time and costs of arbitration. The arbitration is stated to take place in The Hague to reduce costs as the PCA is able to host arbitrations at its facilities free of charge.

Annex I – Project Description

Annex I Commentary

In Annex I the seller should provide a description of the project. The description should be sufficiently precise to enable the project to be identified. This may include, for example, a description of the project activity, the location of the project and expected dates of operation. However, the inclusion of the project description is not intended to tie the seller to implementing the project according to its provisions (the relevant obligations of the seller in implementing the project are dealt with in Article VII). As such, it is not necessary for the project description to include a great level of detail regarding the project's implementation.

Schedule 2 - Contract Amount and Contract VER Price

Schedule 2 sets out the relevant amount of VERs that are the subject of the contract in each vintage year, together with corresponding prices and due dates. This is a crucial schedule which sets out the core terms of the agreement. All the relevant terms are defined in Section 1.01.

It is common for VER contracts to distinguish VERs by the year they are generated (the "vintage year"), and this is reflected in the template. It is important to note that this refers to the generation of emission reductions underlying the VERs, and not their actual issuance in the registry.

The contents of the second and last columns will depend on whether the contract is for a guaranteed or indicative amount, and corresponding alternatives are provided for each case. In the case of a guaranteed amount, that amount should be included in the second column, while the last delivery date should be included in the final column. In the case of an indicative amount, this amount will be provided.

If guaranteed amounts are used, care must be taken to safeguard against the project not performing as well as projected in the project design document, which is not an uncommon occurrence. Most amounts included in a delivery schedule are typically set at between 50% and 80% of the total amount of VERs stated in the project design document. Relevant amounts should be set only after considering if there is particular uncertainty regarding the capacity of the project to generate that amount.

In the third column, the price should be indicated. Though taxes are dealt with in Article VI, it is useful to clarify here that the contract VER price is including or excluding tax, as the case may be.

Where the contract does not include provision for options, the fourth column can be deleted.

SCHEDULE 3 - FORM OF OPTION EXERCISE NOTICE

Schedule 3 provides a standard form for the exercises notices for both call and put options.