

Africa Regional Workshop:

Legal and Regulatory Capacity Building for Carbon Trading & CDM Investment

28 - 29 September 2010

Simulation and Group Exercise:

Negotiating a Carbon Emission Reduction Purchase and Sale Agreement

1. Scenario:

Kenwind, a private wind project developer incorporated in Kenya, wishes to build a 100MW windpower project in Kenya and register this project as a CDM project.

The project is expected to generate 500,000 CERs in each year of its operation.

The development approvals required for the project have not yet been granted, but Kenwind is confident that these will be issued within the next three months. Kenwind has also not yet had any discussions with Kenya's Designated National Authority (*DNA*) about the development of the project as a CDM project.

In parallel with pursuing development approval for the project and notwithstanding that it has not yet discussed the project with the DNA, Kenwind has commenced the development of the project as a CDM project. It has identified a specialist CDM consultant to develop the CDM project documentation (including the PDD and monitoring plan) but has not yet formally engaged the consultant, meaning this work has not yet commenced. The CDM consultant has particular expertise in fuel switch projects but no specific experience in windpower CDM projects. Due to high global demand for validation and bottlenecks in the provision of such services, Kenwind has not yet identified a Designated Operational Entity (*DOE*) to perform the validation of the project.

The funding for the capital cost of the project will be provided as a secured loan by a private Kenyan bank, on the condition that Kenwind first contracts (under one or more agreements) to sell all CERs generated by the project.

Notwithstanding this debt finance, Kenwind will still require \$250,000 to cover the cost of preparing the CDM project documentation, having the project validated and registered, and drafting and executing an ERPA with a CER buyer.

Kenwind has identified a potential buyer for the CERs generated by the project, and they are about to commence negotiating the terms of an ERPA. The buyer is a dedicated carbon developer with experience in CDM projects around the world, but the buyer has not yet undertaken any due diligence investigation of the project.

The buyer has also identified a secondary buyer to whom it wishes to on-sell all CERs delivered.

The current spot price for CERs is €13.70/CER.

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2. Seller Notes

Kenwind should consider the following issues when negotiating an ERPA with the buyer for the sale of CERs from the project:

- When should Kenwind contact the DNA to commence discussions about the development of the project as a CDM project?
- Can Kenwind seek that the Buyer provide a prepayment under the ERPA, which can be used to cover the cost of preparing the CDM project documentation, having the project registered, and preparing the ERPA?
- Should Kenwind seek that the buyer have some involvement in the development of the project as a CDM project?
- Given that the buyer is likely to make a profit on the secondary sale of CERs to the secondary buyer, can Kenwind seek to take a share of this profit? If so, how?
- Should Kenwind allow the secondary buyer to have any role in the primary CER transaction? If so, what sort of role?
- How will the ERPA affect the funding arrangements being negotiated with the debt financier?

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3. Buyer Notes

The buyer should consider the following issues when negotiating an ERPA with Kenwind for the purchase of CERs from the project:

- Should any preconditions be included in the ERPA, such that the buyer is not required to purchase any CERs until the preconditions have been satisfied?
- Is the CDM consultant identified by Kenwind acceptable? Which party should be responsible for selecting and engaging the DOE?
- In light of the volatility of CER spot prices, what price per CER should be offered to Kenwind?
- Should the Buyer offer to cover the cost of preparing the CDM project documentation, having the project registered, and preparing the ERPA?
- If the parties agree that the buyer will make a prepayment to cover the above costs, on what terms should such a payment be provided, and how could it be secured?
- How should the buyer match its primary purchase to the secondary buyer's secondary purchase?

