

# Chilume and Company Attorneys

# Negotiation of CDM Contract

- Background
- This presentation discusses the negotiation of Emission Reduction Purchase Agreement commonly referred to as ERPA Agreement from Seller's perspective. Knowledge of different forms of business in the market and principles of corporate governance is paramount.

# Basic rules of Contract Drafting

- Identification and intent of parties to contract
- Determination of stage of negotiation – whether basic terms have been negotiated or deal been struck
- Has any document been drafted- memorandum of understanding, letter of intent or heads of agreement, non-disclosure or confidentiality agreement
- Is due diligence required by buyer

# Basic rules of commercial contract negotiation

- Determination of seller/buyer objectives
- Development of appropriate strategy
- Methods of achieving objectives
- Effect of personality types on negotiation process

# Negotiations towards a Definitive Agreement

- Letter of Intent
- Contents – purpose of LOI, description of parties, type of sale
- Commencement and closing of negotiations- fixed period of negotiations
- Purchase price pula or dollar based (subject to adjustment based on changes in equity as of closing) deposit of cash with agent to secure performance of seller's obligations under the Definitive Agreement
- Non competition agreement to be signed by seller
- Sellers representations and warranties, covenants, indemnities and other protections

# Negotiation Towards a Definitive Agreement

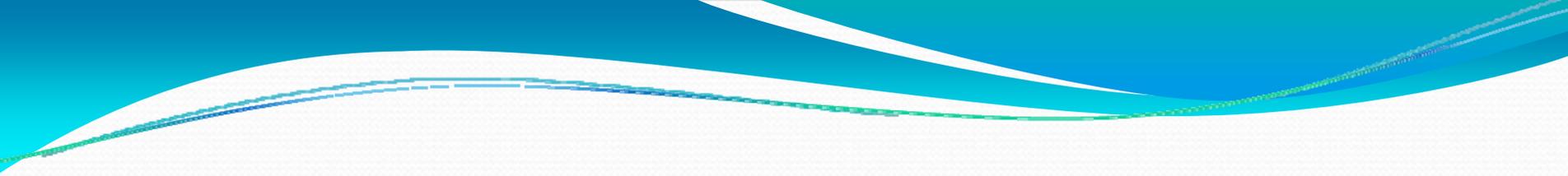
- Binding provisions identified – access to books of company, exclusive dealing, payment of damages for signing with third party, confidentiality, non disclosure , costs, binding clause provision, governing law, jurisdiction, effect of termination, no liability clause except binding provisions
- Parties' mind set in negotiations – know the motivation of a party and differentiate business issues from legal issues

concept	Seller's mindset	Purchaser's mindset
<b>Representation and warranties</b>  <b>Indemnification</b>	Sell the business, pocket the money and leave with no strings attached	Don't buy "pig in a poke" if the business is not as represented, seller needs to make purchaser whole
<b>Risk allocation</b>	Purchaser has opportunity to conduct due diligence and decide to whether or not to buy the business	Due diligence is a limited process and seller is intimately familiar with business for an extended period of time
<b>Closing conditions</b>	Once a purchase or merger agreement is signed, purchaser should be "locked in" to finalise the transaction (unless seller gets better offer)	Getting out of the deal (even if purchase or merger agreement is signed) if certain conditions are not met or adverse events occur
<b>exclusivity</b>	Ability to "shop" business to as many prospective buyers as possible to get as high a price as possible	Getting exclusivity period to consummate the transaction without competition from other parties

# ERPA Agreement

- There are models or precedents of agreements based on the Code of CDM Terms which is used to develop ERPA Agreements.
- Intent of parties- sale and purchase of carbon credits and key elements in standard contract are
- Quantity of CERs to be delivered
- Price per unit
- Delivery schedule
- Consequences of non-delivery
- Other default events
- Negotiation of ERPA requires an appropriate balance between risk and reward.

concept	Seller mind set	Buyer mind set
rewards	Rewards to be reasonably expected so bench mark for reasonable buy offer	Maximizing future revenue from CERs;using ERPA as collateral to obtain finance; upfront project costs
risks	Ability to predict massive fall in CERs prices or failure of delivery of required quantity of CERs; change in ownership of project	Know barriers of delivery of CERs and how great is possibility of failure