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**TERM SHEET #1
FOR EMISSION REDUCTION PURCHASE AGREEMENT**

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| Contract CERs | <ol style="list-style-type: none">1. With respect to each Verification Period, all CERs issued with respect to the Project during the Verification Period, but in any event no less than 90% of the PDD Volume for the Verification Period (the <i>Minimum Delivery Amount</i>).2. The Contract CERs are net of the Adaptation Share of Proceeds. |
| Conditions Precedent | <ol style="list-style-type: none">1. The Buyer's completion of due diligence investigations in respect of the Project and the Seller satisfactory to the Buyer.2. Registration of the Project.3. Commissioning of the Project.4. Financial close. <p>If this condition is not satisfied within 12 months of the date of the Agreement, the Buyer may terminate the Agreement.</p> |
| Unit Price | €10.00 |
| Delivery | With respect to each Verification Period, the Seller shall Deliver into the Buyer's nominated registry account the Contract CERs for the Verification Period, no later than the relevant Delivery Date. |
| Payment | The Buyer shall pay the Unit Price to the Seller for each Contract CERs Delivered to the Buyer in accordance with the Agreement, within thirty (30) Business Days after such Delivery. |
| Validation | The Buyer, in its sole discretion, shall select a DOE to undertake Validation. |
| Verification and Certification | The Buyer, in its sole discretion, shall select a DOE to undertake Verification and Certification. |
| Costs | <ol style="list-style-type: none">1. The Seller shall bear all costs associated with Validation and Verification and Certification, including all DOE costs.2. The Seller shall bear the Administration Share of Proceeds. |
| Taxes | <ol style="list-style-type: none">3. The Buyer shall bear all taxes levied within the Buyer's jurisdiction with respect to the Delivery of CERs to the Buyer.4. The Seller shall bear all taxes levied outside the Buyer's jurisdiction with respect to the Project and the generation, issuance and Delivery of CERs to the Buyer. |
| Focal Point | The Buyer shall be the sole Focal Point for the Project, with exclusive |

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| | <p>authority to instruct the CDM Executive Board and UNFCCC Secretariat with respect to:</p> <p>(a) the forwarding of CERs issued with respect to the Project; and</p> <p>(b) the addition and removal of Project Participants to and from the Project.</p> |
| Project Participants | <ol style="list-style-type: none"> 1. The Buyer and Seller shall each be Project Participants in the Project at all times. 2. The Buyer may, and acting in its sole discretion, add or remove other Project Participants to or from the Project. |
| Representations and Warranties | <ol style="list-style-type: none"> 1. The Buyer and Seller shall each make the standard corporate representations and warranties for transactions of this nature. 2. In addition, the Seller shall represent and warrant to the Buyer, on the date of the Agreement and on each Delivery Date that it has full, unencumbered title to the Contract CERs Delivered. |
| Delivery Shortfall | Any failure by the Seller for any reason whatsoever to Deliver less than the Minimum Delivery Amount by the relevant Delivery Date. |
| Remedies for Delivery Shortfall | Liquidated damages calculated as the Unit Price <i>multiplied by</i> the number of Contract CERs comprising the Delivery Shortfall, payable within 5 Business Days after written notification from the Buyer of the Delivery Shortfall. |
| Events of Default | <ol style="list-style-type: none"> 1. Failure to remedy a Delivery Shortfall in accordance with the Agreement. 2. Breach of a material term of the Agreement. 3. A representation or warranty made under the Agreement becomes false, misleading or inaccurate. 4. Insolvency. |
| Remedies for Events of Default | The non-defaulting party may terminate the Agreement and claim damages calculated as its loss as a result of the termination. |
| Assignment | <ol style="list-style-type: none"> 1. The Buyer may assign its rights and novate its obligations under the Agreement to any third party, without the Seller's consent. 2. The Seller may not assign its rights or novate its obligations under the Agreement to any third party without the Buyer's prior written consent. |
| Governing Law | The laws of the Federal Republic of Germany |
| Arbitration | <ol style="list-style-type: none"> 1. Rules: ICC International Arbitration Rules 2. Location: Munich, Germany 3. Number of arbitrators: 3 (2 appointed by the Buyer, 1 by the Seller) 4. Language of arbitration: English |