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- The basic text guideline for negotiations is Code of CDM Terms. Options may be provided however parties are free to negotiate any other alternatives.
  - Before ERPA comes into effect –
  - Conditions Precedent to be met mainly by Seller are project approval from host country or (reciprocate production of letters of credit) Seller do not take more conditions precedent

# Obligations of Parties

seller	Buyer
Provide an initial verification report(seller may be requested to improve performance by buyer)	Ensure an account is ready to receive delivery of CERs
Complete validation and obtain registration for project	Pay for CERs
Develop and implement a monitoring plan	Communicate with CDM Executive Board as Focal Point (right of communication may belong to seller)
Verification and certification to ensure issuance of CERs	
Operation in a prudent manner (RPO)	
Delivery of CERs to buyer	
Assignment to another party before CERs are delivered	

# Obligations of Parties...

- Seller should not carry additional obligations to those listed above and ensure that there is no room for exit from agreement due to the unfavourable contents of the Initial Verification report.

# Representations, warranties and undertakings

- Most are reciprocal, however warranties of Seller that project shall be constructed and operated along CDM rules or no third party shall gain an interest in the contract quantity

# Termination

- Seller should be cautious what is included under this provision.
- It covers situations that may lead to termination. This includes, events of defaults (non payment, breach of warranty,) delivery failure by Seller (any penalties payable) Force Majeure (natural disasters) Penalty payable ? Technicalities of exercising termination rights and consequences of termination.
- Balance of risk and guarantee between Seller and Buyer is crucial

# Dispute Resolution

- Arbitration or Litigation. Rules recommend Expert Determination, cheaper and efficient but if aggrieved with Expert's decision, either of parties to take up arbitration or use the courts for resolution. (Use arbitration in accordance with Botswana laws)

# Miscellaneous

- It covers confidentiality, transfer and assignment, share of proceeds and taxes. (in business world, the ability to transfer of rights to third parties considered valuable is crucial)

# Negotiations of CER pricing

- The parties should assess risk and unit price. Various options available.
- Types of agreements – Spot Agreements, Future Delivery agreement and the Options

Spot agreement	Future delivery Agreement	Options
CERs – issued and ready for delivery	CERs not issued to be delivered in future	Call option- Right to buy CERs in future, no obligation Put option-right to sell in future for fixed price Collar option-agreement on put and call options
Payment on delivery	Payment to be made in future or payable in stages	Call-buyer pays on delivery (premium paid by buyer) Put-buyer pays for CERs on delivery (seller pays upfront premium)
Risk is negligible to both parties	Buyer risk – upfront payment Seller level of guarantee	Call-if market price falls, then buyer's premium wasted-seller to keep CERs for buyer to exercise option to buy Put-buyer buys at price higher than market price
Price is fixed	Fixed, floating, guaranteed floor with floating	Call- high strike price-low premium (attractive to buyer) Put- high strike price(high premium paid by seller)

# Negotiations of CER pricing...

- The Collar option is combination of two put and call options. Parties negotiate where buyer puts ceiling on future compliance costs while seller puts limit (lowest) on value of CERs. Parties free to negotiate a compromise price guided by the market.
- Price- fixed, floating or combination of two (Seller guided by priority whether certainty or upside potential , important for CERs
- Fixed- certainty and confidence of value of CERs, Seller may use to leverage project financing, buyer may exit from agreement if market prices drop
- Floating price-no certainty as to value of CERs, seller reassured of having clinched a deal and allowing them to retain upside potential
- Combination- seller fixes minimum price and shares in rise of market prices

# Core Provisions

- Assignment- Provision where buyer may assign rights and seller may not do it without buyers consent- it is unbalanced. Factors such as financial standing of buyer are important,. Seller may insist that assignment be made to buyer of equal financial strength
- Advanced payment
- Buyer may want immediate delivery of CERs if advanced payment is made. Wording of provision is critical

# Core Provisions....

- Reporting
- Seller avoid provisions such as “reporting any delays that may endanger or render impossible the implementation of the Project..” buyer may renege on agreement claiming breach
- Deduction of costs from buyers payments
- Payments initial project assessment, legal due diligence, environmental, social and financial (outside the control of seller)
- Risks
- Country- changes in laws, failure to receive DNA approval, currency fluctuations
- Insurance policy
- Project- FM, under performance, market, cost overruns
- CDM- 2012?

# Conclusions

- Exercise Great Caution before signing