**TERM SHEET #2
FOR EMISSION REDUCTION PURCHASE AGREEMENT**

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| Contract CERs | <ol style="list-style-type: none"> 1. With respect to each Verification Period, 75% of the CERs issued with respect to the Project during the Verification Period. 2. In consideration of the Buyer purchasing 75% of the CERs from the Project, the Seller grant the Buyer a call option over the remaining 25%, with a Strike Price equal to the Unit Price. 3. The Contract CERs are net of the Adaptation Share of Proceeds. |
| Conditions Precedent | <ol style="list-style-type: none"> 1. The Buyer's completion of due diligence investigations in respect of the Project and the Seller satisfactory to the Buyer. 2. Registration of the Project. 3. Commissioning of the Project. 4. Financial close. <p>If this condition is not satisfied within 12 months of the date of the Agreement, the Buyer may terminate the Agreement.</p> |
| Unit Price | €10.00 + (0.10 x CER Market Price) |
| CER Market Price | The average of the closing CER spot price quoted on the European Climate Exchange (ECX), calculated over the fifteen (15) Business Day period beginning twenty (20) Business Days before and ending five (5) Business Days before the relevant Delivery Date. |
| Delivery | With respect to each Verification Period, the Seller shall Deliver into the Buyer's nominated registry account the Contract CERs for the Verification Period, plus any CERs purchase in exercise of the Option, no later than the relevant Delivery Date. |
| Payment | The Buyer shall pay the Unit Price to the Seller for each Contract CERs Delivered to the Buyer in accordance with the Agreement, within thirty (30) Business Days after such Delivery. |
| Validation | The Buyer, in its sole discretion, shall select a DOE to undertake Validation. |
| Verification and Certification | The Buyer, in its sole discretion, shall select a DOE to undertake Verification and Certification. |
| Costs | <ol style="list-style-type: none"> 1. The Seller shall bear all costs associated with Validation and Verification and Certification, including all DOE costs. 2. The Seller shall bear the Administration Share of Proceeds. |
| Taxes | <ol style="list-style-type: none"> 1. The Buyer shall bear all taxes levied within the Buyer's jurisdiction with respect to the Delivery of CERs to the Buyer. 2. The Seller shall bear all taxes levied outside the Buyer's jurisdiction with respect to the Project and the generation, issuance and |

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| | Delivery of CERs to the Buyer. |
| Focal Point | <p>The Buyer and the Secondary Buyer shall be the joint Focal Points for the Project, with authority to instruct the CDM Executive Board and UNFCCC Secretariat with respect to:</p> <p>(a) the forwarding of CERs issued with respect to the Project; and</p> <p>(b) the addition and removal of Project Participants to and from the Project.</p> |
| Project Participants | <ol style="list-style-type: none"> 1. The Buyer, Secondary Buyer and Seller shall each be Project Participants in the Project at all times. 2. The Buyer may, and acting in its sole discretion, add or remove other Project Participants to or from the Project. |
| Representations and Warranties | <ol style="list-style-type: none"> 1. The Buyer and Seller shall each make the standard corporate representations and warranties for transactions of this nature. 2. In addition, the Seller shall represent and warrant to the Buyer, on the date of the Agreement and on each Delivery Date that it has full, unencumbered title to the Contract CERs Delivered. |
| Events of Default | <ol style="list-style-type: none"> 1. Failure to deliver the Contract CERs. 2. Breach of a material term of the Agreement. 3. A representation or warranty made under the Agreement becomes false, misleading or inaccurate. 4. Insolvency. |
| Remedies for Events of Default | The non-defaulting party may terminate the Agreement and claim damages calculated as its loss as a result of the termination. |
| Assignment | <ol style="list-style-type: none"> 1. The Buyer may assign its rights and novate its obligations under the Agreement to any third party, without the Seller's consent. 2. The Seller may not assign its rights or novate its obligations under the Agreement to any third party without the Buyer's prior written consent. |
| Governing Law | The laws of England and Wales |
| Arbitration | <ol style="list-style-type: none"> 1. Rules: ICC International Arbitration Rules 2. Location: London 3. Number of arbitrators: 1 (appointed by the ICC Chairman) 4. Language of arbitration: English |

**TERM SHEET #3
FOR EMISSION REDUCTION PURCHASE AGREEMENT**

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| Contract CERs | With respect to each Verification Period, 100% of the CERs issued with respect to the Project during the Verification Period. |
| Conditions Precedent | <ol style="list-style-type: none"> 1. The Buyer's completion of due diligence investigations in respect of the Project and the Seller satisfactory to the Buyer. 2. Registration of the Project. 3. Commissioning of the Project. 4. Financial close. <p>If this condition is not satisfied within 12 months of the date of the Agreement, the Buyer may terminate the Agreement.</p> |
| Unit Price | €7.50 + (0.5 x Secondary Price – Unit Price) |
| Secondary Price | The price at which each CER purchased by the Buyer under the ERPA is sold by the Buyer to the Secondary Buyer. |
| Delivery | With respect to each Verification Period, the Seller shall Deliver into the Secondary Buyer's nominated registry account the Contract CERs for the Verification Period, plus any CERs purchase in exercise of the Option, no later than the relevant Delivery Date. |
| Payment | The Buyer shall pay the Unit Price to the Seller for each Contract CERs Delivered to the Buyer in accordance with the Agreement, within thirty (30) Business Days after such Delivery. |
| Validation | The Buyer, in its sole discretion, shall select a DOE to undertake Validation. |
| Verification and Certification | The Buyer, in its sole discretion, shall select a DOE to undertake Verification and Certification. |
| Costs | <ol style="list-style-type: none"> 1. The Buyer shall bear all costs associated with Validation and Verification and Certification, including all DOE costs. 2. The Buyer shall bear the Administration Share of Proceeds. |
| Taxes | <ol style="list-style-type: none"> 1. The Buyer shall bear all taxes levied within the Buyer's jurisdiction with respect to the Delivery of CERs to the Buyer. 2. The Seller shall bear all taxes levied outside the Buyer's jurisdiction with respect to the Project and the generation, issuance and Delivery of CERs to the Buyer. |
| Focal Point | <ol style="list-style-type: none"> 1. The Secondary Buyer shall be the sole Focal Point for the Project with regard to instructing the CDM Executive Board and UNFCCC Secretariat with respect to the forwarding of CERs issued with respect to the Project. 2. The Buyer shall be the sole Focal Point for the Project with regard to instructing the CDM Executive Board and UNFCCC Secretariat with respect to the addition and removal of Project Participants to |

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| | and from the Project. |
| Project Participants | <ol style="list-style-type: none"> 1. The Buyer, Secondary Buyer and Seller shall each be Project Participants in the Project at all times. 2. The Buyer may, and acting in its sole discretion, add or remove other Project Participants to or from the Project. |
| Representations and Warranties | <ol style="list-style-type: none"> 1. The Buyer and Seller shall each make the standard corporate representations and warranties for transactions of this nature. 2. In addition, the Seller shall represent and warrant to the Buyer, on the date of the Agreement and on each Delivery Date that it has full, unencumbered title to the Contract CERs Delivered. |
| Events of Default | <ol style="list-style-type: none"> 1. Failure to deliver the Contract CERs. 2. Breach of a material term of the Agreement. 3. A representation or warranty made under the Agreement becomes false, misleading or inaccurate. 4. Insolvency. |
| Remedies for Events of Default | The non-defaulting party may terminate the Agreement and claim damages calculated as its loss as a result of the termination. |
| Assignment | <ol style="list-style-type: none"> 1. The Buyer may assign its rights and novate its obligations under the Agreement to any third party, without the Seller's consent. 2. The Seller may not assign its rights or novate its obligations under the Agreement to any third party without the Buyer's prior written consent. |
| Governing Law | The laws of Japan |
| Arbitration | <ol style="list-style-type: none"> 1. Rules: Singapore International Arbitration Centre Rules 2. Location: Singapore 3. Number of arbitrators: 3 (1 appointed by each Party, the 3rd by agreement of the Party-appointed arbitrators) 4. Language of arbitration: English |